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REVENUE ACT OF 1934

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HEARINGS

BEFORE

THE COMMITTEE ON FINANCE
UNITED STATES SENATE

SEVENTY-THIRD CONGRESS

SECOND SESSION

ON

H.R. 7835

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

PART 1

MARCH 6, 1934

UNREVISED

Printed for the use of the Committee on Finance

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REVENUE ACT OF 1934

TUESDAY, MARCH 6, 1934

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

The committee met, pursuant to call, at 10 a.m., in the committee room, Senate Office Building, Senator Pat Harrison (chairman) presiding.

Present: Senator Harrison (chairman), King, George, Walsh, Barkley, Connally, Gore, Costigan, Bailey, Clark, McAdoo, Byrd, Lonergan, Reed, Couzens, Keyes, La Follette, and Hastings.

Also present: Secretary of the Treasury Morgenthau; Dr. Roswell Magill, Assistant to the Secretary of the Treasury; Commissioner Helvering, of the Bureau of Internal Revenue; Mr. L. H. Parker, Chief of Staff, Joint Committee on Internal Revenue Taxation; Mr. Middleton Beaman, Legislative Counsel of the House of Represenatives; and other representatives of the Treasury Department and the House and Senate Legislative Counsel staffs.

The committee has under consideration H.R. 7835.

The CHAIRMAN: Gentlemen of the committee, we are meeting on H.R. 7835. The Secretary of the Treasury is here, and the Treasury experts; and unless there is suggested some change in the order, upon the part of the members of the committee, we will hear the Secretary in open session. I understand his statement is not very long, and he then will turn over the presentation of the viewpoint of the Treasury to his experts. It has been the policy heretofore in hearing the experts on these administrative changes, for the committee to go into executive session because we can expedite the consideration of the bill that way. The Secretary may have some printed statements that he desires to give to the committee. Have you, Mr. Secretary?

Secretary MORGENTHAU. I just brought this one statement to read. We will have more copies for you. I did not realize you wanted copies. We will have some copies made. It is just two and one-half pages.

The CHAIRMAN. All right; Mr. Secretary, you may proceed.

STATEMENT OF HON. HENRY MORGENTHAU, JR., SECRETARY OF THE TREASURY

Secretary MORGENTHAU. The Treasury Department appreciates the opportunity granted by the Committee on Finance to present its views with respect to the revenue bill now pending before the Committee. I shall attempt to state at this time the general attitude of the Treasury, leaving the discussion of the specific provisions of the bill for later consideration.

In the Budget message the President stated that he expected the Budget estimates of receipts to be increased by an additional $150,000,000 to be obtained from the revision of the income tax, estate tax, and miscellaneous tax laws. The President did not at that time recommend the imposition of any specific new taxes, or the elimination of any taxes now in force. The Budget estimate is, however, framed on the basis that any revenue revision should provide for the amount of receipts estimated to be obtained from the existing tax laws, plus at least $150,000,000 additional. It is estimated by the Committee on Ways and Means that the revenue bill now pending before this committee will produce approximately $258,000,000 additional revenue in a full year of operation (including $85,000,000 to be obtained from changes in the administration of the depreciation allowances). It should be noted, however, that most of this additional revenue will not be collected until 1935; and that revenue estimates in respect to technical changes are difficult to make, since they depend upon a number of uncertain factors, the most important of which is future business profits. It is therefore the best judgment of the Treasury that the bill finally adopted should provide for at least as much revenue as it is estimated the pending bill will yield.

The bill was prepared as the result of the work of a subcommittee of the Committee on Ways and Means of the House, which was appointed to investigate methods of preventing the evasion and avoidance of the internal revenue laws, to consider the improvement of such laws, and to study possible new sources of revenue. The subcommittee presented a preliminary report to the Committee on Ways and Means on December 4, 1933. At the request of the committee, the Treasury set forth its views with respect to the proposed amendments in a statement made on December 15, 1933. The Treasury expressed its hearty agreement with the objective of the subcommittee as stated in its preliminary report, namely, to prevent avoidance of the income-tax laws, and thereby to increase the revenue therefrom; but indicated that, on the basis of administrative experience, it would be desirable to modify some of the specific recommendations. The Treasury also recommended some further changes in the law, which, in the opinion of the Department, would improve its administration and prevent evasion. At the request of the committee, representatives of the Treasury participated in the subsequent discussions of the various recommendations in executive session. The bill was thereafter drawn to embody the changes agreed upon by the committee.

The bill does not alter the general framework of the Federal tax system. The only new taxes are those imposed upon the first domestic processing of coconut and sesame oils; and upon the production and refining of crude petroleum. It is proposed to repeal the check tax as of January 1, 1935, instead of July 1, 1935; and to repeal entirely the taxes on fruit juices. In other respects, the existing taxes are left in effect, with amendments designed to assist in their better enforcement.

The income-tax-rate structure is considerably simplified, and the yield increased by heavier impositions upon dividend and partially tax-exempt income, with some reduction in the taxes applicable to salaried incomes in the lower brackets.

Viewing the proposed changes as a whole, I believe that the bill will yield the additional revenue which the President desires, primarily

by the elimination of the serious loopholes which our experience has shown to exist in the present income-tax law. No taxpayer can legitimately complain of these changes, since they result in a more equitable distribution of the tax burden over these persons who are best able to sustain it. The Treasury Department therefore approves the pending bill as a whole, with the exception of some minor matters, which the Department will be glad to discuss with the committee at its convenience.

The CHAIRMAN. Are there any questions of the Secretary of the Treasury?

Senator McADOO. Mr. Secretary, what is the estimated revenue from the tax on coconut oil and sesame oil?

Secretary MORGENTHAU. So far as we know, no estimate has been made.

Senator McADOO. And how about the tax on crude petroleum?

Secretary MORGENTHAU. As I understand it, it is simply enough to provide for the enforcement of the code.

Senator McADOO. The crude-petroleum tax?

Secretary MORGENTHAU. The crude-petroleum tax.

Senator McADOO. Could your experts give an estimate of the revenue that is expected to be derived from these two sources?

Secretary MORGENTHAU. We will be glad to furnish it.

The CHAIRMAN. Do I understand the Treasury Department to endorse the provisions with reference to sesame oil?

Secretary MORGENTHAU. No.

Senator McADOO. Or coconut oil?

Secretary MORGENTHAU. No.

Senator McADOO. How about crude petroleum? Do you approve of that?

Secretary MORGENTHAU. The crude oil suggestion was, I believe, presented by Secretary Ickes, and the Treasury was never asked for its opinion.

The CHAIRMAN. It was their recommendation?

Secretary MORGENTHAU. It was the Department of the Interior, Secretary Ickes, as oil administrator.

Senator GORE. Who?

Secretary MORGENTHAU. Secretary Ickes, as oil administrator, appeared before the committee and asked for that.

Senator GORE. The rate is one tenth of 1 percent.

Senator BARKLEY. The coconut oil and sesame oil tax has no real connection with the oil industry anyway. It is supposed to be a measure of farm relief, isn't it?

Secretary MORGENTHAU. I don't know, Senator.

Senator BARKLEY. Well, that is the theory on which the House put it in, as a matter of protection against the importation of coconut oil, sesame oil, and any other oil that comes into competition with vegetable oils in this country. It has no connection, as I understand it, with oil.

Senator REED. Mr. Secretary, is it calculated to double the price of soap?

Secretary MORGENTHAU. I would rather not answer that.

Senator CONNALLY. Well, who contends it will double the price of soap? That is perfectly preposterous and ridiculous.

Senator McADOO. There are lots of people who contend it will merely increase the price of soap.

Senator CONNALLY. Yes; the soap people, Procter & Gamble, do. It would not add one tenth of a cent to the cost of a cake of soap.

Senator McADOO. It might reduce the number of baths people would take.

Senator GORE. Democratic high tariff is all it is.

The CHAIRMAN. Well, anyway, Mr. Secretary, that was one of the things the House did that was not upon the recommendation of the Treasury Department, as I understand it?

Secretary MORGENTHAU. That is quite true. We have not taken the intiative on any of these matters.

The CHAIRMAN. I understand.

Secretary MORGENTHAU. I mean, we simply feel that so far as this bill is concerned, we are at the service of Congress, and are not initiating any new taxes. It is up to Congress to indicate what they want, and if they feel that the advice of the Treasury is useful, we are there to state what we honestly believe is right or wrong.

The CHAIRMAN. As I understand, Dr. Magill was representing the Treasury Department, for the most part, before the House Ways and Means Committee.

Secretary MORGENTHAU. But he did represent the Treasury, exclusively.

The CHAIRMAN. And he will represent the Treasury Department here before the Finance Committee?

Secretary MORGENTHAU. If you so wish it; yes.

The CHAIRMAN. Well, we want you to designate someone, because we have got to have all of this detail explained here.

Secretary MORGENTHAU. Well, I should be glad to designate Dr. Magill.

The CHAIRMAN. Is there anything else that you desire to inquire of the Secretary of the Treasury? Well, we thank you very much.

Senator REED. Mr. Secretary, does the Treasury recommend this increase in the penalty for the use of consolidated returns?

Secretary MORGENTHAU. That was not our recommendation.

Senator REED. Do you approve it?

Secretary MORGENTHAU. We approve of the bill as a whole, yet there are certain minor matters that, if we are asked, we should like to point out that we think they might be changed.

Senator REED. Is that one of the minor matters that might be changed?

Secretary MORGENTHAU. Do you mind if I let Dr. Magill answer?

Senator REED. All right.

Dr. MAGILL. The Treasury's position, I think, with reference to all of these matters, was indicated in the formal printed statement which the Secretary presented at the time the bill was taken up by the House Committee on Ways and Means, with respect to consolidated returns and some other matters.

Senator REED. We have not seen that. Will you tell us in substance what he said?

Dr. MAGILL. Well, as far as consolidated returns were concerned, the Treasury recommended a continuation of the existing provisions of the law. Now, on that, as on some other questions, as you are aware, the Ways and Means Committee made various changes, many

of them out of line with what the Treasury had recommended in that statement.

The CHAIRMAN. Dr. Magill, viewing the bill as a whole, what is the position of the Treasury?

Dr. MAGILL. Taking into consideration all of its provisions, from our point of view it is acceptable.

Senator REED. We can not view it as a whole. We have to view each separate provision.

Dr. MAGILL. That is right; and I think what the Secretary has in mind is that in the course of the discussion of the various provisions as a whole, we will be glad to indicate, at your request, our view as to any one of these provisions.

Senator REED. Well, as to that particular one, you do not recommend the increase?

Dr. MAGILL. As to that particular one; no.

Senator REED. You realize, I suppose, that in some enterprises, it is necessary under the law, to have subsidiary companies?

Dr. MAGILL. That was brought out.

Senator REED. For example, a railroad cannot be a water company, and yet it has to have water for its locomotives.

Dr. MAGILL. Well, the situation on that, Senator, you may know, was this: The Subcommittee of the Committee on Ways and Means recommended the complete elimination of the provision for consolidated returns. The Treasury recommended the retention of the provision. The final result, after the committee had discussed it, was that they thought it would be well enough to keep the present provisions, with an increase in the rate to 2 percent (the differential rate) in order to see how it would work out.

The CHAIRMAN. It was more or less of a compromise?

Dr. MAGILL. That is right.

Senator REED. Now, as to the provisions redefining holding companies, are those suggested by the Treasury?

Dr. MAGILL. No, sir; they were not.

Senator GORE. Redefining what?

Senator REED. Holding companies.

Dr. MAGILL. Personal holding companies. Those also were part of the recommendations of the subcommittee of the Committee on Ways and Means, and the Treasury in its original statement said that in our view, those provisions were somewhat too specific and were likely to be subject to evasion by the formation of organizations which fell just without, and would also operate somewhat harshly with respect to particular types of organizations that have fallen within.

Senator REED. Well, I have been told that the Coca Cola Co. would be construed as a personal holding company.

Dr. MAGILL. I do not know as to that.

Senator REED. And the Hearst newspapers.

Dr. MAGILL. I do not know as to that.

Senator REED. And the A. & P. Tea Co.

Dr. MAGILL. I would not think so in any of those cases; but you may be right, depending upon the facts.

Senator REED. Controlled and owned by less than five families—that would come within the definition, wouldn't it?

Dr. MAGILL. Well, the definition is not quite that. That is what it was to start with, but it is changed now to bring in the element of the value of the stock owned.

Senator CONNALLY. Hasn't the fact of whether they paid dividends also got something to do with it?

Dr. MAGILL. Yes. Very roughly, if they paid out 90 percent of their income, they will not be subjected to this tax.

Senator CONNALLY. Exactly. That is what I was thinking. It is designed to catch these companies that hold their profits and do not disburse them?

Dr. MAGILL. That is right. To complete the answer, the Committee on Ways and Means made a number of changes in the section, designed to perfect it, and I think the experts for the committee expect to suggest some further perfecting amendments. The general design of the provision the Treasury approves.

Senator KING. Dr. Magill, did the Treasury make any recommendations for the purpose of invading or seeking other fields from which revenue might be obtained to prevent this enormous deficit, or to diminish it, rather?

Dr. MAGILL. Well, we are now engaged in work of that kind. We took this bill as we found it, as the Secretary pointed out. The subcommittee of the Ways and Means Committee has been engaged in this particular study to prevent avoidance and evasion of the present laws, for several months, and this bill was designed to carry out those objectives; so what we have stated with respect to this bill applies to that subject-matter. We are now engaged in studying the possibility of other tax legislation.

Senator REED. What is the attitude of the Treasury on the general manufacturers' sales tax?

Dr. MAGILL. We haven't yet made any public presentation of our views on that subject.

Senator REED. Will you do so for us?

Dr. MAGILL. We might. We, I think, would at some later time. I think not now, because at the moment we have concentrated particularly upon this bill. In other words, whatever might be the attitude with respect to additional taxes, we have felt that the desire of the committee or the desire of Congress to stop the loopholes in the existing law was an entirely laudable one. If we can pick up $250,000,000 that way, we had better do so.

Senator KING. Did the Treasury take the position—and, of course, no one could find fault if it did—that this bill should not transcend the purpose which you have just indicated; namely, of preventing some evasions and escapes through loopholes; or has the Treasury also had in view the fact of increasing the revenues by going into other fields and tapping fountains which perhaps have not heretofore been reached?

Dr. MAGILL. Well, we have had that latter purpose very much in mind, the possibility of tapping additional sources of revenue. We suggested that, at the time of our original statement to the Ways and Means Committee, but for the purpose of expediting, if you like, the consideration of this bill at this time, we have concentrated on this matter of eliminating these loopholes.

The CHAIRMAN. Are there any further questions?

Senator GORE. I want to ask some questions.

The CHAIRMAN. Yes.

Senator GORE. Mr. Magill, in regard to consolidated returns, have you figured on the possibility of dividing these concerns into two categories and allowing one category to make consolidated returns and not allowing the other one to do so? What I have in mind is this: Take these Scripps-Howard newspapers. I think there are 25 or 26 of those. They are engaged in a uniform business. Some lose, and some make profits. Now railroads that own franchises conduct a uniform business, a similar type of service, and it seems to me it might be reasonable to allow them to make consolidated returns on their profits and losses.

On the other hand, take these oil concerns that have producing wells, pipe lines, refineries, tank cars—and a steel company perhaps is in the same situation—where they can shift their profits and their loses and juggle them so as to, I think, cheat the Treasury. Now, they can put down the price of crude oil at the well, and take a loss on it. Then they own the pipe lines, and they can make a profit on the pipe lines, and can offset one against the other. Now, have you figured on the possibility of that?

Dr. MAGILL. We have tried to make some division with respect to the particular companies. In the case you mentioned, the case of the pipe line and producing oil company, we have not yet succeeded in working out any means of making that division between different kinds of organizations, which seemed to us satisfactory, particularly in view of the very diverse kinds of business enterprise which you have. So far as the shifting of profits back and forth between subsidiaries is concerned, that undoubtedly is possible. Our view has been that it would be even more possible in the event that the corporations were required to make separate returns, than if you compel them to consolidate and eliminate the intercompany transactions.

Senator GORE. Well, now, where you compel them to make separate returns, I don't see how they could blend it then and shift it. It looks to me like each would have to stand on its own bottom.

Dr. MAGILL. Well, they cannot blend two types of transactions with each other. It is possible for them to shift profits and losses from one company to the other.

Senator GORE. Well, now you have got something in here aimed at these corporations that sell stock from one to the other in order to create a loss, haven't you?

Dr. MAGILL. Yes; we have.

Senator GORE. Like this man Wiggins, you are aiming at the evil in that case?

Dr. MAGILL. Yes; we are.

Senator GORE. I don't know whether it can be done or not, but there is an evil there. Whether you can arrive at legislation that will cure it or not is a different thing.

Senator MCADOO. I wonder, Dr. Magill, if the Treasury has ever made any estimate of the revenue that would be derived from a general manufacturers' sales tax, exempting from the tax the necessaries of life, food, and medicines?

Dr. MAGILL. I believe that such an estimate was made last year, when Congress was considering the general manufacturers' sales tax. I haven't those figures in my bag here, but I can readily get them for you if you wish.

Senator McAdoo. Could you supply them to the committee?
Dr. Magill. Oh, yes; I should be very glad to.
Senator McAdoo. I should like to have that.
Dr. Magill. Exempting medicines and foods.
Senator McAdoo. Medicines and necessaries of life.
The Chairman. If the committee can go into executive session, so we can get an explanation on these details from the Government experts, it will be in order.

CONFIDENTIAL—MINUTES OF THE FINANCE COMMITTEE OF THE SENATE (IN EXECUTIVE SESSION)

The Chairman. Dr. Magill, we will just take up this bill from the start to the end.
Dr. Magill. Is it your pleasure to take it up section by section; that is, to go over all of the changes, minor as well as major?
The Chairman. I think that is what we ought to do, and if you want other members of the staff or others to explain any part of it, the committee will be very glad to hear them.
Dr. Magill. Of course. Mr. Beaman and Mr. Parker are quite as familiar with it as I am, and we can perhaps interchange in explanation.
Senator Connally. Wouldn't it simplify and shorten the work if you confined it more to the changes that this bill proposes in the existing law?
The Chairman. That is what we are going to do. He is merely going to explain these amendments to the changes in the existing law.
Dr. Magill. Yes, sir. First, as Mr. Parker said to you a few minutes ago, there are three documents which I think you should have in addition to the bill itself. There is the preliminary report of the subcommittee of the Committee on Ways and Means, which is this document.
Senator Gore. Are they available for distribution?
Dr. Magill. They should be. Secondly, there is a statement of the Secretary of the Treasury, which is a printed statement of about 20 pages, dealing with each of the changes which the subcommittee proposed.
Senator Gore. The statement of whom?
Dr. Magill. The Acting Secretary of the Treasury. It was Mr. Morgenthau but he was then acting. Finally, there is the committee report of the Committee on Ways and Means, which also explains each provision in detail.
Then I think, for the purposes of explanation, it would be well for us to agree on what print of the bill we are going to use. My suggestion would be to use the comparative print, the one which is marked "Committee Print No. 1", and is a comparative print showing the changes from the existing law which were made by the bill as passed by the House.
On the first page, there is nothing except a change in the citation of the act.
And the table of contents, of course, contains necessary changes in the titles.
On page 5, section 1, is the first change of importance. You observe it is provided in the first sentence that the provisions of this

title shall apply only to taxable years beginning after December 31, 1933. That is of particular significance with respect to individuals or corporations reporting on a fiscal year basis. If a corporation for example has a fiscal year which started in the middle of 1933 and ends in 1934, the income for the entire fiscal year will be computed on the basis provided for in the existing law. The new law applies only for years which start after December 31, 1933.

The main reason for that provision, which was agreed to all along the line, was that because of the number of changes which are made in this bill, it would be a matter of very considerable complexity to attempt to prorate and to apply the provisions of this bill to that portion of the income realized after January 1 and the other bill to the income realized before January 1.

Senator REED. It follows from what you say then that this bill has no effect whatsoever on the tax payments which are to be made on the 15th of this present month?

Dr. MAGILL. That is true. I believe that, numerically, the great bulk of taxpayers are on a calendar-year basis, and so far as this bill is concerned, this bill will affect their income for the present year which will be shown on the return of March 15 of next year.

Senator HASTINGS. Are you quite certain that this accomplishes just what you say? This does not say anything about any fiscal year.

Dr. MAGILL. It is stated that the provisions shall apply only to taxable years after December 31, 1933. So if a fiscal year commenced, say, July 1, 1933, the title would not be applicable.

Senator COUZENS. May I ask in that connection, is it not more advantageous to the corporation that is on a fiscal year basis, not having to pay any of these additions up to July 1, 1934, than one who pays on a calendar year basis having to pay for the first 6 months of 1934 on a different basis?

Dr. MAGILL. Yes; I suppose there is some gain there. The general design of this bill is to tighten up quite stringently on the present law, and to the extent that a corporation is allowed to report under the present law, it does reap an advantage. On the other hand, as Mr. Parker perhaps can tell you better than I, there are a great many difficulties which you would run into if you endeavored to change that proposition; the principal one of which that occurs to me now is the matter of reporting installment sales. We have changed the percentage of down payments which will make a transaction as installment sale or not.

Senator GORE. What is the change?

Dr. MAGILL. We have changed it from 40 to 30 percent.

Senator CONNALLY. Is there any reason why, for taxation purposes, all corporations should not be required to have the same fiscal year?

Dr. MAGILL. All report on the calendar year basis?

Senator CONNALLY. Yes.

Dr. MAGILL. There would be great advantages to the Treasury and the administration if that could be done.

Senator CONNALLY. Why cannot we do it?

Dr. MAGILL. You could. You have the power. The difficulty which the corporations point out is this. That as a matter of their business activities, for example, it is very difficult for some of them to take an inventory at the end of the calendar year, because that is the peak of their business operations, and that hence, for the pur

poses of their business, it is more or less essential that they should take their inventories at some other time when there is some lull in their business.

Senator CONNALLY. That is purely a matter of convenience for them. I think the Government convenience ought to be consulted about it.

Senator COUZENS. I am frank to say that I could not approve of letting a corporation whose fiscal year ended July 1, 1934, get off with a less tax than a corporation who had a calendar year basis for making their returns.

Mr. PARKER. Senator, there is an answer to that. If this change is made, it seemed reasonable to suppose that Congress would follow the same policy in the future, and what benefit they derive now, will be offset at some future date. Suppose we reduce taxes in 3 years from now? If the same policy is pursued, those same corporations will get the advantage of the reduction 6 months later, so what they gain now, will be taken away from them then. This is a good time to make the change, because we have made no substantial rate changes. If we had shifted corporation rates from 10 to 15 percent, or if we had changed the individual's rates to a large extent, I do not think that this thing ought to be done, but we have not done that.

Senator COUZENS. Let me ask you: How often, and when, can a corporation change from the fiscal year basis to a calendar year basis?

Mr. PARKER. It cannot change without the consent of the Commissioner, and when he gives his consent, he figures up the tax effect, and therefore we have nothing to fear from that if the Commissioner properly goes into the matter.

Senator COUZENS. You spoke about 3 years hence, and that there might be a reduction in tax, so that this corporation that was reporting on a fiscal-year basis would be penalized as an offset to any advantage they have now. Let me ask you this: In the interim, if the Commissioner gives consent to the changing from a fiscal to a calendar-year basis, that penalty which you refer to would not take place?

Mr. PARKER. That is true, but he would probably take all of those facts into consideration before he gives his consent.

Senator COUZENS. I think we should reserve our consideration of that.

The CHAIRMAN. We will reserve our consideration of that.

Senator BARKLEY. In view of the fact that you make no substantial change in rates in this bill, what is the advantage that any corporation would get by waiting 6 months for this to go into effect?

Mr. PARKER. I do not think they would get any substantial advantage.

Senator BARKLEY. And the rate is just the same? And they would pay the same income tax?

Mr. PARKER. That is the idea, Senator. It is very complicated now. If we have a fiscal-year return, the present law provides that you have to figure the net income under the two laws and make two complete computations of the tax; one under the old law and one under the new, and then we prorate that tax according to how many months fall in the old period and how many fall in the new period. It is a complicated thing, and especially complicated where we have different rules for the different transactions.

Senator COUZENS. Let me ask you in connection with Senator Barkley's comment just now. You do change the rate in this bill for the consolidated returns, do you not?

Mr. PARKER. Yes, sir.

Senator COUZENS. This bill carries a change in the consolidated returns.

Mr. PARKER. There is some change. I was speaking in a general way. That is relatively small—1 percent.

Senator GORE. Do you have any data on which you can express any percentages of the number of concerns that base their returns on the calendar year?

Mr. PARKER. About 90 percent of them are on the calendar-year basis anyway. Then, I made some investigation in respect to the number that have fiscal years ending in the first part of the year. There are more fiscal-year returns ending, or beginning—which of course is the same thing—in the first half of the year than there are in the last half of the year. It is rather unusual to find a fiscal year ending in November.

Senator GORE. Do a good many of them correspond with our fiscal year?

Mr. PARKER. Quite a number have the June 30 fiscal year.

Senator REED. A good many of them find it very difficult to take inventory on the last day of December, don't they?

Mr. PARKER. That is correct, and probably unless we had some proration rule, it would be very difficult. It certainly would be a very great step in simplification if we could require calendar-year returns in all cases.

Senator REED. Suppose we tried to put them all on the same basis of reporting, on the calendar year basis. Those companies would not have taken inventory on the 30th of last December, and the effort to make them account for the 6-month period might prove fruitless?

Mr. PARKER. It would be very difficult. You would have to strong arm law or arbitrarily lay down some rule of proration.

Senator BARKLEY. Is there any longer any reason why the Government's fiscal year ought not to correspond with the calendar year?

Mr. PARKER. The Government has always been on a fiscal year.

Senator BARKLEY. I know, but that is no reason why it should always continue to be. I do not see any reason why the Government should not do its business according to the calendar year instead of the so-called "fiscal year" as it is now. But we are not passing on that now.

Senator CONNALLY. If 90 percent of the corporations already have the calendar year instead of the fiscal year, why should not the other 10 percent do it? That question of inventory would only occur once.

Mr. PARKER. In some instances it is almost impossible to take that inventory on account of the rapid transfer of material at that particular period. I may be that the material is moving so fast that it is just impossible to take a proper inventory.

Senator REED. If we were sitting in October or November, we could legislate to require them to do it December 30, but we cannot legislate to require them to do it in the past.

Mr. PARKER. That is true. For instance, the 1st of January for a department store is a very nice time to take inventory. The Christmas rush is just completed, and their things are pretty well sold, and

it is fine for that business, but other businesses are not situated in that same way. Suppose for instance you wanted to make the department stores take inventory on December 22, you would see that it would be almost impossible to ask them to do that at the height of their business activity.

Senator COUZENS. Under this you are planning that a fiscal year can end on October 1 or November 1, and one who reports on that basis would get 8 or 9 or 10 months advantage over one who reports on a calendar-year basis, and just for the convenience of the Treasury or a few of the industrialists or corporations, I do not see why we should make that preference.

Mr. PARKER. But that advantage is very small on account of the very few rate changes, and most of the loophole changes in this act go to individuals rather than to corporations, excepting the personal holding company. Almost all individuals—I guess 99 percent of the individuals——

Senator CONNALLY (interposing). Don't you require all individuals to settle on a calendar basis?

Mr. PARKER. No, sir. Individuals have the same right as the corporations.

Senator CONNALLY. I think it is very unfair, because as suggested by Senator Couzens, this is just an instance at once. If you permit the fiscal year of some people and some corporations to be one thing, and with others another, this might occur in any year by change in business over the latter part of the year, and those that had a fiscal basis would suffer more or suffer less than those on a calendar basis. I think they should all be on the same basis, myself—individuals and corporations. I think we ought to settle on a calendar year.

Mr. PARKER. The main reason for making this change was to make the act understandable. That is the general complaint we get from everybody, that they cannot understand the income tax. The existing fiscal-year provision is especially complicated.

The CHAIRMAN. Let us go on. Perhaps we can find an easier nut to crack.

Dr. MAGILL. The next one, I think, will cause at least as much discussion, and that is the rate changes.

Coming over on page 6, you see there is nothing there but cross references.

On page 7 you come to another major matter, the changes in the rates.

The first change which is indicated on page 7——

The CHAIRMAN (interposing). Before we come to that, I would like to get the reaction of the committee. Shall we go ahead and get an explanation of these proposals, and shall we pass upon the propositions tentatively, or shall we wait until we get through and then come back after the matter has gotten out of our minds?

Senator HASTINGS. Let us pass on that tentatively. I think that is a good suggestion.

Senator COUZENS. Are you going to take a vote then on the first provision?

The CHAIRMAN. It seems to me that these matters get out of our minds, and then we have to have another discussion. We will probably save time by passing on them tentatively. Of course there are certain provisions here where we have had requests to be heard in

opposition. I do not think in those instances that we ought to pass even tentatively on them, because we have got to give these people a brief opportunity to be heard, which we can do after we have finished with the experts.

Senator HASTINGS. I suggest, Mr. Chairman, with respect to this first one, that we not pass upon that until we get through and have a better idea as to how serious it is.

The CHAIRMAN. Just leave that open?

Senator HASTINGS. Yes; that is my suggestion.

The CHAIRMAN. All right. Then proceed, Dr. Magill.

Dr. MAGILL. On page 7, the change there is to eliminate the 8-percent normal tax rate which we have at the present time, and to substitute a single rate of 4 percent in place of it. The major effect of that change is with respect to dividends and to so-called partially tax-exempt bonds. As you know, dividends on domestic corporation are not subject to the normal tax, although they are subject to the surtaxes. Similarly, a great many of the bonds issued by the United States are subject to the surtaxes but not to the normal taxes. The Ways and Means Committee thought that it would be advantageous to simplify this rate structure in the first place in this way by changing from two normal tax rates to one, which is a move in the direction of simplification; but the more important aspect of it is what I have mentioned, that is, that by making this change and making corresponding increases in the surtax rates to take up this other normal tax rate, which has been done, the effect is to levy a heavier tax upon dividend income and bond income from United States securities, the interest on which is partially tax exempt, and exempt from the normal tax.

The CHAIRMAN. You estimate about $36,000,000 from that source?

Dr. MAGILL. Yes; it mainly comes from that change. We estimate about $36,000,000 I believe it is, as the result of the changes in the rate structure generally. This is one of the changes.

Senator REED. Do you consider that fair?

Dr. MAGILL. This change?

Senator REED. Yes.

Dr. MAGILL. Of course, you get into questions that figure in that. So far as the dividend income is concerned, I am inclined to think that it is, although there has been a great deal of discussion.

Senator REED. The theory of the exemption of dividends from the normal tax arose when the normal tax on the individual was the same as the corporation tax, and the earnings of that corporation having paid the tax once, were exempted from paying it twice. The effect here is, under this bill, that the corporation pays on its earnings 13¾ percent, and yet you only recognize 4 percent of that for the purpose of the exemption. Nine and three quarters is taxed twice.

Dr. MAGILL. If we knew that the tax which is paid by the corporation is actually passed on to the stockholder or taken out of the dividends which are distributed to him, your argument would be, I think, conclusive. I do not know that anyone has ever been able to show convincingly that actually the stockholder pays the tax which the corporation has paid from its earnings. In other words, the corporation may pass on the income tax as part of the cost of goods sold.

Senator REED. We know from corporate statements that one seventh of their earnings are always subtracted before they report the amount available for dividends.

Dr. MAGILL. Certainly. But if they are subtracting $1,000,000 of Federal income tax, are they passing on that $1,000,000 to people who buy their goods, or is that really being taken out of what would otherwise come to the shareholders?

Senator GORE. Have you made any study of that to see the incidence of it?

Dr. MAGILL. Economists have worked on that for years, and as far as I am aware, there is no agreement among them as to what actually happens. I think in some cases the tax is passed on to the consumer, and in some cases it comes out of the shareholder.

Senator REED. It comes out of the elementary fact that everybody gets all that he can out of the goods that he sells.

Senator COUZENS. If it is a monopoly, it is passed on. If it is not a monopoly, undoubtedly it is absorbed by the corporation.

Dr. MAGILL. I think it is absorbed in some cases, and in some cases it is not.

Senator CONNALLY. Isn't the tax budgeted just like any other factor in their expenses?

Dr. MAGILL. For the purposes of determining for their shareholders the amount of the net income available for dividends for example, all taxes are taken off.

Senator COUZENS. When they come to fix their price, they do not put in this prospective profit tax, do they? In fixing the sales price of their goods, they do not add to the cost of the goods these profit taxes?

Dr. MAGILL. No.

Senator COUZENS. I think that is what Senator Connally had in mind, that in fixing the price they added the cost of taxation.

Dr. MAGILL. No; I do not believe that when an automobile is being sold for $500 there is $10 added on account of income taxes.

Senator MCADOO. What is taxed is the earnings and not the dividends.

Dr. MAGILL. Yes; what we tax the corporation is not the dividends but the earnings of the corporations. That is the point I think that Senator Reed had in mind, that if a corporation has $10,000,000 of earnings, for example, we impose a 13¾ percent tax on those earnings. If that was all there was to it, then you would be clear that there is only available for distribution to the shareholders, say $8,500,000; or, in other words, that the shareholders are really paying the normal tax imposed on the corporation, and therefore should have some greater credit than 4 percent. The real question is, what is the fact? Is the tax really passed on to the shareholders or is it passed on to the consuming public? As I have said, I know of no agreement on that. I think the situation varies in different corporations.

Senator LONERGAN. It depends upon the different competitive conditions, doesn't it?

Dr. MAGILL. Yes, sir; I think so. My own view would be that at some place there is a stopping point where it would be unfair to eliminate the normal tax completely.

Senator GORE. Will you restate the provision of the bill, please?

Dr. MAGILL. I will start with the present law. Under the present law, an individual pays a normal tax of 4 percent on the first $4,000 of his net income. Then he pays a normal tax of 8 percent on the remainder of his net income. Under the bill it is proposed to eliminate that 8 percent rate so that he will pay a 4 percent normal tax on his entire income. The other 4 percent is really transferred into the surtax rate. This does not result in any reduction in fact, because the 4 percent is taken out and the normal tax put into surplus.

Senator GORE. Yes.

Senator CONNALLY. You say this does not have any change in the amount of the tax collected?

Dr. MAGILL. So far as the rate schedule is concerned as a whole, the Government should get, according to our estimates, about $30,000,000 of additional revenue.

Senator GORE. And this 4 percent makes the summit of it, 59 percent instead of 55 percent?

Dr. MAGILL. The surtaxes are raised approximately 4 percent in all cases.

Senator CONNALLY. All the way up?

Dr. MAGILL. All the way up.

Senator GORE. Would you care to state if the rates were reduced, the revenue raised might be increased? Are they just up in the stratosphere where there is not any income to speak of?

Dr. MAGILL. I do not think the Treasury has any very definite opinion on that. I have talked to our statistical experts, and what they have said is that they think the present rates are about at the maximum height for the best production.

Senator GORE. You do not think you have passed the law of diminishing returns?

Dr. MAGILL. I believe not.

Senator GORE. Isn't it true that when during the 10 years from the war to the crash, when the rates were reduced, the revenues were increased?

Dr. MAGILL. I would have to check up on that. In considering the amounts on the returns, you at once get into the question of what the relative business conditions were in the different years.

Senator GORE. I was figuring from 1920 to 1930 were the same, substantially.

Dr. MAGILL. Well hardly so, Senator. There were considerable reductions.

Senator GORE. Would it be considerable trouble to have a report on that?

Mr. PARKER. What was the question?

The CHAIRMAN. The revenue over a series of years where the surtaxes were raised.

Senator GORE. There was a series of years where the taxes were reduced. I saw some figures once which indicated to me that when the rates were reduced, the revenues increased.

Mr. PARKER. I can give you the tax collections from individuals for all of the years, if you want them.

Senator GORE. I do not want to encumber the record. But if you have the date of the acts—there were three or four I think, 1923,

1924, and 1928. If you could give us the receipts for the year before and the year after each revenue act, that might give us an index.

Mr. PARKER. Starting with 1924, we had a Revenue Act of 1924 which applied——

Senator GORE (interposing). Dated when?

Mr. PARKER. June 2, 1924, and that applied to 1924 and that is the only year it did apply to.

Senator GORE. Give us the year prior to that.

Mr. PARKER. In 1923, in the case of individuals it was $661,000,000.

Senator GORE. That is the revenue?

Mr. PARKER. Yes. For 1924 it was $704,000,000.

Senator GORE. The rates went down?

Mr. PARKER. The rates were decreased.

Senator GORE. And the revenues went up?

Mr. PARKER. That is correct. And the next act——

Senator GORE (interposing). It may have been an accident.

Mr. PARKER. The next act was passed February 26, 1926, which was applicable to the years 1925, 1926, 1927; and the revenues in 1925 were $734,000,000 and $732,000,000 in 1926.

Senator GORE. It went down $3,000,000?

Mr. PARKER. It went up. The 1926 act applied to the year 1925. It was retroactive, and it went up from $704,000,000 in 1924 to $734,000,000 in 1925.

Senator GORE. And the rates were reduced?

Mr. PARKER. The rates were substantially reduced, especially the surtax rates, which were reduced from 40 to 20 percent. The normal rates were substantially reduced in that act.

Senator COSTIGAN. To what do you attribute the increase?

Mr. PARKER. To increased business profits.

Senator BARKLEY. It was not due to the decrease in the rates?

Mr. PARKER. Well, we got more revenue with less rates, therefore there was greater net income. It must have been greater business. Possibly some would say that under the lower rates people did not practice the evasion that they practiced in the case of the higher rates. I could not substantiate that, but that might be claimed.

Senator REED. Possibly they work harder when the tax rate is lower.

Senator GORE. What I have in mind is what the reaction is. It often happens—I believe it was the case in England—that when they reduced the rate, the receipts went up. If that is so, we should arrive at it if we can.

Mr. PARKER. We do know with higher rates it is more difficult to administer the law. It is human nature that when people have to pay a higher tax they are particularly diligent in taking all of the exemptions and deductions that they possibly can figure out. In the case of the lower rates they do not bother quite so much.

Senator HASTINGS. What was it in 1927?

Mr. PARKER. The revenue in 1927 was $830,000,000, which is a substantial increase under the same rates of tax. We had a new act in 1928. The 1928 act however did not substantially change the rates.

Senator GORE. What date?

Mr. PARKER. The date of the 1928 act was May 29, 1928. The amount of revenue for 1928 was $1,164,000,000.

Senator CONNALLY. For individuals?

Mr. PARKER. Yes, sir; individuals.

The CHAIRMAN. What was the surtax at that time?

Mr. PARKER. Twenty percent.

Senator GORE. Have you made any study of the tax on diamonds, for instance? I have heard the same statement made on that—that a low tax raised a higher revenue on diamonds because there was less smuggling.

Mr. PARKER. I am not familiar with the revenue from this source, Senator.

The CHAIRMAN. Let us proceed to the next item.

Senator BYRD. What do I understand if we pass it?

The CHAIRMAN. We will leave it open unless we tentatively agree to the proposition. What is the wish of the committee? To keep that open for the present?

Senator COUZENS. Before we pass upon that, may I ask Dr. Magill what effect that section change would have in respect to these normal and surtaxes as long as this is not applicable to January 1, 1934? Would that not affect all of these rates?

Dr. MAGILL. It would affect any individual who is making a fiscal-year return, but as Mr. Parker has said, the number of individuals who make fiscal-year returns is quite small, perhaps 1 percent of the total.

Senator COUZENS. Those would get the advantage of these changes?

Dr. MAGILL. Yes, sir.

Senator COUZENS. It seems to me, Mr. Chairman, the whole picture ought to be passed on at one time.

The CHAIRMAN. Yes; we will leave this provision open with the other. Your next provision is on page 19?

Dr. MAGILL. No. Page 14.

Senator CONNALLY. Just one question before you leave this. Have you made any changes in the surtax except this 4 percent?

Dr. MAGILL. Yes, sir; we have. I will speak on those now. We are just coming to that.

You will notice that on pages 8, 9, 10, 11, 12, and 13 are the surtax rates under the present law which are repealed. You will observe one thing which is of some importance, that is, that you have a relatively long schedule of surtax rates, amounting I believe to 56 different brackets.

Mr. PARKER. Fifty-three.

Dr. MAGILL. One change is to reduce the number of brackets considerably, substantially to cut it in half, so that you have 28 brackets instead of 53. The next thing which has been done has already been referred to, the 4 percent which was taken off of the normal tax has in substance been added in to these surtax rates, in order to get substantially the same results. And then next you will observe that the surtaxes are to start at $4,000, whereas under the present law they start at $6,000.

That brings us to another change that appears in another part of the bill, but you will have to consider it now. Under the present law, the personal exemption and credit for dependents are applicable with respect to the normal tax, but not with respect to the surtax. To simplify it, a single individual at the present time has an exemption of $1,000. A married individual without children has an exemption

of $2,500. If the incomes in the two cases fall below that amount, he pays no tax at all. If they fall above that, he pays a tax upon the excess, but for the purpose of the surtax, the personal exemptions and credits for dependents heretofore have not been allowed, so that the surtaxes have uniformly started at $6,000 of net income in either case.

In this bill it is proposed to change that so that the surtaxes will start at $4,000, but the individual will be permitted to apply against the surtaxes, the amount of his personal exemption and credit for dependents. Thus in the case of a bachelor the surtaxes will start at $5,000 instead of the present $6,000. In the case of a married person without children, they will start at $6,500 instead of $6,000. If he has children, they will start a little higher still.

The obvious and immediate effect of that is that single men will pay somewhat higher taxes in proportion to married men than they do at the present time.

Senator REED. Does that run all the way through the surtax schedule?

Dr. MAGILL. It does in effect, yes, because the personal exemption is applied against the net income.

The CHAIRMAN. To show the corresponding changes in the present law by virtue of the present normal tax and surtax in the report as I understand it, of the Ways and Means Committee, you have a table there?

Dr. MAGILL. Yes, sir.

The CHAIRMAN. That would show it?

Dr. MAGILL. Yes, sir.

The CHAIRMAN. So that anybody can see just what the effect is?

Dr. MAGILL. It appears on pages 6 and 7 of the report of the Ways and Means Committee.

The CHAIRMAN. Would it not be well to just put that in your remarks there?

Dr. MAGILL. Yes, sir; I think it would.

The CHAIRMAN. So that anyone reading the minutes of these hearings can see it.

(The tables referred to are as follows:)

Comparison of present and proposed tax

SINGLE MAN

Net income	If all earned income		If half income, half dividends		All dividends	
	Present law	Proposed	Present law	Proposed	Present law	Proposed
$2,000	$40	$32				
$3,000	80	68	$20	$8		
$3,500	100	86	30	18		
$4,000	120	104	40	28		
$4,500	140	122	50	38		
$5,000	160	140	60	48		
$6,000	240	216	80	108		$40
$7,000	330	292	110	166	$10	80
$8,000	420	368	140	224	20	120
$9,000	510	448	170	282	30	160
$10,000	600	538	200	350	40	210
$12,000	800	728	320	496	80	320
$14,000	1,020	938	460	662	140	450

[1] Earned income means wages, salaries, professional fees, or other amounts received for personal services actually rendered.

[2] Dividends from stock of domestic corporations. Same treatment is accorded interest from partially tax-exempt Government bonds.

Comparison of present and proposed tax—Continued

SINGLE MAN—Continued

Net income	If all earned income		If half income, half dividends [1]		All dividends [2]	
	Present law	Proposed	Present law	Proposed	Present law	Proposed
$16,000	$1,280	$1,168	$620	$848	$220	$600
$18,000	1,520	1,428	800	1,068	320	780
$20,000	1,800	1,728	1,000	1,328	440	1,000
$25,000	2,640	2,648	1,640	2,148	880	1,720
$30,000	3,600	3,708	2,400	3,108	1,440	2,580
$40,000	5,920	6,148	4,320	5,348	2,960	4,620
$50,000	8,720	9,098	6,720	8,098	4,960	7,170
$60,000	12,020	12,558	9,620	11,358	7,460	10,230
$70,000	15,820	16,498	13,020	15,098	10,460	13,770
$80,000	20,120	20,948	16,920	19,348	13,960	17,820
$100,000	30,220	31,168	26,220	29,168	22,460	27,240
$200,000	86,720	87,638	78,720	83,638	70,960	79,710
$500,000	263,720	264,608	243,720	254,608	223,960	244,680
$1,000,000	571,220	572,088	531,220	552,088	491,460	532,160
MARRIED MAN, NO DEPENDENTS						
$3,000	$20	$8				
$3,500	40	26				
$4,000	60	44				
$4,500	80	62				
$5,000	100	80				
$6,000	140	116	$20	$8		
$7,000	210	172	50	46	$10	$20
$8,000	300	248	80	104	20	60
$9,000	390	328	110	162	30	100
$10,000	480	408	140	220	40	140
$12,000	680	583	220	351	80	235
$14,000	900	778	340	502	140	350
$16,000	1,140	993	500	673	220	485
$18,000	1,400	1,228	680	868	320	640
$20,000	1,680	1,498	880	1,098	440	830
$25,000	2,520	2,348	1,520	1,848	880	1,480
$30,000	3,480	3,378	2,280	2,778	1,440	2,310
$40,000	5,800	5,743	4,200	4,943	2,960	4,275
$50,000	8,600	8,633	6,600	7,633	4,960	6,765
$60,000	11,900	12,003	9,500	10,803	7,460	9,735
$70,000	15,700	15,868	12,900	14,468	10,460	13,200
$80,000	20,000	20,258	16,800	18,658	13,960	17,190
$100,000	30,100	30,358	26,100	28,358	22,460	26,490
$200,000	86,600	86,783	78,600	82,783	70,960	78,915
$500,000	263,600	263,708	243,600	253,708	223,960	243,840
$1,000,000	571,100	571,158	531,100	551,158	491,460	531,290

The CHAIRMAN. If there are no further questions on that, we can proceed to the next item.

Dr. MAGILL. I might say that the personal exemptions and credits for dependents are not changed in this bill from the present law.

The CHAIRMAN. The next is page 19.

Dr. MAGILL. The reference to the tax on personal holding companies is simply a crossreference.

The CHAIRMAN. B and C are merely crossreferences.

Senator CONNALLY. Just a minute, Mr. Chairman. You say the 4 percent is passed to all of them. What other changes in the surtaxes did you make?

Dr. MAGILL. The principal changes are to shorten the number of brackets.

Senator CONNALLY. In making one bracket where there were two, did you take a rate——

Dr. MAGILL (interposing). Mr. Parker knows something more about the drafting of those brackets than I do, but the idea was to

retain substantially the present rate of tax with respect to earned or salaries incomes. Since the Ways and Means Committee later on made an allowance for earned income and also reduced the rates between $8,000 and $25,000 from what they had originally contemplated, the net effect is that a salaried person under $60,000 will pay somewhat less tax than he does under the present law. Above that he will pay slightly more.

Senator CONNALLY. We have been giving preference to earned incomes, but in view of all of these graftings on high salaries and bonuses, it looks to me as though we ought to give the other fellow the advantage.

Dr. MAGILL. You will observe as far as dividend income is concerned, as has been brought out here, a man with an income entirely from dividends today pays very much less tax than a man with an income entirely from salary, due to the fact that incomes of dividends are exempted from the normal tax. The effect of this bill is to increase the tax with respect to the man whose income comes from dividends.

Senator GORE. I think you had better put those figures in the record.

The CHAIRMAN. Yes; they are in. It speaks for itself. Go on now.

Dr. MAGILL. There is nothing on page 9, I think.

The CHAIRMAN. That tax on personal holding companies.

Dr. MAGILL. That occurs later on. That is just a cross-reference.

The CHAIRMAN. On page 20.

Dr. MAGILL. On page 20; there is nothing there I think of real importance. That is a series of minor changes.

On page 21 that change is simply clerical.

The CHAIRMAN. Page 21 is clerical, you say?

Dr. MAGILL. Yes.

On page 22, the change in annuities there is of some consequence. There has been some discussion on it, and possibly the insurance companies will appear before you with reference to it.

Under the present law if an individual is in receipt of an annuity which he has paid for, he is not taxable on his receipts from the annuity until he gets back the amount which he paid for it.

The CHAIRMAN. I may say, Doctor, that the committee has had a great many protests from these insurance companies with reference to that, and they desire to be heard. So you can go ahead with the explanation.

Dr. MAGILL. As I say, under the present law, if an individual has paid $25,000 for an annuity and reached the age of 65 and the annuity starts, he is allowed to receive without any income tax $25,000, and then after he has got the $25,000, he is taxed in full on what he gets after that. He is allowed to get back his purchase price first.

The Committee on Ways and Means thought that it would be desirable to change that so that the Government would collect some tax with respect to the annuity from the time when the man starts to get it. I presume the theory of that is this, that in computing the amount of the money which the insurance company will pay, it takes into account the amount of consideration which the man pays, plus the interest which the company expects to earn, and hence each amount which he gets is, I presume, as a matter of actuarial compu-

tation, made up in part of what he has paid and in part of what the company has earned as interest on the money.

The CHAIRMAN. The insurance company would not pay this? But the individual policyholders would?

Dr. MAGILL. Yes, sir.

The CHAIRMAN. But the insurance companies use it as a selling proposition?

Dr. MAGILL. Yes, sir.

Senator GORE. Have you any statistics as to the extent of annuities in the country?

Dr. MAGILL. They have greatly increased in recent years. We could give you statistics, I think, on the amount of annuity income which has been reported. We would not know how many annuity policies have been written.

Senator GORE. During what recent period would you say this substantial increase has taken place?

Dr. MAGILL. I think it is quite clear that the writing of annuity policies has largely increased in recent years.

Senator COSTIGAN. Since 1929?

Dr. MAGILL. I believe so; yes. The companies can probably tell you much more about that than the Treasury.

Senator GORE. Don't you think that is a pretty good old-age pension?

Dr. MAGILL. I think it serves the same purpose.

Senator GORE. Don't you think it ought to be encouraged?

Dr. MAGILL. I have not yet explained what we have done here. As a matter of fact, we have not discouraged annuities in any substantial sense, although the companies think we have. What has been done is this, to provide that the individual will be taxed each year on 3 percent of the consideration which he paid. The idea of that is, I believe, that the company is considered to have earned at least a minimum of 3 percent upon the amounts which the man has paid in for his annuity. It is therefore proposed to tax him to that extent, since that represents interest on his investment rather than the investment itself. In the long run if he lives out his expectancy, he ought to come out exactly the same as under the present law.

Senator COUZENS. What inspired the change in the law?

Dr. MAGILL. I think the committee had two thoughts. First, experience has shown that in any case in which you refer a tax, you are likely to lose it entirely. The theory of the present law is that once the individual has gotten back the consideration that he paid, then he must pay tax on the excess. It is difficult for the Treasury or anybody else to find out exactly when that time comes in the varying cases of many individuals. If he did not report it at all, he would be quite likely to escape.

Senator MCADOO. Do you mean to say if you get an income from an annuity of $1,000 a year, it is not taxed now until he gets the full amount of the investment back?

Dr. MAGILL. Yes.

Senator MCADOO. But you would in this case tax $300 of that annuity?

Dr. MAGILL. No, sir. Suppose he had paid $10,000 for that $1,000 annuity. Then your illustration would be true that in each year he would pay a tax of 3 percent of his investment in the annuity of $10,000, which would be $300.

Senator HASTINGS. Don't you think that there is danger of driving a person who has bought the annuity to some tax-exempt security instead of buying the annuity?

Dr. MAGILL. Possibly, although, as I have said, it is not the intention of this provision to tax the annuitant on any more than what he would be taxed on at present. The real condition is that you are taxing currently instead of postponing the tax in the future.

Senator REED. Isn't this what you are trying to do? Tax him on what is fairly regarded as the interest return on his capital, but not tax him on that part of his annuity which represents a return to him of his principal?

Dr. MAGILL. That is right. This provision will in fact exempt him just as much as he is exempted under the present law on the principal which he pays.

Senator REED. I think you have worked out a very fair solution.

Dr. MAGILL. I think it is very fair. I think the complaint of the insurance companies, as far as I am aware, is simply due to the fact that heretofore they have been selling annuities on the theory that for a considerable period of time, a man would pay no tax on that income.

Senator REED. Exactly. They have had a soft snap.

Mr. PARKER. May I illustrate it in this way? Suppose a man has $2,000,000 and puts that $2,000,000 into an annuity. We have to sit down and wait 10 or 12 years before we get any tax. He goes off the tax rolls entirely.

Senator GORE. Do you wait until he gets his $2,000,000 back?

Mr. PARKER. Yes, and if he dies, we are out of luck.

The CHAIRMAN. If it is a 20-year annuity, you wait 20 years?

Mr. PARKER. Yes, sir. That would not be so bad if we had our standard corporation rate of tax on the insurance companies, but our tax on the insurance companies amounts to about one quarter of what the ordinary corporation pays.

Senator REED. Have you made any effort to correct that in this bill?

Mr. PARKER. On the insurance companies? No; we have not, because of the mutual character of that business.

The CHAIRMAN. We tried to correct it last time, if you remember.

Mr. PARKER. Take the big case, where the amount is $2,000,000, 3 percent of that would be $60,000. He would be taxed on the $60,000. That is, the amount of the tax would be approximately sixteen or seventeen thousand dollars. So even under this bill, by buying the annuity, he has reduced his tax from $30,000 to $17,000, but we do not think he ought to go off the tax-paying rolls entirely.

The CHAIRMAN. The Government would not get any more revenue, but it might get part of it quicker?

Mr. PARKER. We would get it quicker, and another thing, we don't think it is so hard for a taxpayer, because, under the present rule, he may go along for 10 or 12 or 20 years, as the case may be, and have no tax whatever. Then he will have to pay a tax on the entire annuity which will upset perhaps his living arrangements. I think it is just as fair for him to pay a small tax each year, which in the end amounts to the same thing.

Senator HASTINGS. Mr. Parker, suppose it is a widow, with no dependents, and she has an annuity of $2,500 a year. Is she entitled to a $1,000 exemption before she begins to pay?

Mr. PARKER. Yes; she is entitled to such an exemption but we cannot tell what her tax would be unless we know what she paid for the annuity. Let us assume, in this case, that $30,000 was paid for the annuity.

Senator HASTINGS. Yes.

Mr. PARKER. She gets $2,500 a year. Of that amount, 3 percent of the $30,000 would be taxable, or $900. She has an exemption of $1,000, so she pays no tax on it.

I think the main types of annuities that are held in large numbers, certainly do not amount to over $3,000 a year. Now, if a man is married, there will be no tax there, because 3 percent is always less than the amount of annuity received.

Senator HASTINGS. And if $100,000 was paid in, the normal tax on that would be $3,000?

Mr. PARKER. Well, if $100,000 was paid in and say the annuity was $10,000, the amount of the income subject to tax from that $10,000 would be 3 percent of the $100,000, or $3,000. Now, as to the $3,000, that would go into income. If it was a married person, he would get a $2,500 exemption. That would leave $500 subject to tax. That would be considered as earned income, whether it was earned or not, and the tax on that $500 would be $8. Now, that is not very much tax for a person to pay that gets $10,000 a year. He would get $10,000 in cash and I cannot see any reason why a tax of $8 is going to hurt him.

Senator MCADOO. He pays $1,000 to get this annuity. Now, if you tax him, as you are proposing to do, he wins if he dies before the whole annuity is paid. If he lives long enough to exhaust the annuity, then he is not subject to the tax under the old law.

Mr. PARKER. Under the old law; yes.

Senator REED. You mean in that case, the $3,000 would be considered to be income on the investment, and so much return on principal?

Mr. PARKER. That is correct.

The CHAIRMAN. All right, Dr. Magill.

Dr. MAGILL. The next is on the following page, 23, "Tax-free interest".

The CHAIRMAN. We will leave this open—the matter of the annuity.

Dr. MAGILL. Yes. All right. Now, the purpose of the amendment there is this. You notice that subsection (b) is changed. These various provisions here I should say consist of exclusions from gross income, among which is interest upon "obligations of a corporation organized under act of Congress, if such corporation is an instrumentality of the United States." Then on the next page, 24, it is provided, that the exemption is granted only to the extent provided in the acts creating such corporations.

The CHAIRMAN. Well, that is to take care of this new legislation that we have passed.

Dr. MAGILL. That is right.

Senator REED. So that the effect of this is not to give additional tax exemptions?

Dr. MAGILL. No.

Senator REED. But merely to accommodate the revenue law to exemptions that may be given in other laws?

Dr. MAGILL. That is right.

The CHAIRMAN. Well, if there is no objection, we will approve that.

Senator REED. Well, I don't know. I think that ought to be objected to, but I suppose there is no use. It is just adding to the number of tax-exempt securities, giving further asylum for rich men to invest their money without sharing the common burdens.

Mr. PARKER. This does not add to it. The other law did.

Senator MCADOO. This does not change the tax exemptions.

Senator COUZENS. If it does not change that, we may as well approve it.

The CHAIRMAN. All right, Dr. Magill.

Dr. MAGILL. The change on page 25 is merely clerical.

The CHAIRMAN. Well, we will approve it then, if it is clerical.

Dr. MAGILL. The change on page 26 is again a substantial change in the provision with respect to interest. You notice the general heading of that section is "Deductions from gross income." Generally speaking a taxpayer is allowed to deduct whatever interest he pays on his indebtedness. Then we were confronted with the case, in the prior law, of an individual who borrows money from his bank and buys tax-exempt securities. The present law does not permit him to reduce his ordinary taxable income by deducting the interest on this loan, otherwise, he could eliminate his taxable income entirely by that device. Well, that is the present law. Well, then, this provision is designed to extend that somewhat, by providing for the case not merely where the indebtedness is incurred, for the purpose of purchasing tax-exempt securities, but the case where the proceeds of the loan are actually used for that purpose. In the case of the ordinary taxpayer, I see no reason why that should not be done. It simply carries out the general purpose of the present law. The real objection which has been made to it, or the principal objection which has been made to it, has been on the part of banks, their situation being this: A bank has certain funds which it invests in the market in tax-exempt securities, Federal or State; now, some of its deposits are interest-bearing, and some of them are not, at the present time.

Under this provision, it could at least be contended that if the Treasury could trace the source of the money which was invested in the tax-exempt securities and could find that some of it came from savings deposits on which interest is being paid, that the bank would be denied the deduction of the interest on the savings-bank deposits. Have I made that clear? It is a very complicated subject.

Senator REED. Well, isn't it inevitable that that contention will be made, and that, in view of this change in the law, it would probably be successful, that any person who was paying interest could not deduct it as long as he happened to be the owner of tax-exempts? Isn't that the way it will work out?

Dr. MAGILL. Certainly the Treasury would need to investigate, in each case, because as I read this thing, what it does is to put it on a purely factual basis. That is, the proceeds which are used to purchase and carry; so that in every case you would have to examine to see whether this money which he used to buy this was tax-exempt.

The CHAIRMAN. Did the Treasury recommend this?

Dr. MAGILL. No; it did not. This was in the subcommittee's report; and as a matter of fact, on investigation, the Treasury feels that the provision ought not to be applied in the case of banks.

Senator REED. I agree with you.

Senator GORE. I was going to ask about that.

Dr. MAGILL. The difficulties there are twofold. Now, I am presenting simply the Treasury position, and I have discussed this with the Secretary. I do not know how the other experts may feel.

Senator REED. Let us take a practical instance. Suppose the Riggs National Bank has a considerable quantity of Governments, no matter what issue. These, so long as a corporation holds them, are tax exempt. Undoubtedly, it was in order to keep themselves completely liquid. Undoubtedly, also, they are paying interest on their time deposits. Your field agent is going to claim—and I don't see how the claim can be resisted—that until they have sold all those tax-exempts, out of the proceeds of their time deposits, they are being used to carry this.

Dr. MAGILL. Well, it probably would not be quite that, Senator, although the general result which you suggest is correct. Suppose that the Riggs Bank had sufficient capital and surplus to cover the tax-exempts? Let us say it had $100,000,000 capital and surplus and it invested $5,000,000 in tax-exempt bonds.

Senator REED. That is a violent assumption, because practically every bank has more than its capital and surplus in Governments today.

Dr. MAGILL. That is true. I was just about to state the Treasury's position with respect to the provision as it stands. In the first place, as I said, it appears that what these italics put in is a factual test. That is, the question whether or not particular money was used to buy tax-exempts.

Now, the information which we have is that it would be quite difficult to apply that in fact, in the case of a bank, because here you would go down and make a deposit in a bank today, on which you are to receive interest, and then tomorrow the bank buys a million dollars of tax-exempt bonds. Well, if they used your deposits, or if they used some other deposits that have been made in checking accounts, where did this money come from?

Senator REED. You cannot prove either the affirmative or the negative.

Dr. MAGILL. It is usually very difficult.

Senator GORE. The banks have been absorbing most of these Government bonds.

Dr. MAGILL. That is our other point, Senator Gore.

Senator GORE. Yes; I think that is substantial.

Dr. MAGILL. At the present time. And this is the reason the Treasury is recommending the change. That is, to go back to the present law on this, so far as banks are concerned. The banks are very much upset about this provision because of revisions which they understood will have to be made by the Treasury, and consequently, the Treasury feels that the offsetting effect with respect to this financing will outweight any revenue which can be obtained under this provision. As a matter of fact, our estimates of additional revenue on the provisions as a whole not including banks and everything else, are something like three or four million dollars.

Senator REED. There never could be a worse time for the law to be changed this way than right now, could there?

Dr. MAGILL. No; I think that is true. The Treasury has enormous financing ahead of it.

The CHAIRMAN. Do you merely suggest that banks be eliminated from it, or that the whole provision be stricken out?

Dr. MAGILL. Well, we would be particularly concerned with banks, I think.

Senator HASTINGS. In order that I may see whether I understand it or not, suppose a man has $200,000 in Government bonds. At 3 percent, that will bring him an income of $6,000. Then, if he goes and borrows $100,000 on those, that will cost him $5,000 interest, supposing the interest to be 5 percent. Then he is entitled, under the old law, to deduct that $5,000 and he has other income in addition to that, in addition to these securities, that has brought him $6,000. He is entitled to deduct this interest, so that he might not pay any tax at all; isn't that the truth?

Dr. MAGILL. Well, I don't think the old law would actually affect the situation which you gave, because the old law said that if he incurred indebtedness in order to buy tax-exempt securities, and the case you gave me was a case of a man who already had the tax-exempt securities.

Senator HASTINGS. And then went and borrowed on them——

Dr. MAGILL. And then borrowed the money. I do not think the present provision affects that, but if he did it in the reverse, if you want to consider that case, if he borrows $200,000 and buys Governments and pays the bank——

Senator HASTINGS (interposing). Five percent.

Dr. MAGILL. $10,000 interest on that, and he gets $6,000 interest, he is allowed to deduct the $10,000 interest which he pays from his other income, whatever that may be, and he does not report the $6,000 income which he receives.

Senator REED. Well, now, Doctor, I should think that from the standpoint of the administration, with this tremendous bond campaign which we have got ahead of us, almost as bad as in war time, you would discourage any effort to penalize the purchase of Government bonds by individuals as well as by banks. A great deal of this has got to get into the hands of estates and private investors, if your bond program is going to be successful.

Senator COUZENS. But you are not expecting that they will borrow money with which to do that, are you Senator?

Senator REED. Surely, just as you did in war time. You wanted them to borrow, and you wanted them to "buy until it hurt."

The CHAIRMAN. Ninety-nine percent out of a hundred couldn't borrow money for the purpose, if they wanted to, today.

Senator GORE. The banks would be about the only purchasers of Government securities now. About 3 percent of it would go to private purchasers, or to purchasers other than the banks.

Senator MCADOO. Banks and fiduciary interests take the Government bonds.

Dr. MAGILL. I think that is true. I think at the present time banks and these former security affiliates—that is, security and insurance companies—would cover the big buyers.

Senator GORE. I saw an estimate which said that about 3 percent were in other hands than banks, but it might have included these concerns.

Mr. PARKER. I think about 65 percent of all Government bonds are held by corporations. There is about 35 percent in the hands of individuals.

Senator MCADOO. I think the provision is a very unwise provision. I cannot see any substantial benefit to be derived from it, from the record, but I can see a great injury which may happen to our Government securities.

Senator GORE. It looks like it might be hard to administer.

Senator MCADOO. They must absorb these great issues that we are trying to emit. I think it is foolish to try to get a penny or two here at the expense of proper financing.

The CHAIRMAN. As I understand it, Dr. Magill, what the Treasury wants done is to strike out that on page 26, to reincorporate paragraph 3 on page 36?

Dr. MAGILL. Well, the affirmative recommendation which we would like would be that banks, dealers in Government securities, and trust companies should be eliminated from this provision. Now, if in the judgment of the committee, it is better to go back to the present law, completely, this is agreeable to us.

Senator MCADOO. Wouldn't it be very hard to administer?

Dr. MAGILL. From the view of our United States securities, we would like very much to have the banks, security dealers, and trust companies taken out.

Senator REED. I should think you would want to widen your market, rather than narrow it.

The CHAIRMAN. Gentlemen, let us settle this question, while it is fresh in everybody's mind.

Senator COUZENS. I think the doctor's position, with reference to making those exemptions, eliminating the lines in page 36, is sound. I can't see any reason why we should go back to the old law and encourage the wiping out of normal income by the borrowing of money to buy Government securities.

Senator HASTINGS. I am agreeable to the Treasury's recommendation, myself.

Dr. MAGILL. Your case, Senator Couzens, would still be covered. That is, if a man went out and borrowed money to buy Government securities, the present law and this bill would still catch him.

Mr. PARKER. We had a special case, which was an actual case, of a bank that got $12,000,000 of taxable interest and $8,000,000 tax-exempt interest. After deducting interest on deposits amounting to $16,000,000 they paid no tax at all, although they had twelve millions of taxable interest.

Senator REED. If we have tax-exempt securities, you are going to have injustice like that.

The CHAIRMAN. All in favor of going back to the old law which the Treasury says will put out these fellows who deal among themselves and buy tax-exempt securities, will say "aye"; those opposed "no".

Senator HASTINGS. Before putting the question, Senator, do I understand we are approving what the Treasury recommends?

Senator REED. We are disagreeing to the amendments on page 26.

The CHAIRMAN. We are disagreeing to the amendment on page 26, reincorporating paragraph (3) on page 36.

Senator REED. We don't need to reincorporate that. We disagree with that amendment on page 26.

Dr. MAGILL. There are really two different things there, Senator Hastings.

Mr. PARKER. On page 27, there is another purpose in mind. We have got to retain something there if we possibly can.

Dr. MAGILL. You can do this in either of two ways, depending on how you want to do it. You can either go back to the present law, simply striking out this italicized part on pages 26 and 27, or on 26. You don't need to do it on 27. Or you can except banks, trust companies, and security dealers, for example, from the operation of this provision, and leave others subject to the new provision.

The CHAIRMAN. Why isn't it better to go back to the old law?

Dr. MAGILL. My judgment would be that the best thing to do would be to go back to the old provision.

Senator MCADOO. That has been interpreted and settled, and there is nothing in this, and it would be much better to go back to the old provision, in my judgment.

Senator BYRD. I would like to know exactly what protection the old provision gives in the case of a man who borrows money on Federal bonds, and deducts that from his income tax, while the income from the Federal bonds is not taxable?

Dr. MAGILL. Well, the old provision catches that case. That is, if you go down to the bank and borrow $100,000, with which to purchase tax-exempt securities, this present provision of the law provides that you may not deduct the interest on your loan from the bank, since you do not report the interest on securities.

Mr. PARKER. But, on the other hand, If I have some tax-exempt securities, and I go down to the bank and borrow some money, and buy stock, I put myself in the same practical position, and in that case, under the existing law, I will get the deduction.

Dr. MAGILL. That is right.

Mr. PARKER. It is very hard to ear-mark dollars.

Senator HASTINGS. In order to correct that, you ought to leave the provision in as written, and simply exempt the banks and security houses from its operation.

Dr. MAGILL. I don't think the provision as written would cover that case.

Mr. PARKER. The provision, as written, is very troublesome. There is a technicality here that we have already gone into. It would not affect the individual, but it would affect a corporation.

Dr. MAGILL. I think you had better go back to the original provision.

Senator REED. Mr. Chairman, I move that the Committee disagree to the amendment on page 26.

The CHAIRMAN. That goes back?

Mr. BEAMAN. Strike out the words in italic in lines 19 and 20, on page 26.

Senator REED. That is right.

The CHAIRMAN. All in favor of that, say "aye". Those opposed say "no". It is carried.

Senator MCADOO. You are striking out part of paragraph (b)?

The CHAIRMAN. Striking out the new language in (b).

Senator BARKLEY. That restores automatically the two words that were striken out?

Mr. BEAMAN. No, Senator. That is another matter, entirely.

Senator CONNALLY. Why should they be striken out?

Senator REED. They have done it all through the bill, Senator.

Dr. MAGILL. That is purely clerical.

The CHAIRMAN. Proceed, Dr. Magill.

Dr. MAGILL. There is this change, on the top of page 27, in this same provision.

The CHAIRMAN. Should that be striken out?

Dr. MAGILL. That has nothing to do with what I am talking about.

The CHAIRMAN. Oh, I see.

Dr. MAGILL. That simply denies the deduction of interest on indebtedness, used to purchase an annuity.

The CHAIRMAN. That ought to be adopted?

Dr. MAGILL. I think so.

The CHAIRMAN. But on the annuity, did we take action?

Senator HASTINGS. No.

The CHAIRMAN. So we will just leave that open.

Senator MCADOO. Doctor, may I ask a question here? I haven't looked up the special tax laws for a long time, but going back, for a moment, to subsection (a), page 26, you referred to "trade or business." Are "professions" embraced in "trade or business"?

Dr. MAGILL. Yes. It is so interpreted by the Treasury.

Senator MCADOO. Yes; that is what I thought. I wanted to make sure.

Senator REED. On that, Dr. Magill, to be personal for a moment, I have a ruling from the highly respected Department of Internal Revenue to the effect that all the extra clerk hire that I have to pay here in my office is not deductible.

Senator HASTINGS. I have the same information.

Senator REED. Isn't that considered a trade or business?

Dr. MAGILL. I haven't gone into that situation, but I have a recollection of rulings along the line that you point out. In one that I have in mind, I think that they have held that the expenses which you incur in the course of a campaign——

Senator REED. This has nothing to do with a campaign. This is hiring extra clerks to answer the many letters that come in to me.

Dr. MAGILL. I would like to look that up, because I am not advised as to that ruling.

Senator REED. So far as I am concerned, it is not necessary to look it up. They have disallowed every penny.

Senator BYRD. Why not deduct telephone calls that are made in the transaction of public business?

Dr. MAGILL. I presume that if they have disallowed the clerk hire, they will disallow telephone calls, too.

Senator BYRD. That certainly is not right.

Dr. MAGILL. I don't know why they have done it. I would like an opportunity to look up the rulings.

Senator REED. Couldn't we, by changing a word or two, protect ourselves against that?

Dr. MAGILL. Yes; but may we leave this open until I see what they have done, and the reason why they have done it? I will report to you on it. Suppose I get that and let you know. I think I can do that by tomorrow morning.

Senator GEORGE. That is not a trade business. I suppose that is the ruling.

Senator CLARK. Mr. Chairman, it seems to me the point raised by Senator McAdoo might very well be cleared up. Dr. Magill says that the Department has construed "trade or business" to include "professions" or "vocations", or activity; but it seems to me the words "profession" or "vocation" ought to be inserted there. In other words, certainly there is no more reason why a lawyer, a doctor, or anybody else should have the right to make a deduction for the necessary expenses of carrying on their professions and vocations, than in the case of a man engaged as a plumber, or anything else.

Senator CONNALLY. The Treasury makes you turn in your mileage, but they won't let you deduct for bringing your family up here. They won't let you deduct the amount you actually spend on your mileage. You have got to turn it all in.

Senator REED. I think it would be cured by putting in the words "vocation, profession, trade, or business", in lines 8 and 12.

The CHAIRMAN. What do you think about that?

Dr. MAGILL. I don't see any objection to it.

The CHAIRMAN. Without objection, the draftsman will be directed to insert it at the proper place. Just where would that be inserted?

Senator MCADOO. Line 8, on page 12, after the word "any."

Senator HASTINGS. Senator Reed, wouldn't that clearly take care of the thing you are talking about?

Senator REED. I think "vocation" would take care of the thing.

Senator GORE. That won't do it.

The CHAIRMAN. Read that again. Let us get that wording, Senator.

Senator MCADOO. Any "profession, vocation, trade, or business."

Senator CONNALLY. Mr. Chairman, that won't cover it at all.

Senator GEORGE. I don't think it would cover public officials.

Senator CONNALLY. Holding public office is not a vocation.

Senator REED. "Vocation" I suggest, is all you need.

Dr. MAGILL. I would like to defer this until I can have an opportunity to consult the rulings of the Department on it.

The CHAIRMAN. Suppose we pass that for a minute. Look into it, please, and give us a statement.

Senator BARKLEY. Would that include a case like this, in connection with the Public Works Administration? I was asked a few months ago for a list of competent engineers in Kentucky who might be considered for engineering work. I spent $60 in long-distance telephone calls, trying to get a suitable list of engineers, which I submitted to the Department later. Of course, I paid that out of my own pocket. Is there any justice in requiring us to pay out those expenses without permitting them to be deducted?

Senator BAILEY. Mr. Chairman, while you are correcting the words, I notice on page 24, a reference to "ministers of the Gospel." Why not amend that to read "ministers of religion"?

The CHAIRMAN. The term "ministers of the Gospel" is very restricted.

Mr. PARKER. I don't think the Treasury has restricted it in its rulings.

Senator MCADOO. They might change their minds.

Senator BAILEY. It might include a rabbi.

Mr. PARKER. I am sure it does.

Senator BAILEY. I am sure it does, too, as interpreted by the Treasury, but I am not willing to leave it that way.

Senator REED. The rabbi is a minister of the first half of the Gospel, anyway.

The CHAIRMAN. Suppose we go to page 27, Doctor, and now bring that to the attention of the committee, with the suggestion of Senator McAdoo.

Dr. MAGILL. The first change in the paragraph marked (1) in subdivision (c), is simply a clerical change. Substitute "Federal" for "imposed by authority of the United States."

The CHAIRMAN. We will approve it.

Dr. MAGILL. The next change, down in (3), is a substantial change. Heretofore some deduction has been allowed either from the income of the estate, or from the income of the beneficiary, with respect to an estate, inheritance, and so forth, taxes.

Senator GEORGE. You mean that are paid by the taxpayer?

Dr. MAGILL. Yes; no matter who pays them.

Senator REED. Whether it is the estate or the individual?

Dr. MAGILL. Whether it is the estate or the individual.

Senator GORE. I did not get the point.

Dr. MAGILL. Suppose that you are the beneficiary of an estate, Senator Gore, and there is paid to the State of Oklahoma, $1,000 in taxes in respect of the interest which you receive. Heretofore, a deduction has been allowed from your income, or the income of the estate in some cases, with respect to that $1,000 succession tax which was paid. The proposal in the bill is to eliminate that deduction.

Senator GORE. Would you pay a tax on your taxes? That is what it amounts to.

Dr. MAGILL. I think the theory of it is this: That, as a result of the whole transaction, you have profited to the extent of whatever legacy you received, and that there is no very legitimate reason for letting you offset this tax against the amount of your other ordinary income.

Senator CONNALLY. Doctor, isn't this the distinction between this deduction and the deduction of other taxes, that the other taxes are continuing taxes, as a rule?

Dr. MAGILL. Yes.

Senator CONNALLY. They are an incidental to your business, whereas an inheritance or a gift is something that you get once in a lifetime?

Dr. MAGILL. Yes; that is right.

Senator CONNALLY. If you are going to let them deduct that from income, you are doing the Government an injustice.

Senator GORE. It is a tax on "velvet", we might say.

Senator REED. Isn't the theory of the succession tax that it is supposed to be a participation by the Government in a part of the capital?

Dr. MAGILL. That is right.

Senator REED. It is not a tax out of income at all?

Dr. MAGILL. That is it. That is the theory.

The CHAIRMAN. Does the Treasury recommend that?

Dr. MAGILL. Yes.

The CHAIRMAN. Without objection that will be approved.

Dr. MAGILL. And that involves the elimination of the lines at the foot of page 27 and the top of page 28. The next change is in lines 12 and 13, on page 28, which is essentially a clerical change.

The CHAIRMAN. The change at the bottom of page 27 and the top of page 28, is simply carrying out the other idea which was mentioned?

Dr. MAGILL. That is carrying out the other idea; yes.

The CHAIRMAN. So, if one is to be adopted, the other follows?

Dr. MAGILL. The other follows. In lines 12 and 13 on page 28 subsection (r) formerly provided a restriction upon the deduction of losses upon the sale of securities. That section has been eliminated, and the corresponding provision in effect, is that in (j) on page 29, in lines 21 to 23, and then the general provision in section 117, which we will discuss later. In other words, stated simply, the provision on page 28 is merely a clerical change, necessitated by other changes in the bill.

The CHAIRMAN. Without objection, we will insert that.

Senator MCADOO. If we insert the words "vocation or profession", would we have to repeat it here in line 16?

The CHAIRMAN. We are waiting for the draftsman to make a suggestion.

Senator MCADOO. I raise that question so they will make a note of it. That is all.

The CHAIRMAN. We will adopt that on page 28, then.

Dr. MAGILL. On page 29, the first change, in lines 3 and 4, is similar to the change I have just spoken of, that is, a clerical change, due to the elimination of subsection (r).

The CHAIRMAN. We will adopt that.

Dr. MAGILL. The next, paragraph (g), is a new provision which is self-explanatory, that losses from wagering transactions are to be allowed only to the extent of gains from such transactions.

Senator REED. Doctor, on its face, it looks entirely reasonable; but is there not a danger of a lot of litigation, growing out of a claim by the Government that various transactions in securities are wagering transactions, in fact?

Senator GORE. In securities, you say?

Senator REED. Yes. A man buys stock on margin. He is really betting that that stock is going to go up.

Dr. MAGILL. I would doubt it. I haven't thought of it in that light. I doubt it, because of the fact that, as you know, there has been a good deal of litigation in the past, in which gambling transactions and what are not such transactions are pretty well defined under the various State laws.

Senator GEORGE. Your commodity exchanges have been held not to be gaming under the Federal laws?

Senator REED. I think you are probably right.

Senator BARKLEY. As a Kentuckian, and in the name of the horse, I resent that section (g).

Senator LA FOLLETTE. Your resentment will be noted, and the paragraph will be agreed to.

The CHAIRMAN. Explain that paragraph.

Dr. MAGILL. Well, that means, to take Senator Barkley's illustration, if a man bets on horse races during the year, and loses $10,000 and he has made no successful bets during the year, he can no longer deduct the $10,000 from his salary.

Senator HASTINGS. Can he do that under the old law? Could he deduct the $10,000?

Dr. MAGILL. No; I should say not, generally speaking. The line which the Treasury draws, is, I believe, whether or not the particular gambling transaction was legal in the State in which it occurred; and they have gone into a good deal of dissertation as to whether it is legal gambling.

Mr. PARKER. He could deduct it, if it was conducted in Maryland under the State law, and that is what this provision is aiming at.

Senator REED. Also, haven't they discussed the question of whether that is the taxpayer's regular business?

Dr. MAGILL. You wouldn't need to in this connection, because he could get the deduction as a loss, if the transaction was entered into for profit, in the event that the transaction was legal.

Senator LA FOLLETTE. Isn't this really aimed at the States where they have legalized betting or horse races and dog races, and things of that kind?

Mr. PARKER. Yes. We don't need this rule at all in respect to illegal gambling, because that is the way the courts have already interpreted it. This was put in to cover cases where you have legal gambling, like in Maryland. The claim is that persons go over there, and bring in a lot of tickets to prove the losses and forget about the gains. Thus they get the losses but don't report the gains.

The CHAIRMAN. Without objection, that will be adopted.

Dr. MAGILL. Now (j) on page 29, is one of the most important changes made by the bill, but I think it is probably advisable to defer the consideration of that.

Senator BAILEY. Where is that, Doctor?

Dr. MAGILL. (j), on page 29, lines 21 to 23.

The CHAIRMAN. That will come up for discussion later, in connection with section 117. Let us pass that for the present.

Dr. MAGILL. I think that is preferable.

The CHAIRMAN. All right.

Senator MCADOO. Mr. Chairman, how long is it your intention to sit today?

The CHAIRMAN. We won't have an afternoon recess. We have got to vote.

Senator REED. We have got to quit pretty soon.

The CHAIRMAN. Well, I suppose that is about as good a place to stop, as any.

Senator LA FOLLETTE. I wanted to raise a question. I have had a lot of correspondence and personal interviews with people who wish to be heard on this bill. Has the committee taken any action on the question of hearings?

The CHAIRMAN. I announced in the beginning, Senator La Follette, that we wanted to finish with the Government experts and go over the bill first, here, in executive session. We think we can finish it this

week. We hope to begin Monday, then. We have received hundreds of letters from people wanting to be heard and then we would try to fix a calendar and give these people an opportunity to be heard, as briefly as possible, trying to bring pressure on them so that groups will select representatives, so we can expedite it.

Senator LA FOLLETTE. I thought the way you handled it on the sugar bill was good, asking the people who wanted to raise the same points, to select some one to speak for their point of view.

The CHAIRMAN. I wish we could adopt the policy now whether or not we are going to take up the question of eliminating any of these nuisance taxes. We have received hundreds of letters here from this and that representative who wanted to appear and ask us to take this nuisance tax off, on fights, wrestling matches, athletic events, and all that. If we would adopt a policy, we could eliminate a good deal of that.

Senator REED. I think there will be an effort made, Mr. Chairman, to propose a general manufacturer's tax as a substitute for those nuisance taxes.

Senator BARKLEY. Well, of course, if we go into a general revenue bill——

Senator REED (interposing). This is a general revenue bill because you are reenacting the law.

Senator BARKLEY. But it doesn't levy any new taxes. It is merely a technical bill and a way to correct whatever deficiencies there are in the present law. If we are going to open it up as a general revenue bill, we will have to have prolonged hearings and prolonged discussions.

The CHAIRMAN. As a matter of fact, there is no change in this bill that takes any tax off, as I understand it.

Senator REED. I will say there isn't.

The CHAIRMAN. Merely the check tax is brought up.

Mr. PARKER. The date of repeal is changed from July 1, 1935, to January 1, 1935.

The CHAIRMAN. The date of repeal is the only change on that. If we start taking one off, we have got to hear innumerable witnesses on these other industries and interests.

Senator HASTINGS. Mr. Chairman, do we have to do anything unless we have a bill before us?

The CHAIRMAN. Here is the bill before you. The interested persons are here and they are going to press their claims.

Senator BARKLEY. That raises, of course, a parliamentary question, in connection with this bill here, as to whether we may not, under the rules, add all sorts of new taxes.

The CHAIRMAN. Oh, yes.

Senator BARKLEY. But, as a matter of fact, it is in conformity with the spirit of the Constitution, that revenue bills should originate in the House. Now, if we could wipe out all this and write a tax bill——

Senator LAFOLLETTE (interposing). But the House has reenacted this whole thing. This is certainly a revenue bill.

Senator BARKLEY. Technically it is.

Senator REED. It places new taxes on articles such as fruit juices, oils, gasoline, and so forth.

The CHAIRMAN. Those are carrying forward the old taxes without change.

Senator REED. How about coconut oil?

The CHAIRMAN. Coconut oil is a new proposition, of course.

Senator HASTINGS. Is it in here?

The CHAIRMAN. Yes. That is in there, and we have more trouble about it than anything else.

Mr. BEAMAN. This bill does not reenact the old taxes.

The CHAIRMAN. No; but it carries them forward. They are in this bill.

Dr. MAGILL. No; they are not in this bill.

The CHAIRMAN. Well, there will be an effort made to repeal certain parts of it. I wish the committee would adopt a policy on it.

Senator HASTINGS. Well, what do you suggest, Mr. Chairman?

The CHAIRMAN. That we not take that up and that we are not going to take off any of these so-called "nuisance taxes" at this time, because of the condition of the Treasury.

Senator BYRD. I don't think we ought to decide that today. I am in favor of repealing the Federal gasoline tax, and I am going to offer an amendment.

Senator MCADOO. So am I, Senator Byrd.

Senator BYRD. That is a temporary tax, and it should be reserved to the States.

The CHAIRMAN. Let us adjourn until 10 o'clock in the morning.

(Thereupon, at 12:20 p.m., the further hearing upon H.R. 7835 was adjourned until 10 a.m., Wednesday, Mar. 7, 1934.)

CONFIDENTIAL

REVENUE ACT OF 1934

HEARINGS

BEFORE

THE COMMITTEE ON FINANCE
UNITED STATES SENATE

SEVENTY-THIRD CONGRESS

SECOND SESSION

ON

H.R. 7835

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

PART 2

MARCH 7, 1934

UNREVISED

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REVENUE ACT OF 1934

WEDNESDAY, MARCH 7, 1934

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

The committee met, pursuant to adjournment, at 10 a.m., in the committee room, Senate Office Building, Senator Pat Harrison (chairman) presiding.

Present: Senators Harrison (chairman), King, George, Walsh, Barkley, Connally, Gore, Costigan, Clark, McAdoo, Byrd, Lonergan, Reed, Couzens, La Follette, and Metcalf.

Also present: Dr. Roswell Magill, Assistant to the Secretary of the Treasury; Commissioner Helvering, of the Bureau of Internal Revenue; Mr. L. H. Parker and Mr. C. F. Stam of the Joint Committee on Internal Revenue Taxation; Mr. Middleton Beaman, Legislative Counsel of the House of Representatives; Mr. B. H. Bartholow, Special Assistant to the Secretary of the Treasury, and other representatives of the Treasury Department and the House and Senate Legislative Counsel staffs.

The CHAIRMAN. All right, Dr. Magill. Where did you stop yesterday?

Dr. MAGILL. I think we left off on page 35, Senator Harrison, with that stricken-out matter in line 9. That was a special provision contained in the 1932 law, for a deduction for expenses incurred in connection with a casual sale of real property; that is, a sale of real property by someone who is not in the business of selling. We find, as a matter of fact, that this matter is already taken care of by the Bureau under the more general provision for the deduction of business expenses, so that there is no necessity for this special provision.

The CHAIRMAN. We will just strike that out, then.

Dr. MAGILL. Regarding page 34, a corporation was in the past given a deduction not only for dividends received from other domestic corporations, but also for dividends received from a foreign corporation, if 50 percent of its income was earned in the United States. The House thought that all foreign corporations should be put on the same basis.

The CHAIRMAN. That is a pretty important provision, isn't it?

Senator KING. Yes.

Dr. MAGILL. This is not, I think, the provision you have in mind, Senator Harrison. You mean the credit for foreign taxes.

The CHAIRMAN. Isn't this somewhat interwoven with that?

Dr. MAGILL. No, sir; not really. The credit for foreign taxes comes along a little later and is somewhat different. Do you want me to explain them both at this time?

The CHAIRMAN. No.

Dr. MAGILL. Suppose that the Socony Vacuum Corporation owns the stock of a British corporation, let us say, on which it receives dividends. In the past, if the British corporation did no business in the United States, the Socony Vacuum would be taxable on all the dividends which it received from the British corporation. On the other hand, if the British corporation did more than 50 percent of its business in the United States, then Socony Vacuum could get a deduction for the dividends which it received from the British corporation.

This change allows the domestic corporation a deduction in respect of dividends which it receives from domestic corporations. That is the present law, and that is continued, but insofar as dividends from foreign corporations are concerned, the American corporation will now be taxed upon them.

The CHAIRMAN. This is one of those tendencies to keep American capital at home.

Senator GEORGE. No; not necessarily.

Dr. MAGILL. It is a tendency, I suppose. It does not go very far in that direction.

The CHAIRMAN. It does not go very far, but it is a tendency that money made in foreign corporations is not deductible.

Dr. MAGILL. Of course, if the Socony Vacuum Corporation, in the illustration I gave, organized an American corporation to do the same thing as this British corporation was doing, it would be given a deduction for its dividends from that American corporation. What this does in practice, is to relieve the Bureau of the necessity of investigating in each case how much business the foreign corporation is doing in this country.

The CHAIRMAN. Is there any loss of revenue or any gain?

Dr. MAGILL. I doubt if very much is involved either way.

Mr. PARKER. It makes a difference, of course, a substantial difference, in some cases, in the tax on the domestic corporation, under existing law. If they get dividends from a foreign corporation which does 50 percent of its business in the United States, they don't pay any tax on these dividends now. Under the change, they will pay a tax on the dividends just as if it was interest or earned income, so there will be a difference in the tax. There will be some gain in revenue therefore, although, of course, I do not suppose there is a great amount, or a large number of those cases.

The CHAIRMAN. Shall we pass that over, or just approve it?

Senator GEORGE. I am in favor of approving it.

The CHAIRMAN. Unless some of the other members want to open it up.

Senator GEORGE. Unless they want to ask for a review of it.

The CHAIRMAN. I think it is fair myself.

Senator GEORGE. All right.

Dr. MAGILL. I think the changes on page 35, lines 13, 15, and 16 are essentially clerical.

The CHAIRMAN. Approved.

Dr. MAGILL. The stricken-out matter with respect to the deduction of losses on sales and exchanges of stock ties up with the whole question of the treatment of capital gains and losses.

The CHAIRMAN. We will pass that.

Dr. MAGILL. Mr. Beaman stated it might be your pleasure to go into capital gains and losses at this time.

The CHAIRMAN. No.

Dr. MAGILL. Or would you prefer to wait until we reach it in the regular order?

The CHAIRMAN. Let us pass that until later on because that is a pretty knotty problem here.

Dr. MAGILL. All right.

The CHAIRMAN. Maybe some of us will understand it when you get through discussing it.

Dr. MAGILL. That will be where the blackboard comes in.

The CHAIRMAN. Yes. We will just pass everything on Limitation on Stock Losses.

Doctor MAGILL. At the foot of page 37 is a new subdivision which is more or less self-explanatory. The case involved is this. Suppose that an oil company has some leases, for example, of some school lands, the income from which is tax exempt. Suppose it has other leases which are taxable. The company has expenses in connection with the operation of the tax-exempt leases. Under the present law, notwithstanding the fact that the income from those leases is not taxable, the company may deduct expenses in the operation of the leases. The purpose of this provision is to prevent the deduction of the expenses in the event that the income from the property with respect to which the expenses are paid out is not taxable.

Senator REED. Wouldn't that apply to banks as well as to loan companies?

Doctor MAGILL. Yes. To carry out the purpose of the committee yesterday in the amendment with respect to banks, in section 23 (b), this would have to be further amended by putting in, on page 37, section 24, line 23, after the letters "t-i-o-n" at the beginning of the line substantially this: "except interest on indebtedness." That would, as I say, carry out the action of the committee yesterday with respect to the allocation of expenses in the cases of banks.

The CHAIRMAN. Is it agreeable to approve this?

Senator REED. I think so.

The CHAIRMAN. Approved.

Mr. PARKER. I understand this is approved, with the change?

Senator KING. Yes.

The CHAIRMAN. With the amendment.

Senator REED. That would still allow room for controversy, wouldn't it, about the clerk hire and rent and things of that sort?

Dr. MAGILL. There is that possibility. We have debated about that section a good deal. It is one of those cases where there is undoubtedly an evil to be corrected, but it is possible by too stringent an administration that you might get into difficulties. Our own view has been that if the provision is administered with any intelligence, it will do a good deal of good and ought not to be inequitable.

Senator REED. Yes; but you can't guarantee that.

Dr. MAGILL. You cannot guarantee that.

Senator REED. You might find the Bureau inclined to apportion rents, clerk hire, and matters of that sort.

Dr. MAGILL. Yes.

Senator REED. And we are just manufacturing lawsuits, aren't we, if we leave that open?

Dr. MAGILL. I think there is that possibility, if the provision is administered foolishly.

Mr. PARKER. What we had in mind, I think, was that these items that we disallowed should be able to be definitely and specifically allocated. For instance, if you had two clerks that did nothing but cut coupons on Government bonds, you might disallow their expenses, but when you come to allocate overhead and office rent, and all that, thereis no basis for allocation. You would not know whether to base it on the value of the asset, on the income derived, on the actual labor, or what?

Senator REED. Why not adopt your very words, and in front of "allocable" insert "definitely and specifically"? Wouldn't that fix it?

Mr. PARKER. I think, perhaps, we ought to discuss that further.

Senator REED. What do you think about it?

Mr. PARKER. I would like to hear from Mr. Beaman on that.

The CHAIRMAN. What do you think of that, Mr. Beaman?

Mr. BEAMAN. I think we may as well cut the thing out.

Mr. PARKER. No; I don't think so.

Senator REED. It is definitely allocable if you have a clerk who spends all his time on it.

Mr. PARKER. It is a very important thing in these State oil leases. We thought at first we could tax the income. Now, the Supreme Court says we cannot do it. When a big oil company takes an oil lease on State land, we can't bring the income into the tax returns, but those expenses of operating that lease are allowed and deducted. Those expenses are specifically allocable to the tax-exempt income.

Senator REED. They are definitely and specifically allocated?

Mr. PARKER. We certainly should not give up the disallowance of such items because of difficulties that will be met.

Senator REED. What do you think about that, Doctor?

Dr. MAGILL. I see no special objection to it. I doubt if it would really correct the problem. That is, if they want to hold that some of these things definitely and specifically are allocable, I think they may hold that they are definitely and specifically allocable.

Mr. PARKER. If you put that in, doesn't that limit the allowance to anything that is definitely and specifically allocable under the act? It gives them less discretion in making allowances than they have under the language as it is.

Senator REED. That is right.

Dr. MAGILL. I think there is one thing we should do that we discussed yesterday afternoon. That is to put some example or the like in the report, to indicate the limitations which we think there should be on this provision.

Senator REED. Yes, but those reports are forgotten. Otherwise, if we leave it as it stands it means that every bank in the United States will have a lawsuit over each year's income tax, and every insurance company.

Senator BARKLEY. I don't know about that. Banks are not in much position to have lawsuits now.

Senator KING. Doctor, in dealing with the question of what may be deducted from your income, why not state affirmatively what may be, which would exclude everything else?

Senator REED. They do.

Dr. MAGILL. Well, we do it already; the difficulty in this connection being that the provision for the deduction is broad enough to include, for example, any business expenses, no matter whether they are incident to the production of taxable income or not.

Senator KING. Then you have made it too broad, and therefore you have got to come back and restrict it?

Dr. MAGILL. That is what it amounts to.

Senator KING. Why couldn't you narrow it, instead of making this amendment?

Dr. MAGILL. I think you would probably come out at the same point, Senator King. That is, if you tried to do it by amending the deduction for expenses, you would put in "except expenses incident to the production of income which is not subject to tax", or words to that effect.

Senator KING. Well, it seems to me that one of the great evils that has developed in our taxing system is that we have allowed too much for these exemptions, too much for various things, for supposed deterioration of property, and many other things. It seems to me we have lost millions that way, and it would be far better if we could just in a definite way say that this and this only will be the deduction allowed, or the credit allowed.

Dr. MAGILL. This method has some advantage, in this way. This provision, you see, is applicable to all of the deduction provisions, whereas if you wanted to follow out the general policy which you have in mind, you have to insert some phraseology in each of a dozen different provisions for deductions. This is a somewhat simpler way of doing it in the law.

The CHAIRMAN. Do you believe this ought to be in this bill, or do you think it would be clearer if we just struck this provision out?

Senator KING. Do you mean section 5?

The CHAIRMAN. Yes.

Senator KING. Subdivision 5?

The CHAIRMAN. Yes; paragraph (5). What we are trying to get at here is that we may be clear and definite. If you are getting into more ambiguities, it seems to me like it is bad.

Dr. MAGILL. You are going to get into ambiguities if you are going to put in illustrations.

Mr. PARKER. There is a substantial amount of revenue involved in this matter. I remember one case in which I think we lost about 4 or 5 million dollars when we got the decision about income from State lands. It is an important matter therefore.

Senator KING. You think that this would have saved that?

Mr. PARKER. Well, it would help. It would cut it in half, because they not only were not taxed on the income, but they get the deduction.

Senator REED. Let us put in the words "definitely and specifically." That will catch the case you mentioned.

Dr. MAGILL. I am agreeable to that.

Senator REED. I move that that be done.

The CHAIRMAN. Where does it go?

Senator REED. Right in front of "allocable", so it will read: "Any amount other allowable as a deduction, except interest on indebtedness which is definitely and specifically allocable to one or

more classes of income." That takes care of your oil cases and at the same time takes care of this effort to allocate general expenses.

The CHAIRMAN. What do you think of that, Mr. Beaman?

Mr. BEAMAN. Do you mean to ask what I think of the suggestion, or of the paragraph?

The CHAIRMAN. The suggestion.

Senator KING. The paragraph and the suggestion both.

Mr. BEAMAN. I have a feeling that the suggestion will practically amount to wiping out the paragraph, which I am in favor of doing anyway, but you take Mr. Parker's case of two clerks who are spending their time clipping tax-exempt bonds. All they have got to do is to put the clerks, for an hour or so a day, clipping some other kind of bonds, and thus avoid this provision.

Mr. PARKER. You cannot do that in respect to many of the expenses in connection with oil leases.

Senator REED. The essential thing is, you have clerks clipping coupons, but you also have the oil leases.

Mr. BEAMAN. I feel that if the thing is administered in the spirit in which you gentlemen approach it, it will be fine, but I do not think it will be so administered. I think the zealous "watch dogs of the Treasury", around the Bureau and the General Counsel's office, will scrutinize every deduction in the entire list, and if a man has some tax-exempt income, they will try to see which one is smart enough to figure out a new way in which to disallow the deduction. I think the provision will raise more controversies than it will revenue.

Senator REED. We can't change their spirit.

Mr. BEAMAN. No. I am not at all sure you ought to.

Senator REED. I was taught that every tax law should be construed in favor of the citizen, but that has been most effectively reversed.

Mr. BEAMAN. There is undoubtedly an evil here that ought to be corrected, but I seriously doubt whether it is an evil that can be corrected without leading to considerable disputes and litigations and controversies and general disruption of affairs.

Senator KING. Where there is an evil so palpable as that indicated by Mr. Parker, it would seem that our terminology is broad enough to permit us to draft a provision that would attack the evil.

Mr. BEAMAN. I am very much afraid, Senator, that there are a lot of things about this income tax of which that is not true. I feel very strongly on the subject of this income tax. Up until about 1928, evils developed which could be cured, but beginning about 1928, it became difficult to find plugs for some loop-holes. In other words, the evil is there, but it cannot be remedied without doing injustice to somebody else. I mean, you are faced with the proposition of either being rough, and curing the evil, and doing a lot of harm to somebdoy else, or letting the good man go on happily, and the evil man pursue his evil way. We have just about run out of the "plugs", that is the trouble, and I think this is one of those cases. There is undoubtedly an evil, but how to fix it? In the absence of administration in the spirit that you gentlemen have in mind I think that that thing is going to cause more trouble than it will good.

Senator KING. You are not a good theologian, because your view is contrary to the doctrine which so many moralists accept, that for every evil there is a virtuous antidote. You do not believe that?

Mr. BEAMAN. Not in the case of the income tax.

Dr. MAGILL. I think the case in which we are mainly interested now is where, as you know, the income from certain oil leases on Indian lands and school lands is exempt from Federal income tax. The same company may have income from other leases, which is taxable. Under the present law, the company can deduct any expenses incurred in connection with the tax-exempt leases, although it does not have to pay any tax upon the income from those leases. The result is, of course, to reduce the otherwise taxable income from the taxable leases. The main purpose of this provision would be to extend the theory to other types of income.

Senator REED. Of course, it will have to be more or less arbitrary, will it not?

Dr. MAGILL. Yes.

Senator REED. It seems to me it is a perfectly proper thing. If they have done that in the case of an individual, they ought to do it in the case of every corporation that owns Government bonds.

Dr. MAGILL. I should think so.

Mr. PARKER. There is a case on that. The case which Senator Couzens mentioned during the informal discussion just now, is a case that Mr. Stam knows about. He can state that.

The CHAIRMAN. All right.

Mr. STAM. There is one case, on individuals, the Marquette case, in which the court has held that that deduction is not allowable.

Senator COUZENS. What do you mean—the deduction for the corporation, on tax-exempt property?

Mr. STAM. The deduction on tax-exempt property owned by individuals; but the Department has not applied this rule to corporations, I think, on the theory that they cannot determine definitely whether the deduction is directly allocable to the tax exempts.

Senator COUZENS. I know; but I think if the Department has the power, it can, in collaboration with the taxpayer, fix an agreed amount as to the cost between the one and the other; but it is wholly unfair to deduct the cost of handling tax-exempt property from taxable income.

Senator REED. And yet every bank does it.

Senator COUZENS. It ought to remain.

Senator REED. The point is, it is not fair to apply one rule to the individual and another rule to the corporation.

Mr. STAM. That is right.

Senator BARKLEY. Isn't it true that in the case of a corporation, where they have a force of people working generally for the corporation, it is difficult sometimes to determine what part of their time is occupied in looking after tax-exempt securities, and what, after the ordinary business of the corporation; whereas, in the cast of an individual, it is not very difficult?

Senator COUZENS. I may point out, Senator Barkley, that it should not, if you attempt to get together on a reasonable basis. In other words, if your tax-exempt property is 10 percent of your whole, you can then fix it on a 10-percent basis. I mean, there is no great difficulty in getting together with the Bureau, if they have the power, and the taxpayer would not object, I think, if he is getting the advantage of the tax-exempt properties.

Senator REED. In view of that decision, I do not see any purpose in putting this in.

Senator GORE. What is the point?

Mr. PARKER. They have not applied it to the corporation. They have only applied it to individuals. Of course, that is not a Supreme Court case.

Senator GEORGE. Isn't there broad enough authority in the Bureau to formulate a rule by which they will make it applicable to corporations?

Senator GORE. How does it apply to oil companies that have tax-exempt leases?

Senator GEORGE. Senator, let me get my answer first.

Senator GORE. Pardon me. I thought you were through.

Senator GEORGE. Isn't there broad enough authority to formulate a rule, by which it can be made applicable to all classes of taxpayers as well as to individuals?

Dr. MAGILL. If this decision that Mr. Stam refers to should be upheld in other courts, for my part, I see no reason why it could not be applied to corporations as well as to individuals, subject to the matters that we have been discussing here. That is, the extent to which you can allocate particular expenses to tax-exempt income, which is a difficult problem.

Senator GEORGE. Couldn't there be a broad, general amendment inserted, providing for the allocation?

Dr. MAGILL. That is the purpose of this, to make it specify that the Bureau does have the authority. This decision that Mr. Stam refers to, may or may not stand as good law.

The CHAIRMAN. What is the decision of the court?

Mr. STAM. It is by the Circuit Court of Appeals.

Senator GEORGE. What I meant to inquire was this: Wouldn't it be quite possible to say that the expenses should be separated and allocated on the basis of the income from the tax-exempt property in relation to the taxable income, or the total net income of the corporation, individual, or taxpayer?

Dr. MAGILL. That is the purpose of this paragraph, Senator.

Senator GEOGE. It is?

Dr. MAGILL. Perhaps it could be better stated.

Mr. BEAMAN. No; not if I understand the Senator. You mean to not go into any question about it, but simple to arbitrarily prorate it on the basis of the income.

Senator GEORGE. Give the Bureau that power; yes.

Mr. BEAMAN. I am afraid the Supreme Court would not uphold that.

Senator GORE. State the point, please, with particular reference to exempt oil leases.

Dr. MAGILL. Senator Gore, suppose that an oil company has operating expenses in connection with a tax-exempt lease—that is, a lease, the income from which is not subject to the Federal income tax, amounting to $50,000 in a given year; supposing that the company further has an income from other leases, which is subject to the Federal income tax, amounting, say, to a million dollars. At the present time, the oil company is permitted to deduct the expenses in connection with the operation of the tax-exempt lease from its income from the taxable properties; in other words, to deduct the $50,000 from the million dollars, in the case I gave. The million dollars was the income from the taxable leases. The $50,000 was expenses in connection with the

nontaxable leases—$1,000,000 revenue from the taxable leases. The purpose of this provision is to prevent the corporation from deducting expenses in connection with the tax-exempt income from the income which is taxable.

Senator KING. Mr. Beaman, I am not quite clear as to the reasons which you assign for your statement that it would be unconstitutional, or at any rate that the court would not uphold it. It seems to me we can, merely in accordance with the suggestion of Senator George, authorize the taxing authority to ascertain a fact, towit, the general income, general expenses, and how much of those general expenses were attributable to tax exempts.

Mr. BEAMAN. I did not understand that that was Senator George's proposition.

Senator KING. And then to apply the rule.

Mr. BEAMAN. What we have in the bill is what you just said. What I understand the Senator to say, if I got his suggestion, was that if you find a man has $100 of tax-exempt income, $200 of other income that is taxable, or a total of $300, his proportion is 1 to 3. If he had deductions, you would disallow one third of the deductions without looking to see whether there is any connection between them and the tax exempts.

Senator KING. No.

Mr. BEAMAN. Is that your idea, Senator?

Senator GEORGE. Not exactly.

Mr. BEAMAN. I am sorry. All I can say is, if that suggestion should be made, I think the Supreme Court would not uphold it.

Senator KING. But the view I just indicated, quite imperfectly, you think would not be upheld?

Mr. BEAMAN. That is what is in the bill now.

Dr. MAGILL. That is about what is in the bill.

Mr. PARKER. It is a problem to get the basis of allocation. We might imagine a hypothetical case in which a man has a clerk who handles his investments. He has $1,000,000 in tax-exempts, and $1,000,000 in stock of corporations. He says to his clerk, "We will put the tax-exempts in the box. I am not going to change those investments, but you watch the stock market now, on these other things." In a case like that, you would plainly want to allocate that clerk's expenses on the basis of the capital. His entire time is put on the dividends. Just because he has half of his capital in tax-exempts, locked in a box, and the clerk has a key, that is not a basis for allocating half of that clerk's expenses to that; and that is one of the troubles.

Senator REED. Let me give you another illustration that shows you the unfairness of it. The taxpayer has a commercial business in which his expenses run about 65 percent of his gross. He has got an equal amount invested in tax-exempt bonds, in which case he could turn the whole business over to a trust company to manage for him on a 2-percent basis. Certainly that is not fair, to refuse to allow him to charge off all his expenses in his commercial business, because half his income comes from tax-exempts.

Mr. PARKER. That is true; but I think that if he turned it over to the trust company, that the payment of the 2 percent to the trust company should not be allowed as a deduction against his other income.

Senator REED. I grant you; but that shows that you cannot make a flat percentage allocation right through. That would work out a great injustice.

Senator GORE. On these tax-exempt oil leases, in that sort of case, wouldn't they transfer that lease to some other concern as a holding company, for that purpose alone?

Mr. PARKER. I do not think that. If this provision would work as we hope it will, I do not think that would make any difference. Nobody could get those expenses in connection with operating that State lease.

Senator GORE. How is that?

Mr. PARKER. That would not be deductible from anybody's income. It would not make any difference who owned that tax-exempt lease. The expenses of operating the lease would be disallowed, so I don't think any shift in ownership would matter, Senator Gore.

Senator REED. It seems to me that the Bureau has power now to establish a regulation which would work out fairly in these cases. If they can do that in the case of an individual, they can do it for a corporation. There isn't any difference in the law, between them.

Senator BARKLEY. Why isn't that language as it is about as near as we can get to arriving at a solution of it?

Senator COUZENS. That is what I think. I think it is broad enough to let the Department do it.

Senator BARKLEY. It is certain that it is clear enough.

Senator REED. Before you came in, the committee adopted an amendment to line 23, to insert a parenthesis after the first fraction of the word "deduction" at the beginning of line 23, and insert in the parenthesis "except interest on indebtedness." That is in line with the decision made yesterday. The pending proposal is to insert in front of the word "allocable" in that same line the words "definitely and specifically."

Senator BARKLEY. I am not convinced that those two words ought to go in there.

Senator REED. Dr. Magill says he is satisfied to have them inserted. They still take care of the cases he has in mind.

Senator GORE. The point in this is to prohibit them from deducting expenses connected with tax-exempt property or other income, and reducing their taxes.

Senator REED. That is so. When you remember that every Government bond is totally tax exempt in the hands of corporation, you can see that you are introducing the elements of a lawsuit in the returns of every bank and every insurance company in the United States. We do not want to manufacture an annual lawsuit for every bank and every insurance company. Yet that is what we do if we don't put in those words "definitely and specifically allocable."

Senator COSTIGAN. Dr. Magill, do you regard those words as an addition to the purposes you have in mind?

Mr. BEEMAN. Here is the kind of trouble that I fear from those words. Supposing that I have a State lease, the income from which is tax exempt, and I have another lease which is taxable; and that I employ an engineer at $25,000 a year to run them both. How much of that $25,000 is definitely and specifically allocable to the State lease?

Senator REED. I don't know. It depends on where the man spent his time.

Senator KING. That is a fact which is susceptible of demonstration.

Mr. BEEMAN. I think it is under "allocable," but "denitely and specifically allocable", I don't know. I fear we will get into trouble.

Senator REED. Suppose you said just "directly allocable"?

Senator COUZENS. What is the matter with the language as it is?

Senator REED. It is too vague. It means a lawsuit every time.

Senator BARKLEY. Whether a thing is allocable to one thing or another is not vague.

Mr. PARKER. If you had the president of that company over in New York, it would be pretty hard work to allocate his time. If it was an engineer operating the property, the records would ordinarily show where he was spending his time.

Senator BARKLEY. Suppose that 50 percent of his time is definitely and specifically allocable to one class of business which is taxable, and that the other half is definitely allocable to something else. How are you going to prove that?

Mr. PARKER. The burden would be on the taxpayer to disprove it. They would come in with records and show that three quarters of his time was spent on the taxable lease, and therefore only one quarter of his time should be charged to the tax-exempt, and if that was a fact, that would be the correct allocation.

Senator BARKLEY. Suppose there is no part of it that is definitely and specifically allocable to either branch? He devotes his time to both of them as the case may be. How can this language then—it limits the Department in dealing with this situation, because it is not definitely allocable to one class of business, and the department can not make it definitely allocable.

Mr. PARKER. I do not think that problem would be any more difficult than any other we have in the income tax law, like telling how long property is going to last and telling what the depreciation is, and so forth.

Senator REED. There is another phase of this. Every obstacle that you add to the ownership of Government bonds is going to have a substantial effect on the Treasury operations this coming year.

Senator KING. I wish we could tax Government bonds, but in view of the fact that we have got 31 billions, and we don't know how many more we will be compelled to issue, there is very much in the suggestion made by Senator Reed. We have to be very careful and not put into this bill something that may be an obstacle to the sale or tend to frighten purchasers or impair in any way the value or the salability of Government securities.

Senator GORE. We would lose on the one hand more than we would gain on the other.

Senator MCADOO. There is no trouble about taxing Government bonds in the future. All you have to do is to charge a higher rate of interest. I think the people of the United States would save money by selling Government bonds without any tax exemption and tax-exempt income. I think it is a poor economy the way we are doing it, and I was responsible for the first taxation on income from Government bonds. We exempted them only from the normal tax. But I cannot see, in discussing this question, where it makes much differenc

whether you put "specifically" or "directly" in here. You say whatever is allocable. It is up to the Department to find out what it is.

Senator COUZENS. It is not half as difficult as figuring obsolescence in oil properties or depreciation. It seems to me we are magnifying difficulties here which do not exist.

Senator MCADOO. I think it adds to the administrative burden that much more of a controversial point to administer. But in each case you have to settle it.

Senator KING. Under the word "allocable", you would try to ascertain what would be justly allocable. That would mean the costs incident to the handling of your tax exempts, and those which are not tax exempt.

Doctor MAGILL. That is right.

Senator KING. It seems to me it would have to be justly allocable, although you do not use the word "justly" or "fairly", but obviously the court would hold, or any board would hold, that there must be a fair allocation of those costs based upon the time spent in handling one or the other.

Senator REED. If the Bureau says "This constitutes 50 percent of your income and therefore 50 percent of your clerk hire is out"——

Senator MCADOO (interposing). We have the same problem with the expense of an automobile. You determine how much of that you may charge up as a part of the expense of your business, if it is used jointly for business purposes and pleasure. It is no more difficult to apportion than that. It depends naturally, I think, upon the fairness of the clerk or the examiner as to what the allocation is to be. I myself think the addition to those words does not help.

Senator KING. I suggest we let it go in and let it go to conference.

Senator REED. I move that we insert "definitely and specifically".

The CHAIRMAN. On line 23, after the word "deduction"—the last four letters of that word "t-i-o-n" appearing there, it is moved that the words "definitely and specifically allocable" be inserted. All in favor say "aye."

(Chorus of "ayes.")

The CHAIRMAN. Those opposed, "no."

(Chorus of "noes.")

The CHAIRMAN. Those in favor will show by the rise of their hands.

[Hands raised.]

The CHAIRMAN. Those opposed, will do the same.

[Hands raised.]

The CHAIRMAN. The amendment is lost. It was understood that following "deduction" on line 23, that "except interest on indebtedness" be included There was no objection to that, as I understand.

Senator KING. I move we approve and pass on.

The CHAIRMAN. Will you proceed, Dr. Magill?

Dr. MAGILL. The provision at the top of the next page, 38, is designed primarily for the purpose of disallowing losses on sale and exchange of any property between members of a family or between an individual and a corporation which he controls.

Senator KING. Or between partners and partners?

Dr. MAGILL. Partners and partners are not in here, and that is the big loophole.

Senator KING. Why not?

Senator McADOO. Why don't you put in partners and friends and everybody else and be done with it? [Laughter.]

Senator BARKLEY. The stopper would not fit the loophole.

Senator KING. Everybody would be your friend then. [Laughter.]

Mr. PARKER. This provision is easy to evade, anyway.

Dr. MAGILL. I do not think you can get a provision that will really stop that hole completely.

Mr. PARKER. All you have to do is to deal through a third party.

The CHAIRMAN. You think this would be more restricted, though?

Mr. PARKER. I do not think this provision will accomplish anything. It may be taken as a gesture, but that is all you can say for it. You cannot stop it. A man can go to a third party.

Then you take partners for instance. It may be that some transaction between partners is colorable, but they may be perfectly normal business transactions which would take place between partners at arm's length on personal dealings. I think we would restrict ordinary business. I do not see why you would want to give your business partner any advantage.

Senator GORE. What is that?

Mr. PARKER. I do not see really why you should want to give your business partner a great advantage, or why you should want to sell him something below cost, or whatnot. It seems to me it is a business matter and would be a perfectly normal business matter in a great majority of cases.

The CHAIRMAN. Was this recommended by the Treasury?

Mr. PARKER. No, sir. This is one of the various recommendations of the subcommittee. We approved it. I think the situation is quite clear. This does stop some of the most obvious cases of tax losses which we have had.

Senator GORE. Does it fit this case? I know of an instance where a man sold stock at the end of the year, and his wife bought the same amount of stock the same day, both acting through a broker. Does this provision cover that sort of a case?

Mr. PARKER. If they act through a third party, no; and the fact of the matter is that the provision with respect to capital losses and gains, which we will come to a little later, are much more effective, in fact the only effective preventive that we have. This thing as I say only catches the more obvious cases.

Senator KING. Couldn't you make your stopper here—to use that expression—a little larger by employing language something like this—that where a third party or an intermediary has been employed for the purpose of evading the spirit of the act, that the terms here shall apply?

Mr. PARKER. The Commissioner can do that now, and does. No matter what form the transaction takes, if he concludes it is really an evasion of the law, he will so find. The difficulty here is this——

Mr. BEEMAN. Just a moment. We thought we had done as much as we could in that line by putting in the words "directly and indirectly."

Senator KING. I think probably the word "indirectly", if it were a palpable evasion, or the indicia were that it was an evasion—I am inclined to think that under the word "indirectly" it would be covered.

Mr. PARKER. Suppose the husband sells through one broker and the wife goes to another broker and buys the same stock—not really the same numbers of the certificates, but the same stock—where is your "directly or indirectly"?

The CHAIRMAN. They may evade it, but it may do some good. Is there any objection to the adoption of it?

Senator KING. I move it be adopted.

Senator MCADOO. I would like to ask a question here. Suppose you have an unlisted stock which has no market anywhere, and it turns out to be absolutely worthless, and you can produce testimony by some salesman that you cannot sell it at any price. Or a mortgage, or anything else like that—a junior mortgage. As I understand it, the Bureau won't allow the charge-off of that loss unless you actually sell that stock.

Mr. PARKER. If it is absolutely worthless under the regulations, they are supposed to allow the deduction.

Senator MCADOO. I know, but you have to prove it. Unless you sell it somebody—and you cannot sell it to anybody except somebody who just buys it for the purpose of convenience, just to enable you to say that you made the sale. It is a fraudulent sale in one sense, because it is not bona fide, and yet it is required by the Bureau.

Senator COUZENS. Dr. Magill said it was not required by the Bureau, didn't he?

Senator MCADOO. It is required to this extent. If you sell it, it probably won't be questioned; but if you do not sell it, you have to produce evidence.

Senator COUZENS. Why shouldn't you produce evidence that it is valueless?

Senator MCADOO. The best evidence of its value is the sale that you have made.

Senator COUZENS. But you say you could not make a sale. You are painting a picture where you cannot make a sale.

Senator MCADOO. No; the Bureau compels you to make a sale, but if you charge it off, you have to get supporting evidence that it has been properly charged off. But here you have made a sale for, let us say a dollar——

Senator BARKLEY (interposing). Should not the burden be on the taxpayer?

Senator MCADOO. Yes; if it is sold for a dollar and challenged by the examiner, he should have to prove it. But as a rule those sales are colorable, yet made in good faith and in compliance with the requirement of the Bureau.

Dr. MAGILL. As you probably know, as a practical matter most of those sales where there are large amounts involved, are made at auction. The individual simply sends it down to an auctioneer, where it is publicly advertised and auctioned. In that case the Bureau would allow the loss shown in that auction sale.

Senator MCADOO. Sometimes you cannot even get a bid to that extent. Suppose you have no bid?

Mr. PARKER. That would be evidence of worthlessness.

The CHAIRMAN. Without objection, this provision will be adopted.

Dr. MAGILL. We have a small amendment there in line 6, that I think you will have no objection to, where it reads: "50 percent of

the voting stock", strike out "of the voting" and substitute "in value of the outstanding."

Senator KING. What is that?

Dr. MAGILL. In line 6 on page 38, strike out "of the voting" and substitute "in value of the outstanding."

The CHAIRMAN. All right.

Dr. MAGILL. The change at the top of page 39 is merely clerical or a cross reference.

Senator KING. You mean the words "nondeductibility"?

Dr. MAGILL. Yes, sir.

The CHAIRMAN. That will be approved.

Dr. MAGILL. Section 25, page 39, has been rewritten, and you will find the section commencing on page 41.

Senator KING. Just indicate what that is.

Dr. MAGILL. There are two changes I will speak of. The first is this provision which we discussed yesterday——

Senator MCADOO (interposing). May I interrupt you? What are you dealing with now?

Dr. MAGILL. With the rewritten section 25 which appears on page 41.

The first change of importance appears at the foot of page 43 and following. That is the provision for allowing a personal exemption and credit for dependents against the surtax as well as against the normal tax. You recall we discussed that yesterday.

The CHAIRMAN. That is "B".

Dr. MAGILL. The other changes of importance is this provision of allowance of credit for earned income, which is a very limited provision.

Senator GORE. The most you can get is $32, isn't it?

Dr. MAGILL. Yes; the most you can get is $32.

Senator KING. What do you mean by that?

Dr. MAGILL. The provision as it stands here is that a taxpayer's income up to $3,000 is presumed to be earned. That is for administrative simplicity. Whatever in any event is earned income may not be regarded as in excess of $8,000, no matter how much his earned income may be in fact.

The CHAIRMAN. What is the present law on that?

Dr. MAGILL. There is no earned income provision in the present law. Earned income was allowed under the Revenue Acts of 1924, 1926, and 1928.

The CHAIRMAN. How much was it?

Mr. PARKER. $30,000 was the limit. The old limitation to $30,000 used to result, even with low tax rates, to a $400 or $500 reduction in the tax. That was the maximum. This new earned income deduction affects only the normal tax. The old provision used to affect the surtax and normal tax both. The new provision recognizes earned income only up to $8,000 and allows a 10-percent deduction, which in the maximum is $800, and the greatest reduction in the tax which you can secure is $32.

Senator COUZENS. What is the purpose of putting that in?

Mr. PARKER. It relieves the small taxpayer somewhat. It makes a proper differential. Every country has this earned-income provision. We had it for many years, and it is thought to be a sound principle. That $32 is a reduction, you understand.

Senator McAdoo. But you have to examine all of the papers and the documents to determine whether or not they are entitled to the deduction. Isn't that too much administrative expense?

Senator Couzens. It is automatic.

Senator Gore. It is more blowing a kiss at them than anything else.

Senator Reed. It is a recognition of a principle.

Senator Couzens. I move we approve it.

The Chairman. Is there a further explanation, Doctor?

Dr. Magill. No; I think there is nothing more. This provision for earned income, as Mr. Parker indicated, is somewhat simpler than the one we used to have. I do not think it will result in great difficulty in administration.

Senator Barkley. I move we O.K. it.

The Chairman. O.K.'d, without objection.

Senator Reed. It is much simpler than the old one.

Dr. Magill. Yes; it is much simpler than the old way.

Section 26 on page 45 is stricken out, because I believe it is meaningless. It is surplusage at the present time.

The Chairman. All right. Approved.

Dr. Magill. Now, at the foot of page 45, that was a cross reference which is taken out, since there is no such section any more.

The Chairman. Without objection that will be approved.

Dr. Magill. The next two changes are those on pages 46 and 47, in sections 42 and 43.

Senator Reed. Is not that the present law?

Dr. Magill. No; you will notice the italics at the end.

Senator Reed. That is what I mean.

Dr. Magill. What that is designed to catch, as I understand it, is this: Suppose that an individual who is on the cash-receipts basis of reporting income dies on the 28th of the month. At the end of the month the estate receives rents on properties which he owned at the time of his death. At the present time, I believe the courts have held that the amount of the income from those rents which had accrued up to the time of his death, can not be treated as his income, since he was on a cash receipts basis and had not received the rents.

Senator Reed. Well, the probate courts of every State in the Union would give to the estate ascribed to the testator the accrued rents up to the date of death.

Dr. Magill. Yes, sir; and that is the purpose of this provision.

Senator King. It is in harmony with State laws.

Dr. Magill. Yes.

The Chairman. Approved.

Dr. Magill. Section 43 does the same thing as to deductions.

The Chairman. Approved without objection.

Senator King. Mr. Chairman, may I ask whether we are accepting ipso facto the language here that is not the amendment, or are we going back to it? Have you any suggestions to make with respect to any of these provisions other than those where there are amendments?

Dr. Magill. As far as the Treasury suggestions are concerned, or the suggestions which we have worked up among ourselves, I will suggest those as we go along. As to others, if any of the members of the committee wish to make changes in the existing law, I presume you can handle it now or later, as you think best.

The CHAIRMAN. I am sure that if these legislative hawks do not say anything it is all right.

Senator KING. I wonder if Mr. Beeman is satisfied with some of the text here?

Dr. MAGILL. I think he will speak up if he is not.

Senator KING. I think it is very ambiguous.

Mr. BEEMAN. So do I.

Dr. MAGILL. On page 48, the change in the definition of what constitutes an installment sale. Mr. Parker can explain that.

The CHAIRMAN. This is on installment sales.

Mr. PARKER. There is a change in subdivision B. Subdivision B provides in the case of casual sales of personal property or sales of real property when a taxpayer is entitled to report on the installment basis. If a man reports a sale on the installment basis, he willl prorate the prospective profits from that sale over the years during which he receives the payments.

The CHAIRMAN. That is under the law now, if the first installment is 40 percent or less.

Mr. PARKER. That is right.

The CHAIRMAN. And you change it to what extent?

Mr. PARKER. If it is less than 40 percent, he can report on the installment basis, which is some advantage to him.

Senator GORE. What is that?

Mr. PARKER. If the down payment is less than 30 percent—if a man sells a piece of real property, for instance——

Senator KING (interposing). If it costs him $10,000, or $4,000, for example.

Mr. PARKER. If he sells a piece of property which costs him $10,000 for $20,000, and he receives for that $4,000 in cash and the rest in notes due over a period of 3 years, that would be less than 40 percent. He would be entitled to report on the installment basis, and he would prorate the profit on that sale according to the amount received in each year, and be taxed for the profits in those years. If he receives under the existing law more than 40 percent of the selling price, then he must report the entire profit from that sale in the year of sale.

Senator KING. Suppose he gets $4,000 and then discounts the notes at par. Then he would have to pay it all, wouldn't he?

Mr. PARKER. Yes; that makes those installment payments all come into the year. He would be entitled to the installment basis; but having received the money, he reports the profit on the installment basis whenever he actually receives the money.

The CHAIRMAN. In other words, it is reduced from 40 percent to 30 percent?

Mr. PARKER. Yes, sir; we are less liberal with the taxpayer. That is a matter of judgment. Prior to 1928, this limitation was 25 percent.

The CHAIRMAN. I wish you had not had installment sales. I had a good deal to do with putting them in. However, that is all right, and without objection it is O.K.

Senator REED. What difference will this make in revenue? Anything material?

Mr. PARKER. It speeds up the collection of the tax in a number of instances and puts the Government in less jeopardy. We get the

tax quicker. It probably would make a million or two million difference.

Senator GORE. Under this provision, any down payment less than 30 percent makes it an installment contract?

Mr. PARKER. Yes, sir.

Dr. MAGILL. The next is page 50, which is essentially a clerical change. Inserting the word "organization" there.

The CHAIRMAN. Without objection, O.K.

Dr. MAGILL. Page 52 is also a clerical change.

The CHAIRMAN. Without objection, it will be approved.

Dr. MAGILL. On page 53, the last sentence of that definition of "taxable year"—that is the same proposition in substance that we spoke of at the beginning of the meeting yesterday.

The CHAIRMAN. We passed over that.

Dr. MAGILL. As to whether or not the bill should apply to the past fiscal year.

The CHAIRMAN. We will keep that open.

Dr. MAGILL. On page 48, that should go out, shouldn't it? Well, I guess you had better tie that up with the other.

There is a little change on page 57. That is simply clerical.

The CHAIRMAN. This is the first time we have considered a bill where something was not suggested about the publicity of the returns.

Senator COUZENS. We are not finished yet.

Dr. MAGILL. At page 59, and on the top of the next page 60, a great deal of material is stricken out as to receipts. That we considered as surplusage. And it is not necessary.

That brings us, I think, to the top of 62, which are also clerical changes.

The CHAIRMAN. That is a clerical change also, and approved.

Dr. MAGILL. At the foot of page 62, and the next several pages——

The CHAIRMAN (interposing). That is true of page 64, which is also a clerical change.

Dr. MAGILL. Page 65 is the same proposition we were speaking of with respect to the effective date of the title.

Senator COUZENS. That remains open.

The CHAIRMAN. Yes.

Senator REED. In the legislative action by the House, did they amend these sections as shown here?

Mr. BEEMAN. This income tax is an income tax for the future, and the 1932 income tax is not repealed. It stays in force for the collection of revenue for the years to which it applies and to which this bill does not apply.

The CHAIRMAN. Now you come to capital gains and losses.

Mr. PARKER. That is on page 113, and the following pages.

Dr. MAGILL. Do you want to go into that now?

Senator KING. Let me see if I understand it. These supplemental provisions, supplemental rates of taxes are all stricken out. Now, where do you go?

Dr. MAGILL. The provision on page 113 is the substitute in this page for the present provision with respect to capital gains and losses.

Senator REED. Before you start that. Have you taken into account at all the fact that we have changed the value of the currency of America so that there is a nominal profit which is really non-

existent? Assuming a man gets back his cost in gold equivalent, there is a nominal profit in the so-called dollars, whereas we all know that there is no profit as expressed in gold. There has been no account taken of that?

Dr. MAGILL. No provision directly directed to that proposition. This provision with respect to capital gains and losses, you will observe, gives some relief with respect to property which is sold at a profit, and conceivably you could regard what is done with respect to capital gains and losses as being a provision to take care of the things you have in mind.

Senator MCADOO. How do you think the gold question affects the transactions you have in mind?

Dr. MAGILL. What we have done is to create a nominal increase in every article that has value.

Senator NCADOO. A specious profit?

Dr. MAGILL. A specious profit, if you please.

Senator REED. If you get today the same number of dollars for something that you bought last year for the same amount of money, you actually are incurring a loss..

The CHAIRMAN. Then under that theory, the Treasury should get a lot of increased receipts this year.

Dr. MAGILL. Do you want to pass capital gains and losses until we get to 113, or do you want to take it up now?

Senator KING. Let us take it up now.

Senator MCADOO. Why not take it up in the proper order?

Senator COUZENS. We are. It is a transposition of the sections.

Mr. PARKER. There is one reason why it will be a good thing to dispose of capital gains and losses. One proposition is to limit the losses to the gains, and that has a very marked effect on many other provisions of the law. In stopping up some of these loopholes, we found that this provision has a great effect; so perhaps other sections would be more understandable if we explained this one section out of order.

Senator MCADOO. I have no objection.

Mr. PARKER. Mr. Beeman suggested that this morning.

Senator MCADOO. I have no objection. I merely made the inquiry.

Senator KING. Go ahead.

Dr. MAGILL. Mr. Parker is the expert on this.

The CHAIRMAN. Explain what the present law is and what you propose here. Do you want to use the blackboard? And do you want it taken down?

Mr. PARKER. I think on the first explanation of this capital gains and losses, it is not necessary to take it down.

The CHAIRMAN. The stenographer need not take this.

(The balance of the session thereupon proceeded without stenographic report but the matter discussed by Mr. Parker is shown in the following extract from the House report on the bill.)

CAPITAL GAINS AND LOSSES

Existing law provides in section 101 for a special treatment of the gains and losses resulting from the sale of capital assets held over 2 years. The tax on gains on such sales is limited to 12½ percent, with a corresponding limitation in case of losses. In the case of assets held less than 2 years, the gains are taxed in full and the losses allowed in full except in the case of stocks and bonds, losses from which are limited under section 23 (r).

Our present system has the following defects:

First. It produces an unstable revenue—large receipts in prosperous years, low receipts in depression years.

Second. In many instances, the capital-gains tax is imposed on the mere increase in monetary value resulting from the depreciation of the dollar instead of on a real increase in value.

Third. Taxpayers take their losses within the 2-year period and get full benefit therefrom, and delay taking gains until the 2-year period has expired, thereby reducing their taxes.

Fourth. The relief afforded in the case of transactions of more than 2 years is inequitable. It gives relief only to the larger taxpayers with net incomes of over $16,000.

Fifth. In some instances, normal business transactions are still prevented on account of the tax.

Your committee has examined the British system, which disregards these gains and losses for income-tax purposes. The stability of the British revenue over the last 11 years is in marked contrast to the instability of our own. In that period the maximum British revenue was only 35 percent above the minimum, while in our own case the percentage of variation was 280 percent.

Your committee, however, has been unable to reach the conclusion that we should adopt the British system. It is deemed wiser to attempt a step in this direction without letting capital gains go entirely untaxed. Your committee recommends the following plan:

First. To measure the gain or loss from the sale of property by an individual according to the length of time he has held the property, only the following percentages of the recognized gain or loss are taken into account for tax purposes:

One hundred percent if the capital asset has been held for not more than 1 year;

Eighty percent if the capital asset has been held for more than 1 year but not more than 2 years;

Sixty percent if the capital asset has been held for more than 2 years but not more than 5 years; and

Forty percent if the capital asset has been held for more than 5 years.

Second. In the cases where the losses taken into account as above exceed the gains so taken into account, the excess losses are entirely disallowed.

Third. In the case of corporations the graduated percentage reduction of gains and losses does not apply. However, capital losses sustained by corporations are allowed only to the extent of capital gains. Under the present law corporations are allowed to offset capital losses against ordinary income.

Fourth. The plan outlined above is not made applicable, for obvious reasons, to stock in trade or property which is included in the taxpayer's inventory.

It is believed that the adoption of this plan (see sec. 117 of the bill) will result in much greater stability in revenue, will give all taxpayers equal treatment, will encourage normal business transactions, and will yield substantially greater revenue. The method proposed is safe from a revenue standpoint, inasmuch as capital losses cannot be used to reduce ordinary income, while gains are taxed in full or in part in proportion to the time for which the property has been held. The existing method which has been in force since 1921 can be defended only on the ground of expediency.

To illustrate the application of the new capital gain-and-loss system in the case of an individual, the following example is given:

Item	Gain recognized under sec. 112	Loss recognized under sec. 112	Time held	Percent applicable	Gain taken into account under sec. 117	Loss taken into account under sec. 117
Corporate stock	$5,000		9 months	100	$5,000	
Bonds		$4,000	1½ years	80		$3,200
Government bonds	1,000		2½ years	60	600	
Real estate		3,000	6 years	40		1,200
Short sales	2,000			100	2,000	
Total					7,600	4,400

In the above case, the taxpayer would include in gross income subject to tax $7,600 in gains and be allowed to deduct $4,400 of losses. The net increase in his income will, therefore, be $3,200. If, however, in another case, the total shown in the last column of the example had been $7,600 (loss) and the total in the preceding column, $4,400 (gain), then the taxpayer would be allowed to deduct from his gross income only $4,400 out of his $7,600 of losses. Practically speaking, in such a case the gains and losses would, therefore, have no effect on the tax paid by the taxpayer.

(Whereupon, at 12 noon, the committee adjourned to 10 a.m., Thursday, Mar. 8, 1934.)

CONFIDENTIAL

REVENUE ACT OF 1934

HEARINGS

BEFORE

THE COMMITTEE ON FINANCE
UNITED STATES SENATE

SEVENTY-THIRD CONGRESS

SECOND SESSION

ON

H.R. 7835

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

PART 3

MARCH 8, 1934

UNREVISED

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REVENUE ACT OF 1934

THURSDAY, MARCH 8, 1934

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

The committee met, pursuant to adjournment, at 10 a.m., in room 312 Senate Office Building, Senator Pat Harrison presiding.

Present: Senators Harrison (chairman), King, George, Gore, Costigan, Bailey, Clark, McAdoo, Byrd, Lonergan, Reed, Couzens, Keyes, La Follette, Metcalf, Hastings, and Walcott.

Also present: Messrs. Magill, Parker, Beaman, Stam, Bartholow, and other representatives of the Treasury, the Joint Committee on Internal Revenue Taxation, and staffs of the Senate and House legislative counsel.

The committee had under consideration H.R. 7835.

The CHAIRMAN. Let us defer the further consideration of this particular phase of the bill, Mr. Parker, and let us go further along, coming back to this capital gains and losses provision later.

Mr. PARKER. We had skipped over to 117.

The CHAIRMAN. You mean page 117?

Mr. PARKER. I mean section 117. If you are coming back, we are at 101.

The CHAIRMAN. Section 101?

Mr. PARKER. Page 72. Mr. O'Brien will explain the change on page 72, section 15.

Mr. O'BRIEN. That is to make the revenue act correspond to the various acts that have been passed creating the new Federal Corporations which, by the terms of the acts creating them, are tax exempt. The old law merely authorized the tax exemption in the case of land banks, but obviously that is inadequate to carry out the policy set forth under the laws that extended that practice to the things like Reconstruction Finance Corporation and production credit associations.

The CHAIRMAN. This would apply to the Home Loan, even though we have not passed the legislation yet?

Mr. O'BRIEN. Yes. It takes in the new ones and the old ones, if by the terms of the act under which they are created and amendments to those acts, those corporations are tax exempt.

The CHAIRMAN. It would seem to me that ought to be done. Without objection, that will be approved.

Mr. PARKER. We now come to the taxes on personal holding companies, which is just as important as the other matter.

Senator GEORGE. Yes.

Mr. PARKER. We had better skip that.

The CHAIRMAN. I think we had better pass that. Let us go on to something else.

Mr. PARKER. We ought to skip section 103. This provision is related to section 102.

The CHAIRMAN. All right, pass them.

Mr. PARKER. I think it would be a mistake to explain that now. On page 78, section 104, is a new and unusual provision. I do not think we ought to take that up now.

The CHAIRMAN. That is with reference to foreign credits?

Mr. PARKER. No. This is a special tax laid on foreign corporations or individuals doing business in this country, where the foreign country of origin discriminates against our citizens—a very unusual provision, and one which should receive very careful consideration. Section 105 is stricken out, in view of our change in section 1, in regard to the new fiscal-year policy, and it shows how much the law is simplified.

The CHAIRMAN. We haven't agreed on the other, so that must be passed also.

Mr. PARKER. Yes, but it does show how much the law is simplified by that change.

The CHAIRMAN. We had better pass that, since we have not taken final action on the other.

Mr. PARKER. Section 111, computation of gain and loss. Mr. Stam, will you explain that, why we changed that?

Mr. STAM. That particular change is made necessary, by reason of some action we take later on; so I think we had better pass that until later.

Senator KING. Yes, that is what I thought. We had better pass that.

Mr. PARKER. On page 85 is the reorganization provision. That is the most technical and difficult thing in the bill. We had better pass that.

The CHAIRMAN. Yes.

Mr. PARKER. On page 87, at the bottom of the page, there is a change in a basis section in respect to gifts.

Senator KING. What change do you make there?

Mr. PARKER. Under the present law, the basis of a gift in the hands of a donee, is the basis in the hands of the last preceding owner, or the donor. He carries forward that basis. The House subcommittee thought that they ought to get as much gain as possible, and recognize the least amount of loss possible, in the case of the sale of property acquired by gift, on the obvious theory that a man did not really pay anything for it; so that we really have two bases for gift, the donee has to take the basis of a donor, or the fair market value of the property at the time of gift, whichever is lower. Of course, that results in diminishing his loss and increasing his gain.

Senator REED. You did not do anything on these reorganization sections?

Senator KING. No, we passed that.

The CHAIRMAN. This is the only thing we have taken up.

Senator KING. I am not quite clear as to the explanation you have just made as to the effect of the change you suggested here, whether it would prevent some of these evasions, or contribute to evasions.

Senator REED. It means, when you register off a loss, Senator, on stock which you got by way of gift, the basis with which you start is either the market value at the time of the gift, or the value in the hands of the first owner, whichever is the lower.

Senator KING. I understand.

Senator REED. Therefore, by taking the lower of the two, you tend to minimize the amount of loss that can be registered off. Is that correct?

Mr. PARKER. That is right.

Senator KING. Well, is that fair to the Government?

Mr. PARKER. Oh, it is fair to the Government.

Senator GEORGE. Yes.

Mr. PARKER. The question is, whether it is fair to the taxpayer. It certainly would be fair to the taxpayer if there was no gift tax, but now that there is a gift tax, that question might be raised.

The CHAIRMAN. Without further objection, we will approve it.

Senator REED. First, in the case of a gift tax, the value for the calculation of the tax is the market value at the time of the gift; is it not?

Mr. PARKER. That is correct.

Senator REED. How does that affect the fairness or the unfairness of this?

Mr. PARKER. On the theory that it is the value to which the gift tax attaches, and therefore that the appreciation has been reached by that tax. When the donee takes the property, under that bill he does not necessarily take that basis. He may take that basis, or he may take the cost to the donor, whichever is lower.

Senator REED. I see; but certainly when you come to tax the gain, it is pretty tough on the donee to say that his gift tax is based on the value at the time he gets it, and his income tax on his gain is based on the value at the time the donor got it.

Mr. PARKER. Of course the provision can only be justified by the fact the donee paid nothing for the property.

Senator REED. That is blowing hot and cold at the same time.

Mr. STAM. A man may pay a certain amount for property, say he pays $100,000 for a piece of property, and that goes down to $50,000, and he hasn't got any income himself that he can apply the loss against, if he makes a sale; so he transfers the property over to a member of his family, and under the basis section, that member of the family would take the basis of the donor, which was $100,000, so the member of the family could get the loss. This prevents that. We came across some cases where that was actually being done, and we thought this action was necessary. It was a case of a "plug" becoming a loophole. We plugged up the basis section in the first place, to require the donee to take the basis in the hands of the donor; but now the donee could get a benefit by using that basis, so we thought we would have to stop that, through this method.

Senator REED. I see.

Senator KING. Suppose that the donor paid $100,000 for the property and then gave it to his wife. At the time that he transferred to her it was worth $100,000. Then in her hands, a week or a month afterwards, when she came to make her return, it was only worth $75,000.

Mr. PARKER. She would get the loss there, because the two bases are the same. The value at the date of gift and the cost are the same.

Mr. STAM. She would have to sell the property in order to realize the loss unless the property became worthless prior to sale.

Senator KING. Supposing the members of the family sold it for $25,000 more than the donor gave for it, and it was a pure gift; would the donee member of the family be taxed on the value of the property at the time of the gift, plus the capital gain?

Mr. STAM. For purposes of gain, he would take the cost to the donor, which would be the $100,000.

Senator KING. Yes.

Mr. STAM. So, if the donee sold it for $125,000, there would be a taxable gain of $25,000.

Senator KING. So there would be a gift tax on the $100,000 and an income tax on the gain of $25,000.

Mr. STAM. Yes.

Mr. PARKER. Of course, this limitation applies only in case of taking a loss. It is not applied on gains.

Mr. STAM. That is true. I answered Senator King on that.

Mr. PARKER. I think I had answered Senator Reed wrong, at first. It applies only to losses, not gains.

Senator REED. I understand.

Mr. PARKER. That is, this is a double limitation.

Senator REED. To be consistent, why shouldn't you make a similar rule in the case of gains, and adopt whichever is the higher? You start out to be unfair to the taxpayer. We ought not to stop with merely one bite in the cherry.

Mr. PARKER. Of course, one answer would be that our gift-tax schedule does not take in small gifts at all. We do not start with the gift tax until a man has given away $50,000. We do not recognize a $5,000 gift to any one person in a year, as a gift. Therefore, the gift tax does not really close loopholes as to a small or middle-sized taxpayer at all. It has no effect. I think this is one reason why we have to be severe, because the gift tax really only affects the man of wealth. It does not affect the smaller taxpayer in any respect; but we have this basis question coming up in thousands of small returns.

Senator KING. May I make an inquiry? I have forgotten some of the facts that we presented before. Why do we not apply the gift tax until the value of it reaches $50,000? If I give my son $25,000, why shouldn't he pay a gift tax?

Mr. PARKER. In the first place, Senator, we do not levy the gift tax on the donee at all. The gift tax is paid by the donor, the giver.

Senator KING. I understand.

Mr. PARKER. You might pay on that $25,000 gift to your son. You wouldn't, if that is the first gift; but if you gave him $25,000 this year, and $25,000 next year, and $25,000 the third year, in the third year you would pay a gift tax on that $25,000, and you can only give away $50,000 in toto, no matter who you give it to. You have got to add those sums altogether, except for this other specific exemption of $5,000.

The CHAIRMAN. Isn't it true, Mr. Parker, that we used to have the amount much higher than it is now?

Mr. PARKER. It used to be $100,000.

The CHAIRMAN. It used to be $100,000. We gradually brought it down. As a matter of fact, for a while we didn't have any gift tax at all.

Mr. PARKER. That is true, and that was the biggest loophole, of course, to the avoidance of the estate tax.

Senator REED. Is that gift tax yielding much return?

Mr. PARKER. In the first year, it returned four and a half million dollars, roughly. I did not expect that we would get as much revenue as that. The gift tax protects our estate tax revenue.

Senator REED. It tends to prevent gifts, rather than to get tax money?

Mr. PARKER. It was not intended entirely to prevent gifts. That is one reason that the gift-tax rates are only three quarters of the estate tax rates. I think it was the intention not to discourage them too greatly, because the fact that we made gift-tax rates lower than the estate-tax rates, shows that we did not intend to do that.

Senator HASTINGS. What are the gift-tax rates?

Mr. PARKER. The gift-tax rates in all instances are just three quarters of the estate-tax rates. The estate tax starts at 1 percent on $50,000, and it is graduated to 45 percent on estates in excess of 10 millions. The gift-tax rates go right along in the same bracketed schedule, but are three quarters of the rate. That is, the first rate of the gift tax is three quarters of a percent, and the last rate is approximately 32½ percent.

The CHAIRMAN. The main object was to protect the estate tax though; wasn't it?

Mr. PARKER. That is the main object. There is no doubt about that.

Senator LONERGAN. You mean by that, the inheritance tax?

Mr. PARKER. No, we distinguish between them; the estate tax and the inheritance tax.

Senator LONERGAN. Is there an examption up to $50,000 on that?

Mr. PARKER. There is an exemption up to $50,000 on the estate tax, and there is in the gift tax, but we have a peculiar provision in the gift tax that makes it cumulative. Your gifts begin to count from the year of enactment of the gift tax, and you have got to cumulate them through the years; but after you have once given away your $50,000, no matter whether it takes 3 years or 10 years to do it, then you start to pay the gift tax. The old gift-tax law permitted you to give away $100,000 every year, so that you could give away $100,000 a year for 10 years. You could give away a million, and there would be no tax. Under the present gift-tax law, that does not happen.

Senator LONERGAN. Was the exemption under the old estate law $100,000?

Mr. PARKER. That is correct.

The CHAIRMAN. We cut that down.

Mr. PARKER. Now it is $50,000.

The CHAIRMAN. And we called it "estate" instead of "inheritance."

Mr. PARKER. Yes, Senator. Of course; that is one reason that the gift tax was put on the donor. There would be much to be said as a matter of fairness and equity for an inheritance tax and gift tax on a donee. After all, they are the ones that get the money. They are the ones that should pay.

Senator HASTINGS. Did you say up to $10,000,000, it gets up to 45 percent?

Mr. PARKER. That is correct, Senator Hastings, yes.

Senator HASTINGS. So that if a man dies, leaving $10,000,000, 4½ millions of it go to the Government?

Mr. PARKER. Not exactly that.

Senator HASTINGS. Pretty nearly that?

Mr. PARKER. The amount of an estate in excess of 10 millions is taxed at 45 percent. The tax on a 10 million dollar estate, I suppose, would be about 3 million or 3 million and a half. It would not be the full 45 percent, because the estate tax, in the lower brackets, is applied just the same as the surtax on incomes.

The CHAIRMAN. Let us proceed to the next.

Senator KING. Let me ask one question. Have you discovered upon the part of many of these men, who in their lifetime were reputed to be very wealthy, and their wealth consisted largely of stocks, that either in anticipation of death or because of their desire to take care of their family, they have disposed of much of their stocks in their lifetime?

Mr. PARKER. There is no question about it, that great fortunes were escaping the estate tax before the enactment of this gift tax. In many instances, the very ones that you would expect to pay a large estate tax paid none. It is a matter of record in refund reports, for instance, that Mr. John D. Rockefeller's income is now very small. It shows that he has given all his property to John D. Rockefeller, Jr., by gift, before the enactment of a gift tax. Therefore, when Mr. John D. Rockefeller, Sr., dies, we will get no substantial estate tax from his estate; and he would be, of course, one of the persons that you would naturally expect to pay an estate tax—and that is not the only instance. I think it is a matter of common report that Edsel Ford has more stock in the Ford Motor Car Co. than Henry Ford.

Senator COSTIGAN. Mr. Parker, your statement is that in those cases there will be very little inheritance tax, as I understand the situation?

Mr. PARKER. I am certain of that, in the case of Mr. Rockefeller.

Senator CLARK. In other words, they have escaped by giving this property away in their lifetime, before the enactment of the gift tax, so we cannot catch them either with the inhertiance tax or the gift tax.

Mr. PARKER. The horse is stolen out of the barn. It is too late now to lock the stable; but we fixed it in the 1932 act.

The CHAIRMAN. Proceed, Mr. Parker, to page 89.

Mr. PARKER. On page 89, at the top of the page, is a change which I am going to ask Mr. Stam to explain, because he handled this matter.

Senator KING. That would embrace, then, subdivision (4) on page 88, and the whole of page 89, that you are about to explain now?

Mr. PARKER. That is right.

The CHAIRMAN. All right, Mr. Stam.

Mr. STAM. I will explain subdivision (4) first. This is what you might call a potential loophole. It really is not actual, but it is one that we thought might arise sometime in the future. A man might have a piece of property that cost him $100,000, and instead of giving that to somebody himself, he might give you a power of appointment to dispose of that property, and you dispose of it to some other per-

son. It may be worth $500,000 at the time you dispose of it. Under the present law, if that power is exercised in contemplation of death, the value that is taken for gain or loss purposes of the person who gets the property is $500,000; so that there has been a $400,000 appreciation on that property, which the Government won't get any tax on at all. It only cost the original donor $100,000, but by the time the person receives the property under the exercise of the power, it is worth $500,000, so that we lose all that appreciation in tax of $400,000 in case he sells it for $500,000. This amendment, by striking this provision out, would force the person receiving the property to take, as his basis, the original cost of the property, which would be $100,000, so we won't lose this tax. It is a situation that might arise, and we thought we had better safeguard against it.

Senator KING. By the elimination of lines 1 to 7, on page 69, you remove that danger.

Mr. STAM. We put it in the same class as any other property acquired by gift.

The CHAIRMAN. In other words, the substitute then is put in the same category as the fellow who originally owned the property.

Mr. STAM. That is right.

Senator KING. Do you accomplish that end, by merely striking out the lines to which I have called attention?

Mr. STAM. Yes.

Senator KING. It did not need any additional language?

Mr. STAM. No, that is right. This was an exception to the general rule.

The CHAIRMAN. Paragraph (5).

Mr. STAM. Paragraph (5) is something along the same line, "Property transmitted at death." Under the present law, we used the value at the date of death for computing gain or loss, in most cases, but in the case of property passing as the result of a general or residuary bequest, the present law permits the person receiving the property to take, as the basis, not the value at the date of death, but the value at the date of distribution, which may be a good deal greater than the value at the date of death.

For instance, when a man dies he may have a piece of property worth $100,000, taking the same illustration. By the time the executor distributes the property, it may be worth $500,000.

The CHAIRMAN. It may be less, too.

Mr. STAM. It may be less.

Senator HASTINGS. Yes, Mr. Chairman. We had a good many instances here, where the tax was a great deal more than the whole estate was worth.

The CHAIRMAN. Does this work both ways?

Mr. STAM. This works both ways. This is not the estate-tax question. I think you have in mind, Senator Hastings, the estate-tax question.

Senator HASTINGS. That is true.

Mr. STAM. And this is the income-tax question. The man that receives this property really did not pay anything for it, and we have gotten the tax up to the date of death through the estate tax, when the value was $100,000. We have not gotten any tax on the increase in value up to the time of distribution, which was $500,000, and we

just want to make it clear that we are going to take as the basis, both for gain or loss purposes, the value at the date of death.

The CHAIRMAN. At the date of distribution, instead of the value at the date of death?

Mr. STAM. We want to take the value at the date of death instead of the value at the date of distribution because that is the last date on which the Government has gotten any tax on the property.

Senator GEORGE. It operates both ways?

Mr. STAM. It operates both ways.

Senator HASTINGS. Isn't the date of distribution the best time to make it?

Mr. STAM. I don't think so, because this question came up and was passed on by the Supreme Court under the 1926 act, and they said that for all practical purposes the beneficiary really receives the property at the date of death. Of course, if he does not get anything he does not have to pay any tax, but if he gets something, then he really should use the basis at the date of death, otherwise the Government will lose the tax on the appreciation from the date of death up to the date of distribution.

Senator HASTINGS. Suppose it is a depreciation instead of an appreciation?

Mr. STAM. Well, the rule works both ways. I mean, if the property depreciates in value, we will still take the value at the date of death.

The CHAIRMAN. The only trouble that I see about that is that at the date of death it would be 2 years, say, before it is distributed, and the value of the property in the meanwhile from death to distribution, might have declined.

Senator HASTINGS. It might have gone away down.

The CHAIRMAN. The fellow not having the control of the distribution or the disposal of his property might have to incur a pretty good loss here to pay a higher tax.

Mr. STAM. If the property had gone down——

Mr. PARKER. His loss would be increased under this rule, because he would take the basis at the date of death.

Senator GEORGE. He would get the advantage?

Mr. STAM. He would get the advantage.

Mr. PARKER. This is the purpose, to determine the income tax of a beneficiary when he sells property acquired by devise or bequest. In other words, the tax in this case may fall 10 years after he received the property. This is the basis rule for income-tax purposes, of this property in the hands of the beneficiary of the estate.

Senator GEORGE. Just the old rule, fixing March 1913 as the basis of the income tax.

Mr. STAM. If the property cost $100,000 and went down to $50,000, Senator Harrison, in the case you put, and the legatee sold it for $90,000, he would get a $10,000 loss, so he would be protected.

Senator KING. This relates to the income which might be charged against the decedent?

Mr. STAM. No, against the beneficiary when he sells the property that he has acquired by bequest or devise.

Senator GEORGE. It is the income tax.

Mr. PARKER. Yes, sir.

Senator GEORGE. It is nothing but income.

Senator KING. But supposing, now, that at the time of the death of the person who owned the property, it was worth, say, $100,000, and at the period of distribution, when the heir by decree of the court has transferred to him that property, it is worth $500,000, what does the heir pay?

Mr. PARKER. He doesn't pay anything at that time.

Mr. STAM. He does not pay anything at that time, but when he sells the property, under the present law, he would take as his basis $500,000, but under our provision he would take $100,000, and have to pay a $400,000 gain.

Senator KING. I think he ought to.

Mr. STAM. I think he should.

The CHAIRMAN. All right. That will be approved, referring to the part beginning in line 1 on page 89. We are getting away from 90. Well, that applies to 90, too, at the end of the paragraph.

Mr. PARKER. You will have to go on with that power-of-appointment matter, Mr. Stam.

The CHAIRMAN. How is that?

Mr. PARKER. There is another proposition at the top of page 90 with regard to powers of appointment, that Mr. Stam will speak on.

Mr. STAM. That really carries out the existing law. That is merely a clarifying amendment.

The CHAIRMAN. It is merely a part of the same amendment?

Mr. STAM. Yes.

The CHAIRMAN. All right, that will be approved. "Tax-Free Exchanges Generally."

Mr. PARKER. There is a small change here that occurs several times. Mr. Beaman will explain that.

Mr. BEAMAN. Page 90, line 13. The same change occurs on page 93, line 2, and it is a purely clarifying amendment of the present declatory law. There is no change in that at all. It is the same amendment in both cases.

The CHAIRMAN. Page 92.

Mr. BEAMAN. That you will have to pass, because you have passed 112 (g) with which it is bound up.

Mr. PARKER. You would not want to come back to capital gains, and dispose of that?

The CHAIRMAN. No. We will wait until certain of the other members are present, on these more important changes.

Mr. BEAMAN. The amendments suggested at the bottom of page 94 and at the top of page 95 are purely clerical amendments.

The CHAIRMAN. All right. They will be approved.

Mr. BEAMAN. Paragraph (12) beginning on page 95, line 12, is a paragraph that is necessary to fix the basis of the property where the 1932 law is different from this law in some of the reorganization provisions. While you have passed those, I do not think there is much need of passing this, because, whatever you do there, if you do anything, this paragraph would be necessary.

Senator COSTIGAN. Mr. Beaman, Senator Reed yesterday spoke of the old base of 1913. That is not specially involved here, but is there a disposition to get away from that base, yet?

The CHAIRMAN. That comes along later, Senator.

Senator COSTIGAN. Are you going to take that up later?

The CHAIRMAN. That will come up later, where they want to go beyond that, and where there is a good deal of opposition to it.

Senator HASTINGS. Mr. Chairman, I have had a lot of letters about going away back 20 years on this matter and making a change.

The CHAIRMAN. That is not involved here, Senator. That comes up later.

Senator HASTINGS. All right.

The CHAIRMAN. That is a question of the distribution of accumulations prior to March 1, 1913, and I hope that the Treasury will not insist upon the proposition, myself.

Senator HASTINGS. It seems to me we ought to know, some time, when we get through.

The CHAIRMAN. You think we can approve this, whatever is done in the reorganization section?

Mr. BEAMAN. I think so. If you decide, in the reorganization sections, to make no change at all in the present law, then this paragraph disappears.

Senator REED. What is the purpose of paragraph 12?

Mr. BEEMAN. In the reorganization sections, the House made some changes, so that the thing that was before, a reorganization, is not under the new law; therefore, the basis provisions, if you figure them out under the new law, would not be what they used to be. If a man got property back in the year when a reorganization was tax-free, obviously his basis should be what it was before and not what it would be under the new bill. Therefore, this says that the basis shall remain under this act the same as it was under the 1932 act.

The CHAIRMAN. Suppose we go back to this capital-gains matter and try to finish that up. We have a pretty full attendance here.

Senator REED. I do not believe we can, because Dr. Magill was to get us up some information from the Treasury, which would amoutn to an extension of that schedule. Twenty percent and 8 years and zero and 18.

Mr. PARKER. I think he was to be here at 11 o'clock.

The CHAIRMAN. Let us take up some of these knotty problems while we have a pretty good attendance. How about the foreign proposition?

Mr. PARKER. Or the personal holding companies?

The CHAIRMAN. Let us take up the foreign proposition. What page is that on?

Mr. PARKER. Page 78. It was represented to the Ways and Means Committee that certain foreign countries were imposing taxes which seemed discriminatory and bore very heavily on our large business concerns in those foreign countries.

(At the direction of the chairman, no stenographic report was made of the discussion of this topic.)

The CHAIRMAN. What is another proposition we can take up how?

Senator HASTINGS. I would like to see what was done with section 131 (b). I would like to know what it means, first. Pages 124 and 125.

The CHAIRMAN. We have not gotten to that yet.

Senator GEORGE. That is ahead of us.

The CHAIRMAN. You do not want to take up reorganization until Mr. Magill gets here?

Mr. PARKER. No. We can take up Personal Holding Companies or Capital Gains.

The CHAIRMAN. Let us take up Personal Holding Companies. What page is that?

Mr. PARKER. Page 73.

Under existing law, we have a section, which is section 104, that deals with corporations formed or availed of to prevent the imposition of surtaxes on their stockholders. That section was not very effective for a great many years. We had a similar section, section 220, in the 1918 act, the 1921 act, and the 1924 act. We never collected any money to any amount from it—about $75,000.

Senator GORE. How much?

Mr. PARKER. About $75,000 is all we collected under that provision. It was a special tax on the individual of 50 percent put on a net income (specially defined) of the corporation formed or availed of to prevent the imposition of surtaxes on its stockholders. It was not effectively enforced—anyway, we did not get any revenue from it until 1927.

Since that time, section 104 has been applied to a number of cases, and I think we have got in 12 or 15 million dollars from it. However, it is very difficult to apply, because, in the majority of cases, under the old provision, the Commissioner must prove a purpose on the part of the corporation to prevent the imposition of the surtax and, of course, the corporation can come in with many theories—ideas of building plants and using this accumulated surplus, and it is very difficult to prove.

However, there is no more serious opportunity for evasion in existing law than in accumulating those profits, because in that case the corporation pays simply the 13¾-percent tax, and these 55-percent surtaxes that we have in the law become entirely ineffective.

Section 102 of the bill, page 73, is designed to separate from the ordinary corporation the personal holding company which it was felt was the worst case.

It was what you might term an incorporated pocketbook. A man of wealth, with a million dollars a year income, would have to pay $571,000 tax, but if he incorporates a company, and puts all of his investments into the corporation, and lets the corporation pay the corporate tax, such tax would be only $135,000, and if the corporation does not distribute the dividends to him, of course, he is saving a very large amount of tax, and in case the property consists of the stock of domestic corporations, there is a still more serious evasion, because one corporation does not pay any income tax on dividends received from another corporation.

Of course, it could be said that we ought to catch that case under the existing law, under the old section 104, but, on account of proving purpose, that law has not worked very well.

Senator COUZENS. Were there any hearings on that by the Ways and Means Committee?

Mr. PARKER. There was full opportunity for hearings, because that was a proposition proposed by the Subcommittee on Ways and Means, and the report of that subcommittee, which is before the Senators, entitled "Prevention of Tax Avoidance", was made public prior to the hearing, so that the public knew about the proposal.

The CHAIRMAN. We have some requests to be heard on this proposition.

Mr. PARKER. That is correct. And this section 102 needs perfecting, and we have some suggestions from the staff on that point.

Senator GORE. As the bill is drawn, it defines the state of facts on which the tax is imposed?

Mr. PARKER. Yes. What is done here, roughly, is that we make a special provision, 102, to deal with personal holding companies. The personal holding company is defined as a corporation the majority of value of whose outstanding stock is held by not more than five persons, and 80 percent of whose gross income is from dividends, rents, interest, and royalties. Therefore, the personal holding company does not refer to a corporation with a large number of stockholders, and it does not refer to an operating company in business, because it must meet two conditions before it can be a personal holding company as defined in this bill. First, 50 percent of the value of its outstanding stock must be held by not more than five persons, and, second, 80 percent of its income must come from interest, dividends, rents, and royalties.

Senator REED. Mr. Parker, I am fully in sympathy with your effort to reach this kind of tax avoidance, but I am wondering if you are not penalizing a lot of inoffensive people here. How about all of the small stockholders who constitute the minority. I think, for example, of cases like the Hearst publications. Their control is in W. R. Hearst, I am told, but there are a lot of small minority stockholders who would be punished by this and who are not in the least to blame and are not guilty of any of the offenses that you are trying to reach.

Mr. PARKER. That is true. However, we have had a lot of complaint from minority stockholders because these very corporations do not distribute any dividends.

Senator REED. I see that, but sometimes they cannot. You take corporations like some of the Standard Oil companies. They would be foolish in the extreme to pay out 80 percent of each year's earnings, because they run into bad years every so often, and they have to have a surplus to meet it.

Mr. PARKER. Would the Standard Oil companies come within this definition?

Senator REED. Some of them, I am quite sure, would.

Mr. PARKER. As to the Standard Oil case, I cannot conceive that it would be very hard.

Senator REED. In the Hearst case, I think each of the papers is published by a separate corporation.

Mr. PARKER. Suppose we have a Standard Oil parent that owns a lot of subsidiaries. Those subsidiaries, at least, are operating companies.

Senator REED. That is right.

Mr. PARKER. Of course, in a case like that, they can beat us. In the first place, if they file consolidated returns, they fall outside of this provision. In the second place, if they do not file a consolidated return, they can keep the earnings in the subsidiary, which is an operating company, and not within the definition of personal holding company.

Senator COUZENS. These subsidiaries do not have to pay to the parent if the parent does not want to divide.

Mr. PARKER. It would be the subsidiary that would need money in their operations, and they need not declare the dividends to their parent.

Senator BYRD. Suppose this condition were to exist—that the company owed a lot of money, and the amount was not due until 10 years from now, but they had amortized it, and set aside a certain amount each year. Then you would tax that at the rate of 35 percent?

Mr. PARKER. The way section 102 is drawn, no deduction is permitted from the adjusted net income to which the tax is applied for payment of indebtedness. Of course, that is usual. We do not, in the case of any corporation, do that.

Senator BYRD. This is an unusual tax. You are trying to force the distribution. Suppose they were keeping that surplus to pay the debt which was not yet due, and could not pay it?

Mr. PARKER. This does not touch any past surplus. It touches only current accumulations of surplus.

Senator BYRD. It is the same thing, if they apply it.

Mr. PARKER. We have talked about that—Mr. Beeman and Mr. Magill, and I am sure Dr. Magill is agreeable. We have practically agreed on a provision which will allow some deduction for the purposes of this tax, for indebtedness which is paid. It will considerably relieve the real-estate situation and people that are obligated on bonds and mortgages to pay off indebtedness.

Senator BYRD. Suppose that they had issued the bonds on the basis that they were going to keep a certain surplus during the period of years, but to pay these bonds off. Suppose that was a part of the contract in the issuance of the bonds?

Senator COUZENS. I think they could do that without having to create a personal holding company.

Senator BYRD. Suppose they already have a personal holding company?

Senator COUZENS. They could change it.

Senator BYRD. And the personal holding company had already given the bond. You could not change it without the consent of the shareholders.

Senator COUZENS. I do not see in that case that it would be a personal holding company.

Senator BYRD. It comes within the definition of this section.

Senator COUZENS. Anybody who sat through the hearings of the Banking and Currency Committee and saw what was done in the case of Wiggins and all of those other concerns, and even the Morgan partners, can hardly sit here and not do something to plug up that sort of thing.

Senator REED. We are all agreed on that, but we do not want to hit innocent people or those that do not deserve it.

Senator HASTINGS. Will you explain again what the present law is with respect to this?

Mr. PARKER. There is no provision exactly like this in the present law.

Senator HASTINGS. There is a provision which gives the Internal Revenue Department authority to levy a tax if they find it is being held for the purpose of evading the tax.

Mr. PARKER. That is correct, and in this bill we are retaining essentially the same provision for all corporations other than the personal holding corporation, which we especially define.

Senator HASTINGS. Let me inquire whether or not you might not meet that objection by assuming that it was held for that purpose, and placing the burden upon the corporation itself to prove that it was not done for that purpose? In other words, reverse the burden of proof. Would that relieve it in any way?

Mr. PARKER. We have tried many of those things, and we have never been able to draft anything along that line that would be satisfactory, or rather, to determine the policy which was to be pursued. It is difficult to deal with that section.

One of the things that they raise is, "Well, we put a million dollars into this company, and the value of our investment has gone down to $700,000, and we ought to be able now to accumulate $300,000 of earnings before we pay out any dividends, because we have a right, an inherent right, to maintain our capital."

Senator REED. Take a particular case of this Radio Center over in New York, practically all owned by young John D. Rockefeller. There is a huge building built on leased ground; it has to be amortized in any kind of sensible accounting, and yet, as this thing is written—I presume, but I have never talked to him about it—I presume that all of his amortization deductions, his payment of the bonds, on that building, would not be allowed. He would have to pay 35 percent.

Mr. PARKER. That is true, as this is drawn, but we are prepared to recommend a provision which will permit a deduction, not in excess of 20 percent of this adjusted net income annually, when it is paid on indebtedness. In the case you mention, I assume from what you say that there are bonds.

Senator REED. I don't know. I suppose so.

Mr. PARKER. They could take 20 percent of this adjusted net income and purchase those bonds and set that up, and that would amortize the debt. They could cancel the bonds, which would pay the indebtedness, and they would be permitted to deduct that. Ordinarily, 20 percent of the annual income is a pretty fair amount to apply to amortization.

Senator HASTINGS. That would answer Senator Byrd's objection.

Mr. PARKER. That answers a good deal of his objection. If a man has a mortgage and wants to make a payment on the mortgage, he can deduct that, provided it is not more than 20 percent of the net income. Perhaps that is not the right rate. We will propose for the consideration of the committee an amendment along that line.

Senator GORE. What is the justification of permitting one of these personal corporations to get in under the wing of a consolidated return?

Mr. PARKER. We are letting the consolidated return operate here because we think it stops up a loophole rather than permits one.

We run into this case, for instance: If we do not permit the consolidated return, instead of a man organizing one personal holding company, he will organize a chain of personal holding companies. He has a great series, one holding the stock of the other, and this 10 percent deduction which we give will be 10 percent each time, and will accumulate up so that he can practically nullify the effect of this provision.

Senator COUZENS. Isn't it true that the State of New York does not permit the payment of a dividend while the capital of a corporation is affected?

Mr. PARKER. I believe that is true.

Senator COUZENS. That is another thing which stands in the way of paying dividends. These are not cases like that, in the Banking and Currency Committee, where some of these corporations did not pay any dividends, and the alibi was that they could not, under the State laws of New York, while their capital was below par, and so they held their surplus until the capital was built up to par again, and after that time they were again permitted to pay dividends. Unless there is some provision like that which you have referred to a while ago, if a concern put in a million dollars, and it dropped to $700,000, they were not, under the State laws of New York, be permitted to pay any dividends at all until their investment was brought back to a million dollars and would, therefore, be penalized.

Mr. PARKER. I am not sure whether the State of New York requires the corporation to revalue its assets.

Senator COUZENS. That was the statement made before the Banking and Currency Committee, that they could not pay dividends until their capital had been rehabilitated.

Mr. PARKER. It is quite an ordinary system of bookkeeping. If the State of New York requires a revaluation of these assets in the case of a corporation, you are meeting a serious situation which I do not think is covered by that amendment which we propose to submit.

Senator COUZENS. Why not let it go over until they prepare the amendment?

The CHAIRMAN. Yes, we will have to let it go until they prepare the amendment.

Senator MCADOO. In this provision as you have got it here, and even taking into consideration the amendment you have suggested, I am just wondering how it would meet a situation like this: I will take a California case, where they are dealing every day in real estate. A man buys a piece of property for subdivision and he incorporates a company, because he wants the title to be in a corporation. He might die, and he does not want the complications which would naturally arise out of the administration of his estate. He has a big mortgage on it—it is subject to that mortgage. It is a personal corporation, not designed to defraud the income-tax laws. How would you deal with a corporation like that?

Senator COUZENS. Would that be a personal holding company rather than an operating company?

Senator MCADOO. It would be both, under this definition, I should think.

Mr. PARKER. What is the nature of the income of this company—rents?

Senator MCADOO. It might come from rents. It might build houses or sell the property off.

Mr. PARKER. In that case, supposing the dividends are all rents, it would be permitted to deduct from this income, subject to tax, 20 percent of its rents, provided it actually pays them on the mortgage.

Senator MCADOO. There are cases out there where there are no rents, but where they raise the question of the deferred payments on property which they sell. In other words, the income that they

would get would be represented by the profit apportioned on each installment sale. Do you see? Now you get into a rather complicated situation there, under the provisions, as I see it.

Mr. PARKER. That would not be a holding company.

Senator MCADOO. A personally owned corporation. You have the title in the corporation because, as I said before, he does not want the complication incident to death to affect the title to the property.

Mr. PARKER. This provision is somewhat harsh. But that is just exactly the point. After all, the matter of fact would be that if in that case we did not permit an individual to incorporate himself, he would have to pay that surtax.

He can declare the dividend out, and, if the corporation needs it, he can pay it back again, and then he will avoid this tax.

Senator MCADOO. If you are going to make any such drastic provision as this about all corporations, then don't you think you ought to provide some reasonable means by which they could dissolve the corporation and restore the status without being penalized?

Mr. PARKER. This does not affect all corporations. The definition is rather restricted, and I think a great many of these personal holding companies will dissolve. In fact, we hope they will.

Senator MCADOO. I was going to say that I think that what you are striking at here is very proper—that is, to try to rid the abuses that have grown up through the organization of these personal holding companies which clearly have been designed to escape the tax. That is all right. I am in full sympathy with it, but I agree with Senator Reed that in trying to make a definition to reach those fellows, you should not destroy or seriously injure a great many corporations which are perfectly legitimate and organized very properly to conduct certain classes of business.

Senator HASTINGS. Mr. Parker, aren't you quite certain that somewhere in this act and in this section you have got to leave some very great discretion to the Internal Revenue department? I do not believe you are going to be able to lay down any hard and fast rule which is not going to be hurtful to somebody.

Mr. PARKER. Well, we have been trying that for the past 15 years. That is all I can say.

Senator COUZENS. They have always failed, because the taxpayer always makes very plausible argument to the Commissioner, and the Commissioner is placed in a difficult position to decide whether they have to pay a tax or not. That is one of the openings for all kinds of pull and graft and what not.

Senator WALCOTT. When you are at liberty, I would like to call your attention to a memorandum which I have received, with a lot of other memoranda on this bill.

It is not labeled as to whom it comes from, and I do not remember from whom it comes. It was handed to me by some other Senator, and I have forgotten who it was. This is a brief, and it says:

I urge an additional exception in the definition (b) of personal holding company, such as the exception of banking and insurance corporation, of "a corporation used in aid of a manufacturing, industrial, printing, or mercantile business, the assets of which consist entirely or principally of real estate and/or machinery rented to and used by such a business."

Such a corporation is in no sense a personal holding company and should not be arbitrarily classified as such in the bill merely because of limited ownership. It is essential that such a corporation should have the use for business purposes

and acquisition of physical property of more than 10 percent of its net income derived from rents, and a tax on such use in aid of industry at the rate of 35 percent is unjust and in effect an actual prohibition of the use of the corporation's moneys in aid of industry. There is no fair reason for taxing the earnings of such a corporation at a higher rate than the earnings of industrial corporations generally are taxed.

Further, the act in its present form renders the liquidation and abandonment of such a corporation impossible, by taking at the time of distribution, earnings heretofore for many years back applied to the reduction of mortgages and improvements of the real estate at full surtax rate rather than the rates prescribed for capital gain.

I think his argument is sound, and I think perhaps I had better turn that over to you.

Mr. PARKER. I see right away, though, that the amendment which I have already partially described would help to take care of that situation. As I make it out, he has formed a personal holding company to buy certain assets and physical property, and his other companies or other businesses pay rent to that company, and he has some outstanding indebtedness which has to be retired. That will be taken care of under the amendment we propose, which is something like this:

On page 74 of the bill you see in line 17 under "2" it says: "The term 'undistributed adjusted net income'—and that is the income to which the 35 percent tax attaches—'means the adjusted net income minus the sum of: (A) 10 percent of the adjusted net income; and (B) dividends paid during the taxable year.'"

We are going to propose in addition to that something substantially like this: "Amounts paid not in excess of 20 percent of the adjusted net income during the taxable year in satisfaction of indebtedness incurred prior to January 1, 1934."

We cannot allow payments on future indebtedness, because, if we do, we will open the door to loopholes.

The CHAIRMAN. And you are not sure that 20 percent is the correct figure?

Mr. PARKER. No, I am not sure that 20 percent is correct.

But that deduction for indebtedness paid will be of great assistance to the real estate companies. It will help your case, Senator Walcott.

Senator GEORGE. Your suggestion is for indebtedness paid. Where they must accumulate it against bond issues, how about that?

Mr. PARKER. There is some question as to whether a sinking fund should be permitted, but such a provision will be very difficult to draft.

We had thought of this, that in most cases where there were bonds the company could buy its own bonds and cancel them, and that would be equivalent to setting up a sinking fund.

Senator GEORGE. In many instances the entire adjusted net income is necessary under existing conditions, particularly of real-estate holding corporations, to take care of the maturing bonds and interest on principal.

Senator REED. I know of a corporation that has an issue of bonds, and a big one, coming due in 1937, and that corporation, not for the purpose of hiding their earnings or anything of that sort, is buying those bonds on the market as fast as they can do it, because they are in doubt of their ability to refinance when they come due.

Senator HASTINGS. What would be the effect of this?

Senator REED. They would be taxed 35 percent of this. It would be called a personal holding company because it is not actually in a manufacturing business.

Senator GORE. Why retire the bonds? Why not extend it?

Senator REED. Under the Securities Act, it would make it practically possible for them to renew that issue of bonds when it becomes due, and they are afraid they cannot.

Mr. PARKER. Your thought would be, then, to permit indebtedness to be paid without limitation?

Senator REED. Bona fide indebtedness existing before this act.

Senator HASTINGS. What would be the objection to that? Why limit it to 20 percent? If they are paying off their indebtedness and get it paid off, the bill might apply to them, and they would have to pay the 35 percent tax.

Mr. PARKER. We thought of that, and then we thought if we did that we would have to permit a deduction only for the indebtedness paid, provided it was in the terms of the contract to pay it. Because there is a loophole existing there if we allow it in full.

Senator REED. There is no loophole if you limit it to indebtedness now existing.

Mr. PARKER. Yes. Suppose we have a real estate company that is owned by one man. We should have gotten the surtaxes from him all these years, but we did not, because he put his property in a real-estate company, and held all the earnings in the company. He happens to have a couple of million indebtedness, although he has got perhaps 5 or 6 million dollars worth of property.

Now, of course, although he is not obligated to pay that million dollars, and I know he might extend mortgages on it indefinitely, in order to prevent the imposition of this tax he will pay off that mortgage just fast enough to wipe out the 35 percent tax, so he won't have to distribute dividends for the next 5 years.

Senator GORE. Would it meet that objection if you extended the permission to pay to bonds and maturing obligations, instead of letting him anticipate maturities?

Mr. PARKER. That would meet this objection where he was under contract to pay it. But that would not meet Senator Reed's case, because the indebtedness did not have to be paid for 2 or 3 years.

Senator GORE. My idea would be to permit those people to pay their own debts, and not have the Government drive them to pay their debts. They should be able to pay their own debts if they want to.

Senator WALCOTT. Mr. Chairman, I suggest that we have a chance to see this proposed amendment and return to a discussion on it.

The CHAIRMAN. We won't take any action on it at all. They have several suggestions to make. We are just going over the matter.

We have some requests for people to be heard on this proposition. This is one of the important things in the bill. We are going to have open hearings Monday and Tuesday and probably Wednesday to give those people an opportunity to be heard.

Senator WALCOTT. Meantime, I would like to have the suggestion that Mr. Parker has in mind, if he will send me a memorandum of it.

Mr. PARKER. Yes, sir; we can give you something in tentative form.

The CHAIRMAN. We will pass this for the present.

What other knotty problem is there besides capital gains and losses, and reorganization, that we have got to take up?

Senator WALCOTT. Have you discussed sections 115 and 117 this morning? You were on that yesterday.

Senator REED. Page 104, line 8, presents a rather knotty problem. That is on the distribution of earnings accrued before March 1, 1913.

The CHAIRMAN. We have not reached section 115, Senator.

Senator REED. Mr. Beeman, can we constitutionally tax earnings that were realized before 1913?

Mr. BEEMAN. The Supreme Court says so.

Mr. PARKER. I do not think we finished page 95, paragraph 13.

The CHAIRMAN. We approved 12. We did not take any action on 13.

All right. Explain that, Mr. Parker.

Senator MCADOO. What are we considering now, Mr. Chairman?

The CHAIRMAN. Page 95, paragraph 13.

Mr. PARKER. Mr. Bartholow will explain that.

The CHAIRMAN. Very well.

Mr. BARTHOLOW. One of the most controversial issues the Treasury has had for a number of years that has not yet been definitely decided is: What will be the basis to a partnership for property acquired by a partnership from its partners? Here is a piece of property, speaking in small figures, that cost an individual $10 and is now worth $100. Another individual has a piece of property that cost him $20 that is now worth $100. They transfer those two pieces of property to a partnership in which each partner has an equal interest, since each transferred property has the same value. The piece of property that cost the first partner, A, $10, is sold by the partnership for $100, and the question is whether any income is realized from that transaction.

There are two theories. For some purposes a partnership is treated as a separate entity, and yet for other purposes, in the income-tax law, the separate entity theory is disregarded, and the transaction is treated, in substance, as a sale by the original partner. This is consistent with the theory that upon the creation of a partnership the change in interest is so slight that there is no realization of profit by the partner making the transfer to the partnership. In other words, if two individuals form a partnership, each contributing properties as mentioned, there is no substantial change in property rights such as where a person exchanges one piece of tangible property for a different piece of property. In that case the new property is valued, and gain or loss on the transaction may be definitely determined.

If you organize a corporation, put in your properties, and get back stock, the stock is generally regarded as something so distinct from the property contributed that the gain or loss is realized on the transaction. But we have never gotten to the point of saying that where property it contributed to a partnership, there has been an exchange of property for different property, that is, a partnership interest.

Of course, theoretically, there is the possibility that you might attempt to value a partnership interest and hold that there was an exchange upon which income was derived.

But in the case of small partnerships, where a couple of people form, say, a corner grocery store, the thought has been that the change is

not of sufficient import to result in a profit being realized on that transaction, and the practice has been, therefore, to disregard that as a taxable transaction, and get the tax by insisting that the basis of the property contributed to the partnership does not become increased by virtue of the formation of the partnership. Thus the formation of a partnership is put on the same plane as the formation of a corporation, under express provisions in the Federal revenue act.

If two individuals transfer property to a new corporation, for the stock of the newly formed corporation, that transaction has been disregarded as a taxable transaction pursuant to the provisions of the revenue law, and the revenues have been protected by providing that the basis of the porperty to the corporation is the same as it was in the hands of the individuals.

Senator COUZENS. In other words, it is just carrying out a policy which the Department has been carrying out?

Mr. BARTHOLOW. Yes; sir.

Senator GEORGE. What do you do with this amendment?

Mr. BARTHOLOW. We provide in this provision that in case the partners contribute property to a partnership, the basis of that property in the hands of the partnership will be the same as it was in the hands of the contributing partner.

That is the same rule that has been applied for many years to the case when you contribute property to a corporation, and if that is a good rule in the case of a contribution to a corporation, a fortiori it should be applicable in the case of a partnership, because the change in form by virtue of the transfer is not as significant as in the case of a corporation.

Senator REED. So that if they contribute property of equal value, property A carries a higher potential tax value than property B?

Mr. BARTHOLOW. Yes. You have the same situation in a corporation situation. It is an anomaly, because, after all, let us say the second partner actually paid $100 for his property and put it in for $100, and the other partner paid $10 for his property and put it in for $100. It is quite obvious that they both made equal contributions, but let us say that the first piece of property was sold shortly thereafter for $100. The second partner may say, "we are only getting $100, which we started with." So we say that a $90 profit accrued from that sale, using that old basis, but that the profit must be taken up by the partner who made the contribution of the property that cost $10, thus reaching an equitable result.

Senator COUZENS. That has been the practice?

Mr. BARTHOLOW. That has been the practice.

Senator COUZENS. That is carried out in this provision?

Mr. BARTHOLOW. That is carried out in this provision.

The CHAIRMAN. Without objection, that provision will be adopted.

Mr. Magill, suppose we take this reorganization provision up. What page is that?

Senator COUZENS. Page 85.

Dr. MAGILL. You mean the amendment in the reorganization definition?

The CHAIRMAN. Yes, that was one we passed over this morning.

Mr. PARKER. We have not discussed (g), (h), or the others.

The CHAIRMAN. Would you prefer to take up this capital gains and losses?

Mr. PARKER. It does not matter.

Senator REED. We cannot finish it in 20 minutes.

Mr. PARKER. And we cannot finish reorganization in 20 minutes.

The CHAIRMAN. On this reorganization proposition, we have a joint committee meeting with the Internal Revenue Department.

Dr. MAGILL. That is the partnership reorganization. It is not corporate reorganization.

The CHAIRMAN. What do you wish to bring up? We have 10 minutes more.

Senator REED. We could not take up capital gains because Dr. Magill was not here.

Dr. MAGILL. I regret that very much. The Secretary was asked by the Judiciary Committee to make a statement as to tax-exempt securities. A very important matter.

Mr. PARKER. We might dispose of a lot of minor things, because we cannot finish these major problems in that time.

The CHAIRMAN. Then let us go ahead with some of the minor points.

Mr. PARKER. On page 96, "Property acquired before March 1, 1913"—the change there affects the basis.

Senator COUZENS. The natural resources people are complaining about it.

Mr. PARKER. This is strictly on the basis of the property which was acquired before March 1, 1913.

The CHAIRMAN. There does not seem to be any objection to this amendment.

Mr. BEAMAN. There are two amendments there, Senator. One is purely clerical, and the other is a minor question of policy.

The amendment in line 9 is purely declaratory of the present law.

The CHAIRMAN. Without objection, that amendment will be adopted.

Mr. BEAMAN. Line 12 is a minor change in policy. Under the present law, assuming that I bought property in 1910 for $100 and on March 1, 1913, it came to be worth $110, and I sell it today for $115, under the present bill my basis is the higher, so I have a $5 profit and not a $15 profit. If, however, I sell it for $105, under the present law, instead of $115, under the present law, I would have a loss of $5—the difference between the $110 value of March 1, 1913, and the $105 it was sold for.

Under this amendment in line 12, I have no loss unless my sales price is lower than my cost, which is probably what is just and right. You do not tax any gain if he sells for $105. He still has the $110 basis. But you take the cost for the purpose of determining whether or not I have a loss.

Dr. MAGILL. As far as I can see, from the decisions, there is some doubt as to whether or not the Supreme Court would not hold this anyway, because the only loss you are allowed to deduct under the decisions of the Supreme Court is a loss which has been sustained.

The Court has held in a case somewhat similar to the situation Mr. Beeman has described that if you sell for more than your cost, you have not sustained any loss under the deduction provisions.

Consequently, I do not think that there is any objection to this.

Senator HASTINGS. I do not think that there is any objection.

The CHAIRMAN. Without objection, it will be adopted.

Senator GORE. Was that the point in the *Flannery case*?

Dr. MAGILL. That was held in the case of the *United States* v. *Flannery*.

The CHAIRMAN. What else have you?

Dr. MAGILL. That section at page 99. There are various places in the basis section where you have one basis for determining gain and another for determining loss.

The CHAIRMAN. They are clerical.

Dr. MAGILL. This was to make the gain basis apply for depreciation purposes.

Senator REED. That gives you the lower of the two?

Dr. MAGILL. No.

It gives you the higher.

Senator REED. Oh, yes, that is right. There is really a concession to the taxpayer.

Mr. PARKER. No, we did not give the taxpayer any more than he is getting under existing law. We have reduced the loss basis and kept the gain basis the way it was, and he has always had this gain basis.

The CHAIRMAN. What next.

Dr. MAGILL. The next in importance is on page 103.

The provision on page 103 will give the taxpayer the option of whether or not he will take depletion on the basis of percentage depletion or whether he will take the depletion computed in the ordinary way.

Senator GORE. He has the election?

Mr. PARKER. Under the 1932 act, when we put this thing in, we gave him one opportunity to make the election.

Mr. BEAMAN. We have an amendment proposed.

Mr. PARKER. Yes, we have an amendment proposed, and I think we might as well take that up here, and I think the committee would agree to it.

Senator REED. Well, is this provision really effective? Can't they all avoid it by fake sales of the property, letting the new owner make a different election?

Mr. PARKER. I don't think so, with Mr. Beaman's amendment.

Mr. BEAMAN. You remember, Senator Reed, that in 1932 after having given the election, we put in the language that appears on page 102, beginning in line 13, down to line 10 on page 103. There it appears in strike-out type, seeking, in the case of a tax-free organization or exchange, to hold the new taxable entity to the election made by the first one who made the tax-free transaction.

Senator REED. That is what we wanted to do.

Mr. BEAMAN. But when we prepared this bill for the Ways and Means Committee, they had stricken out all the reorganization provisions which they subsequently reinserted, so the problem, where the reorganization provisions were different under the new law from the old, became so intolerably complicated that we threw up our hands and said, "The only thing you can do is to give everybody a new election, and give everybody a new deal." Then, when the Ways and Means Committee decided to put back the reorganization provisions, we did not have time to go back to the old system.

The amendment which we now propose is to substantially, in highly complicated and technical language, reinsert the same idea, so that the election which a corporation makes under this new provision will

bind, not only the corporation, but will bind also any corporation that gets it through a reorganization which is tax-free. I can read the language, if you want me to.

Senator COUZENS. Is that taking the place of the language of line 11 on page 103?

Mr. BEAMAN. We take the language on page 103, from line 11 to 21——

Senator COUZENS. And rewrite it?

Mr. BEAMAN. With one or two small changes, and then add onto the end of it a paragraph carrying out the suggestion I made, that the method of computing the depletion allowance that has been settled, as provided in lines 11 to 21 shall apply to the property for all subsequent taxable years, and if it is held by that taxpayer, or if it is held by another person, the basis of the property for gain purposes in the hands of that other person is, under these basis provisions in 113, determined by reference to the basis in the hands of the first fellow.

Senator REED. That would cover the case of an outright gift, too?

Mr. BEAMAN. It would cover the case of a gift.

The CHAIRMAN. Without objection we will take that course.

Senator REED. How has it worked, or haven't you had enough experience in the case of percentage depletion for metal mines and coal mines?

Dr. MAGILL. I do not think we yet know enough about it. They are just now commencing to analyze the 1932 returns, so we haven't had enough experience to know.

Dr. GEORGE. Can't we take up now the beginning of the 1913 value base?

Dr. MAGILL. That is the next thing to come up. The next thing, you see, is distributions by corporations.

Senator GORE. Mr. Chairman, is that agreed to?

The CHAIRMAN. Yes; that is approved with an amendment. Dr. Magill, the Treasury does not insist on that amendment, does it, going back beyond March 1, 1913?

Dr. MAGILL. Your amendment does not go back beyond that date.

Mr. BEAMAN. No; he is talking about pre-March 1, 1913, dividends.

The CHAIRMAN. I am talking about this provision regarding distributions.

Senator REED. Page 104.

Dr. MAGILL. Oh, page 104?

Senator GEORGE. Yes.

Dr. MAGILL. No; I think not, and the revenue in that is relatively small.

The CHAIRMAN. This matter has been before the committee time after time and the Senators have always taken the view that we ought not to go back beyond March 1913. It would be disturbing to business, and without objection, the committee will disagree to the amendment and leave it as the present law stands.

Senator HASTINGS. What particular amendment is that?

Dr. MAGILL. Page 104.

Senator REED. We also disagree to the one on page 103?

Dr. MAGILL. There are a number of them.

Senator GEORGE. That will carry with it a number of them.

Senator WALCOTT. That means replacing the lines that have been stricken out.

The CHAIRMAN. March 1, 1913.

Dr. MAGILL. It would mean making a large number of other changes in the bill, but if that is your policy, we will make them as we come to them.

The CHAIRMAN. Yes.

Dr. MAGILL. Then "distributions in liquidation" is again a subject which you may want to discuss somewhat. You notice that. I think you will pretty nearly have to pass that over until you determine what you wish to do in respect to capital gains and losses.

The CHAIRMAN. We will pass that.

Senator GEORGE. We only have about 6 or 7 minutes remaining, anyway.

Dr. MAGILL. It is tied up with the same thing. Then the strike-out type on page 105 is covered by the March 1 proposition.

The CHAIRMAN. After that is agreed to?

Dr. MAGILL. On page 106, that paragraph is simply transferred from another part, so that is simply a clerical amendment.

On page 107, at the foot of the page, the definition of "earned income" is now carried on page 42.

The CHAIRMAN. "Distribution of stock on reorganization"—that is passed over?

Mr. PARKER. That will be touched on when he gets to reorganization.

Dr. MAGILL. It is put in here instead of in 112, where it has been. The definition of "earned income" at the foot of pages 107 and 108 is carried in another place, so it is not necessary to put it in here.

Senator REED. The meaning is not changed?

Dr. MAGILL. That is right.

The CHAIRMAN. You mean that you would approve this amendment?

Senator WALCOTT. And where does that go?

Dr. MAGILL. It is the stricken-out material.

Senator WALCOTT. And what does that replace?

Dr. MAGILL. It appears on pages 42 and 43, section 25 (a) (5).

The CHAIRMAN. All right. "Teachers in Alaska and Hawaii", page 108.

Mr. BEAMAN. There is no change.

Senator REED. The act of 1932 accomplished the repeal, and this does not repeal the repealer?

Mr. PARKER. Don't repeal the same act twice.

Senator REED. There is no use repealing the thing twice.

Dr. MAGILL. That brings you over to capital gains and losses.

Dr. MAGILL. The amendment on page 117, in section 119, is, I believe, designed to meet the contention which has been made by some aliens, that interest on refunds on taxes paid by the United States is not income from sources within the United States. It is simply a clarifying amendment really.

Senator REED. Well, they are not going to get very far with that contention, are they?

Dr. MAGILL. I do not see why they should.

Mr. PARKER. Well, I think there is danger of the courts holding that way under the present wording of the law.

Dr. MAGILL. It is worded here, "interest on bonds, notes, or other interest-bearing obligations." Their contention is construed that technically it does not include interest on refunds of taxes.

The CHAIRMAN. Do you want to change that language in any way?
Dr. MAGILL. The way it is in the bill, I think is all right.
The CHAIRMAN. Approved.
Senator WALCOTT. The way you have got it in italics on page 117?
Dr. MAGILL. Yes, sir.
The CHAIRMAN. "Sale of Personal Property"—page 119.
Dr. MAGILL. That is simply a cross-reference.
The CHAIRMAN. That is passed.
Dr. MAGILL. Foreign tax credit is next, on page 120.
The CHAIRMAN. We haven't time to take up the foreign tax credits now.
Mr. PARKER. How about this amendment?
Dr. MAGILL. Mr. Beaman says there is an amendment on page 119 which he wants to present. Have you got it?
Mr. BEAMAN. Yes.
The CHAIRMAN. "Sale of Personal Property"?
Dr. MAGILL. Where does it go in?
Mr. BARTHOLOW. Page 119, at line 9, change the period to a comma, and add "but no dividends from a foreign corporation shall, for the purpose section of 131, relating to foreign tax credits, be treated as income from sources within the United States." I can illustrate this briefly this way——
The CHAIRMAN. Is that involved in the foreign tax credit proposition?
Mr. BARTHOLOW. Well, it is, indirectly. Maybe that had better go over until the committee takes up that matter.
The CHAIRMAN. You had better bring that up when we have the whole foreign proposition up for discussion. Is there something else we can pass on?
Dr. MAGILL. I think the next thing you come to is consolidated returns.
The CHAIRMAN. I think we had better have a day on that.
Gentlemen, let me ask the opinion of the committee here, now. I do not know whether we are doing to be able to get through with this by Monday morning.
Senator REED. Not a chance.
Senator GEORGE. No.
The CHAIRMAN. We wanted to start the public hearings at that time.
Senator GEORGE. We can't do it.
The CHAIRMAN. We can go along with the executive session at most any time. Would it not be well to hear these people who have objections on Monday, Tuesday, and Wednesday, say, and then go back into executive session with the experts?
Senator COUZENS. I should think so.
Senator REED. It would help us in executive session to have heard what they have to say.
Senator GEORGE. Yes, I think so.
The CHAIRMAN. So, with the approval of the committee then, we will devote Monday morning, Tuesday morning, and Wednesday morning to hearing these witnesses.
(Thereupon the further hearing upon H.R. 7835 was recessed until 10 a.m. Friday, Mar. 9, 1934.)

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CONFIDENTIAL

REVENUE ACT OF 1934

HEARINGS

BEFORE

THE COMMITTEE ON FINANCE
UNITED STATES SENATE

SEVENTY-THIRD CONGRESS

SECOND SESSION

ON

H.R. 7835

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

PART 4

MARCH 9, 1934

UNREVISED

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REVENUE ACT OF 1934

FRIDAY, MARCH 9, 1934

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

The Committee met at 10 a.m., with the following members present:

Senators Harrison (chairman), King, George, Walsh, Barkley, Connally, Gore, Costigan, Bailey, Clark, McAdoo, Byrd, Lonergan, Reed, Couzens, Keyes, and Metcalf.

Also present: Messrs. Magill, Parker, Stam, Beaman, Bartholow, and other representatives of the Treasury Department, Joint Committee on Internal Revenue Taxation, and the staffs of the Senate and House Legislative Counsel.

The committee had under consideration H.R. 7835.

PROCEEDINGS

The CHAIRMAN. Let us proceed.

Senator REED. Dr. Magill, how much did the Treasury estimate would be added to the revenue by this taxation of dividends prior to 1913?

Doctor MAGILL. I think it was $6,000,000.

Senator WALSH. That has been stricken out, I understand.

The CHAIRMAN. Yes; that was stricken out yesterday.

Dr. MAGILL. We made a check last night as to what we have passed over here, and the first is a matter on page 66. The old section 192, at the foot of the page, provided a limitation of the surtax in the case of sales of mines, and oil or gas wells, to 16 percent. At the foot of page 66, and at the top of page 67.

The CHAIRMAN. I think that ought to come up when Senator King and Senator Gore are present. They probably might be interested in this oil proposition.

Dt. MAGILL. Very well, then perhaps we had better pass that. The next matter is personal holding companies. Do you want to delay that?

Senator REED. I think we ought to have a full attendance before we take that up.

The CHAIRMAN. That, and the matters of reorganization and foreign credits.

Senator REED. Also capital gains and losses.

The CHAIRMAN. And capital gains and losses. We ought to have a pretty full attendance before we pass on that.

Dr. MAGILL. Then, if it is your pleasure, suppose we skip over that. On consolidated returns, you would want a full attendance,

too, I take it. If you would go over to page 133, I think we can go forward from there.

The CHAIRMAN. The consolidated returns proposition is a very simple thing.

Dr. MAGILL. Yes.

The CHAIRMAN. I think we understand very generally what the thing is. You increase the tax rate where they have filed consolidated returns.

Senator WALSH. Mr. Chairman, yesterday I could not be present. Was any action taken on the Capital Gain and Loss section?

Dr. MAGILL. No.

Senator REED. Page 66?

The CHAIRMAN. No; we put that off.

Dr. MAGILL. We have really skipped over a number of matters between pages 66 and 129.

The CHAIRMAN. In connection with the matter of consolidated returns, we have had requests from certain interests to be heard briefly, and I believe that no final action should be taken on some of these more important questions, until after we have the public hearing. Do you think so?

Senator REED. Yes, I do.

Senator KING. Yes, I think so.

Senator WALSH. On what subjects are we going to have the hearing, Mr. Chairman?

The CHAIRMAN. There is no restriction on it. We have had innumerable requests. Of course, there are many interests that want the nuisance taxes removed, and so on. I thought that we would limit it as much as possible. If they want to file briefs for the purpose of the record, all right. The soft-drink people, for instance, Coca-Cola, say, we removed the tax on fruit juices, and, as we have beer now, they are at a great disadvantage. They want to be heard briefly.

Senator WALSH. The match people also want to be heard.

The CHAIRMAN. The match people want to be heard, and various other interests.

Senator WALSH. I think you will have to give them all a short hearing.

The CHAIRMAN. So, I think we could finish with them on Monday, Tuesday and Wednesday.

Senator BARKLEY. I was just wondering if we are passing upon anything here on which we are going to have a hearing later.

The CHAIRMAN. Everything we are doing is tentative. We can reopen every proposition that has been passed upon here. There is nothing final as yet.

Senator WALSH. Don't you think it is very advantageous to have the position of the Treasury on some of these matters in advance?

Senator BARKLEY. Oh, yes; I think so.

Mr. PARKER. I would like to make a suggestion as to the hearings. The witnesses in respect to the provisions of this bill should be heard at greater length than those who want to remove some tax that there is no intention of removing. They could be allowed to file a brief in those cases.

The CHAIRMAN. We are going to follow that policy, Mr. Parker, with these people who want some tax removed. We know, generally

speaking, we cannot take taxes off, with the Treasury in the fix it is; but we are going to give them an opportunity to be heard for 5 minutes, probably, or we will let them file briefs, and so forth, but I know, on matters like sesame oil, we have got to have a hearing, because it is a contentious proposition and there are two or three sides to it.

Senator McADOO. You mean the coconut oil too, don't you?

The CHAIRMAN. That is what I mean.

Senator WALSH. Have any of these excise taxes been increased in the House?

Mr. PARKER. No, Senator; one new tax has been added.

Doctor MAGILL. The coconut oil is the only one.

Senator WALSH. And the others have not been increased?

Dr. MAGILL. No. They are making distinctions there.

Senator WALSH. I do not think they ought to have any hearing, then.

Mr. PARKER. I want to call this to the attention of the committee, that the Ways and Means Committee had their hearings, the witnesses knew the subjects that were being considered and knew in a general way what the subcommittee proposed, but there was no actual print of the bill in existence. Therefore the legal representatives of the companies, et cetera, were at a disadvantage in the hearings. They could not point out specific defects in some of these provisions, in most of which the general purpose seems to have been accepted as good; but that is why, in this hearing, it seems to me that if they have some technical points that are well taken, they ought to be heard.

Senator KING. Yes; I agree with you.

The CHAIRMAN. We would probably have to meet in the afternoons, too; Monday, Tuesday, and Wednesday, with the full committee. We have got to give them a full hearing, I think.

Senator McADOO. Some of the banking interests want to be heard on the section of the bill that Senator Reed brought up the other day.

The CHAIRMAN. On the capital gains and losses proposition?

Senator McADOO. Yes, and I have some telegrams on the subject, indicating a more serious aspect on that question than I realized the other day when it was under discussion. I think we might give short hearings to a few of them.

The CHAIRMAN. I think we have got to hear those people on that.

Senator McADOO. Yes.

The CHAIRMAN. I got a brief this morning on that proposition. Mr. Fleming sent up a memorandum on the proposition, and they seem to think it is quite important.

Dr. MAGILL. I think, if you started at page 133, with section 142, you could probably run along over a series of sections there in which there are no changes of much importance, and on page 133——

Senator KING. There are no changes there, or on 134.

Dr. MAGILL. There are no changes there. Now, the next change of consequence is that on page 135. As you know, at the present time there is a considerable number of bonds which contain a so-called tax-free covenant clause, under which the corporation obligor agrees to pay the tax of the obligee up to 2 percent, which is imposed upon the interest on the bond. That, of course, is a matter of no conse-

quence to the Treasury. We simply get the tax from the corporation obligor instead of the recipient of the interest.

Senator KING. You are speaking of Federal bonds, of course?

Dr. MAGILL. No; private corporation bonds. Now, it would serve the purpose of administrative simplicity a good deal, if the thing could be eliminated; but we thought it ought not to be eliminated with respect to bonds which are now outstanding.

The CHAIRMAN. You start with January 1, 1934?

Dr. MAGILL. That is right. I think it is a desirable change, and as it is worded here, it ought not to do anybody any harm.

The CHAIRMAN. Don't you think we ought to extend the date a little further, since it is now March? You want to work it in futuro.

Dr. MAGILL. I had not thought of that particularly. It would depend on whether there have been any considerable number of these bonds issued since January 1, 1934. I would doubt it, myself.

Senator GEORGE. Dr. Magill, what is the particular objection to that?

Dr. MAGILL. To the existence of the tax-free covenant?

Senator GEORGE. Yes. I was just wondering.

Dr. MAGILL. Mainly the fact that it involves the Treasury in a considerable amount of administrative work in checking over certificates which are filed by the various taxpayers at the time they collect the interest on their bonds. It further involves us in a series of refunds of small amounts.

Senator REED. There isn't 1 taxpayer in 500 that understands the method of accounting required by the Treasury on that.

Dr. MAGILL. That is right. It also compels the corporation, in many instances, to pay more tax than is really due, because the recipient of the interest fails to file the necessary certificate. The corporation has to pay the tax, although the recipient would not be taxable.

Senator REED. We had better make it July 1, then.

The CHAIRMAN. Well, why not make it July 1. Then we will at least have the difference between January 1 and July 1, for conference.

Senator KING. What do you say about that, Mr. Parker?

Mr. PARKER. Well, I think that is all right. Of course, I had hoped it would be practicable to cut the whole thing out. It doesn't amount to anything. It doesn't give the taxpayer much relief. The unfortunate part of it is, if you eliminate withholding, the corporation makes the saving and not the bondholder. They have got about 30 people, I think, down in the Bureau, sorting these information returns out. It is a big job. It is a troublesome job.

The CHAIRMAN. You mean the House part ought to be stricken out?

Senator WALSH. The whole thing.

Mr. PARKER. The recommendation of the House subcommittee was, not to permit any withholding at all, but later on the Ways and Means Committee provided that there should be withholding only in case of tax-free covenant bonds issued before January 1, 1934.

Senator REED. Mr. Parker, that would cause a great deal of trouble to the bondholder. He has got to put in a claim for refund to the corporation.

Dr. MAGILL. Yes.

Senator REED. And it is like collecting this Pennsylvania 4-mill tax on foreign corporations. It is a difficult job.

Mr. PARKER. I don't think there is any use to get into it for 2 or 3 months. I should think July 1, 1934 or January 1, 1935 would do, and there is no use to get into a controversy about it.

The CHAIRMAN. Without objection, we will change it from January 1 to July 1.

Mr. PARKER. There is no revenue involved here. It is just merely for the purpose of getting rid of these administrative nuisances at some future date.

Dr. MAGILL. The changes on the next page, 136, are simply due to the change in the normal-tax rates, eliminating the 8-percent bracket.

The CHAIRMAN. Without objection, it will be approved.

Dr. MAGILL. And there is nothing on page 137, but what is clerical.

Senator REED. You are going to lose a little revenue on that, aren't you?

Dr. MAGILL. Yes; we will. On page 138 is this same change in the normal tax to which I referred. The change on page 139, striking out subdivision (g), is purely clerical. It is unnecessary.

The CHAIRMAN. Without objection, that will be approved.

Dr. MAGILL. And the same is true at the top of page 140.

The CHAIRMAN. Without objection, that will be approved.

Senator KING. Let us see what that is.

Dr. MAGILL. That is put in because of the raise in rates in the 1932 law.

Senator REED. Mr. Parker makes an interesting suggestion here, that if you withhold, in the case of nonresidents, at the rate of 8 percent, the mere fact that we have transferred the second normal tax of 8 percent over into the surtax brackets should not be used as an excuse for letting nonresident aliens off easier.

Dr. MAGILL. I would be glad to make the change, if it can be worked out.

Senator REED. Why don't we simply disagree to those amendments.

The CHAIRMAN. Agree to it, with an amendment?

Senator REED. No.

Dr. MAGILL. No.

Mr. PARKER. This raises a legal point. There is some question about withholding at a greater rate than the normal tax but it does seem too bad we cannot do so. A lot of surtax probably ought to be paid on many of these dividends to foreigners which we never get.

The CHAIRMAN. Well, you want to disagree to the amendment?

Dr. MAGILL. I would like to ask Mr. Beaman about that. How about that? What is our difficulty with that?

Mr. BEAMAN. I understood the difficulty is, the Treasury did not want it because it involved thousands of refunds.

Mr. PARKER. Well, my suggestion would not permit refunds. I would withhold 8 percent, and keep it. That is where the legal point was raised.

The CHAIRMAN. The question of taxing a nonresident at a different rate than a citizen, or taxing an alien at a different rate than a citizen is a matter for the State Department.

Dr. MAGILL. Yes, that is right.

Senator REED. Then you will get into a lot of trouble.

Dr. MAGILL. Yes, that is the point.

Mr. BEAMAN. If you tax him at the same rate, it means a lot of refunds. The Treasury has always objected to it on that ground, I understand.

Dr. MAGILL. That is right.

Mr. PARKER. We don't under the present law, tax the nonresident exactly like the resident.

Mr. BEAMAN. No; we discriminate against him now.

Mr. PARKER. We disctiminate against him now, and since we withhold at 8 percent now, it seems we might continue to do so. We can show from our reports, that we did not intend to change the total burden of tax on our taxpayers by the change in normal rates, and the only reason that we cannot reach dividends to nonresident aliens is on account of the surtax.

The CHAIRMAN. Have you talked to the State Department about this proposition?

Mr. PARKER. No, sir.

Senator KING. I would feel that while I would like to get this tax, we are perhaps laying the foundation for a tax upon our American nationals, when we have investments abroad, if we discriminate against foreigners. The treaties, I suppose, give equal rights in the matter of taxation.

The CHAIRMAN. I suggest that we disagree to this for the present, suggesting to Dr. Magill that he take it up with the representatives of the State Department and endeavor in conference, to work it out with them. Let us see if we cannot do that.

Mr. BEAMAN. Do you want the nonresident alien to be taxed at a different rate than the citizen?

The CHAIRMAN. That was the suggestion of Mr. Parker.

Mr. BEAMAN. That won't be done by this amendment.

The CHAIRMAN. You suggest we disagree to the amendment?

Mr. BEAMAN. We have got to change the provisions relating to nonresident aliens. At the present time, when you tax a citizen 4 percent on the first 4,000, and 8 percent on the rest, the nonresident alien is taxed 8 percent on the whole amount, except that in the case of aliens resident in Canada or Mexico, a 4 percent rate is allowed on the first 4,000, insofar as it comes from compensation for personal services performed in the United States. At present, we are discriminating against the nonresident alien, and I have never heard the State Department say anything about it. Now, the proposition is, as I understand Mr. Parker's suggestion, to keep the present normal tax on the nonresident alien, and boost up his surtax along with our citizens'. Now, whether that goes so far that the State Department will protest, I don't know.

Mr. PARKER. I have another suggestion, which answers Mr. Magill's objection about refunds. I don't believe the refunds are going to amount to much, for two reasons. The first is, that the taxpayers won't bother to claim small refunds; and in the second place, I think that the Department could be strict as to those refunds. Possibly we could put something in the law to require the alien to present to us a copy of his income-tax return to his own country because the foreign citizen is really liable for surtax.

Dr. MAGILL. No; he is not liable to tax in this country, on his foreign income.

Mr. PARKER. No; but how do you determine a foreigner's tax, with part of his income in the United States, and part of it outside the United States?

The CHAIRMAN. Mr. Parker, why isn't it the best thing here, since you haven't agreed on the proposition and haven't conferred with the State Department, to pass this over and then later we can come back to it?

Senator REED. Do you mean, Mr. Parker, we can take the account of a nonresident alien, the foreign income, in any sense, in the calculation of his tax, or possibly tax him? I do not think we can.

Mr. PARKER. I wish we could. It measures his ability to pay.

Senator REED. I know, but that is clear out of our jurisdiction.

Mr. PARKER. At least we can add together all of his income in this country. It is not just a question of one dividend.

Senator REED. That is true.

The CHAIRMAN. I suggest you discuss that among yourselves. Let us proceed to the next matter.

Dr. MAGILL. Do you want me to take it up with the State Department?

The CHAIRMAN. Yes; you had better take it up first among yourselves, and come to some kind of a conclusion. And then you could take it up with the State Department.

Senator KING. First see whether the "jury" can agree before we go to the "judge."

Dr. MAGILL. I believe we were on the top of page 140, which again is a clerical change.

The CHAIRMAN. Yes, that is right.

Dr. MAGILL. Now, at the foot of page 145, and at the top of page 146, that subdivision is rewritten for the purposes of clarity, but I believe without substantial change.

The CHAIRMAN. Without objection then, it will be approved. How about subdivision (b)?

Dr. MAGILL. That is the revision of the stricken-out matter.

The CHAIRMAN. All right.

Dr. MAGILL. The next change of consequence is that on page 150, where the italicized words "and the surtax" were inserted. The purpose of that is to carry out the other idea with respect to rates.

The CHAIRMAN. Approved.

Dr. MAGILL. On page 151, the italicized matter is inserted to take care of the change which has been made in this bill, in the treatment of fiscal years, starting January 1, 1934.

The CHAIRMAN. We have not passed on that yet?

Dr. MAGILL. No.

The CHAIRMAN. So that will have to remain open. Shall we just keep that open?

Dr. MAGILL. Well, that would go in anyway, wouldn't it?

The CHAIRMAN. No; we did not settle that. That is the first part of the proposition, that is still open.

Mr. BEAMAN. That is one of numerous amendments. When you decide the major question of policy, it becomes a mere clerical matter to strike them out.

The CHAIRMAN. It has not been passed on.

Senator REED. In connection with the next section, 185, at the bottom of page 151, I have got a case of a company near Pittsburgh,

known as the Long-Knox Steel Co., which had an employees' trust. I dare say you gentlemen of the Treasury have heard of it.

Senator GORE. What is the name of the company?

Senator REED. Long-Knox Steel Co. It was organized by a couple of young Jews, who have been very successful in the steel business.

Senator GORE. They make specialties?

Senator REED. Yes, sir; they make dump cars and things like that. They have got up an employees' trust, by which they sold stock to their employees, and the employee put in money during a 5-year period. The corporation kept contributing some, and then the slump hit them. The present law requires an income tax on all that the corporation has contributed for their benefit during the 5-year period, yet the stock today isn't really worth as much as these people themselves have put in. They get absolutely no benefit out of these corporate contributions, and yet they have to pay a future tax on them. In some cases, the tax amounts to more than the present-day value of the stock. I am not asking the committee to act on it now, but when we come to the individual amendments, I have that to suggest.

Senator LONERGAN. What is the nature of that trust, Senator Reed? You mean all that they have paid into the business?

Senator REED. Yes. It is a stock corporation, subscription plan. There is no insurance, but for 5 years they have deducted a little bit of their pay.

The CHAIRMAN. Is it to prevent strikes up there?

Senator REED. These are mostly clerical and administrative officers, and I will have the figures. It works an injustice.

The CHAIRMAN. Dr. Magill, let us go back to the gas business. Senator Gore and Senator King are here.

Dr. MAGILL. That is on page 66.

The CHAIRMAN. Page 66.

Senator GORE. That is the 5 cents?

The CHAIRMAN. No. That mentioned oil, Senator, and some of them felt that you should be here when it was discussed.

Senator GORE. Yes.

Dr. MAGILL. There is a special provision of section 102 of the present law to the effect that in the case of a bona fide sale of mines, oil, or gas wells, the surtaxes which are to be paid by the seller shall not exceed 16 percent. By the same section the seller is also given the benefit of the capital gain and loss provisions, as included in the old law. In other words, if he had held the property for 2 years, the tax could be limited to 12½ percent.

Mr. BEAMAN. There is one distinction. The 12½ percent provision is 12½ percent of the gain. This is 16 percent of the sale price.

Dr. MAGILL. Yes; I should have made that clear.

The CHAIRMAN. It operates against the oil company?

Dr. MAGILL. To strike it out, operates against the oil company with respect to the sale of that kind of property. The original idea, as I understand it, was to encourage prospecting for oil wells and mines and the like, by giving the benefit of a lower rate of tax in the event of the sale of such properties.

Senator BARKLEY. Do you think something should be done at this time?

Dr. MAGILL. There is no particular reason for special treatment at this time, according to our theory.

The CHAIRMAN. That provision, without objection, will be adopted.

Senator GORE. What is this amendment?

The CHAIRMAN. The House struck it out, and we are just approving the House action. They have taken away a little privilege from the oil people.

Senator GORE. I think we could pass that for the present.

The CHAIRMAN. Very well.

Senator KING. Does it relate to anything but oil?

Dr. MAGILL. It relates to the sale of mines, oil or gas wells, or any interest therein.

Senator GORE. I do not get your question.

Senator KING. The Senator from Missouri and myself have some mines, and the Senator from Colorado. We want to know what effect that is going to have on mines.

Senator GORE. I do not know what effect that is going to have.

The CHAIRMAN. Mr. Parker, will you give them an illustration?

Mr. PARKER. Suppose I go out and prospect for oil, and after spending $50,000, I bring in a well, and the next day I sell that well for $1,000,000. Without this special provision of the existing law, I would pay on a gain in that case, of $950,000, and my tax would be approximately $500,000 at the regular normal and surtax rates. The existing law gives me the privilege not to pay over 16 percent of the total selling price, or $160,000 on that transaction.

Senator GORE. That is the existing law?

Mr. PARKER. Yes, Senator.

Senator GORE. You know, in the war, in the act of 1918, it was 20 percent.

Mr. PARKER. Yes; then we reduced it.

Senator GORE. To 16.

Mr. PARKER. In the later act.

The CHAIRMAN. But now you take it away altogether?

Mr. PARKER. Yes, Senator. It is felt that a man that spent $50,000 on an invention and sold it for a million dollars ought to be entitled to just as much relief. There was really no theory that would support this relief, except encouraging the discovery of oil wells and mines.

Senator GORE. On that point, I want to make this observation. I think there is a reson that marks out the oil business from other lines of business, because, to carry on the oil business, the so-called "wildcatter" is an indispensable factor. He is the pioneer. Big companies do not pioneer. They do not spend their money exploring. They do a little more now than they used to. They don't spend their money, as a rule, in wildcatting territory. They let Tom, Dick, and Harry go out and raise money amongst their neighbors, assembling a lot of acres and drilling a wildcat well. A lot of those come in dry, of course. Occasionally they hit oil, but when they hit the theory of this is to allow them to make enough out of the one hit to pay for the 3 or 4 dry holes they bring in looking for that.

I want to give you an actual case. Congressman Marland, who organized the Marland Oil Co., took a lot of leases in Oklahoma on school land. In fact, he took 20 leases, on 20 different parcels of land, agreeing to drill 20 wells. He drilled 19 wells, and got 19 dry holes. It cost him $500,000. On the twentieth and last well, he brought in a producer, and it was a good one. That was before this 20 percent tax we got through here in 1919 was passed, of course,

He sold the lease to a company that he organized. The tax on that well was nine hundred and some odd thousand dollars.

Senator KING. Did he sell it for cash, or just take stock?

Senator GORE. Stock, and that broke him. He paid $900,000. He borrowed the money and paid the tax. We had a lawsuit for 9 years over it. I represented him in the suit which reached the United States Supreme Court. We finally won, on the proposition that the income derived from a school-land lease by an oil company was not subject to taxation. He escaped that part of the tax.

Senator CLARK. But if all of his leases had been obtained from private individuals or corporations, he would have had to pay the whole tax?

Senator GORE. Yes; but it was really a sale from himself to a company he organized, or a sale from himself to himself. He paid a $900,000 tax. He had to borrow the money. We contested that, but the court held that that was not exempt from taxation. That is the sort of case that this proposition is intended to relieve against. This is not 16 percent of the profits. It is 16 percent of the selling price. In that case it would have been $170,000 or $180,000, and he would have been able to continue. He lost the control of his company. It broke him, and he is broke now. Now, there isn't any other industry that is like that.

Senator REED. Oh, yes, Senator Gore. Professor Fessenden worked for 20 years on the invention of the wireless telegraph and never got a penny out of it until the end of the 20 years.

Senator GORE. I know. Maybe he made a dozen experiments. One of these oil wells costs anywhere from $25,000 to $125,000; but he could make his experiments without any such outlay of money.

Senator REED. Similarly, Cass Gilbert, an architect worked for years on the Woolworth Building in New York, getting his fee all in 1 year. He had to pay 63 percent on it. Those cases are all alike.

Senator GORE. Now, to get personal, I was in that suit myself, in the case I spoke of, 9 years. The firm won it and I got my fee. It wasn't much, but I got it in one year. I had to pay on the entire fee.

Senator REED. And if the thing were worked out justly, you could apportion it over the 9 years.

Senator GORE. That should have been done.

Senator REED. It is like these installment sales.

Senator GORE. It should have been done, but there is a difference, in fact, between this and other industries, as a rule, and I think that difference in fact ought to be taken into account.

The CHAIRMAN. Well, that was why it was first established, I should imagine, Senator.

Senator GORE. Yes, that is exactly why it was done.

The CHAIRMAN. I imagine the Treasury Department feels that the pioneering in the oil business is a thing of the past and that the emergency is over.

Senator GORE. I will say this, concerning the original act. I offered an amendment myself, and the original provision was limited to the sale of discovered properties, and I think you should put in that provision here. Let this stand, with the provision that this concession shall be extended and enjoyed only in the sale of discovered properties.

Senator REED. That is already in, Senator.

Senator GORE. Is it?
Senator REED. Yes. It says:

Where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer,

Senator GORE. Well, I had assumed that had gone out. Now, gentlemen, I think it should stay in.
Senator WALSH. You want the present law?
Senator GORE. Yes, sir.
Senator WALSH. With that in?
Senator GORE. Yes, sir; it ought to stay in the law.
Senator WALSH. Is that in the law now?
Dr. MAGILL. Yes, sir.
Senator GORE. When these fellows go out and spend their money, we should not make them the victims of the big companies. When an oil man brings in a well, he generally does it on capital that he has recruited from among his neighbors, the principal thing that he contributes being his personal time and effort. These big companies regulate the price, boosting the price and making him sell out for almost any price they are supposed to pay. Now, if when he does that, he has got to pay this enormous tax, I do not see any object in it. I thought that provision had gone out, in the intervening 10 years, but limiting it to discovered properties. I think that ought to stay in. It helps these little fellows who are wildcatting out there on the border. They are carrying the business forward. The wells they drill are expensive.
Senator REED. What about an inventor, Senator?
Senator GORE. I am not arguing against the inventor. The royalties of his invention, the Supreme Court held here a few years ago, are exempt from taxation.
Senator REED. I did not know that.
Senator GORE. Yes, sir.
The CHAIRMAN. Is that right, Mr. Parker?
Mr. PARKER. I did not think so, unless there are some peculiar facts. I don't recall the case.
Mr. STAM. They held in the case of royalties from the use of patent rights, I believe, issued by the Federal Government, that they were not subject to State taxation (*Long* v. *Rockwood*, 277 U.S. 142).
Senator GORE. Yes; that is it.
Mr. STAM. But later on, they reversed that decision.
Senator GORE. Is that so?
Mr. STAM. In another case.
Senator GORE. It was a Connecticut case?
Mr. STAM. No; a Georgia case (*Fox Film Corp.* v. *Doyal*, 286 U.S. 123).
Senator GORE. In which they held they were exempt?
Mr. STAM. No; the second decision held them taxable.
Senator GORE. On royalties from the carborundum invention. I had a vague impression it was overruled, but I was not sure.
Mr. STAM. Yes; it was overruled.
Senator GORE. It was?
Mr. STAM. Yes.
Senator KING. We are interested in this, I will say very frankly, especially since the ruling of the Treasury with respect to gold. In

the West, hundreds and thousands of men, who have been for some time out of employment, would organize a little copartnership. They were not corporations, and their friends would grubstake them. Perhaps 10 or 15 or 20, sometimes only 1 or 2, would go out in the mountains and work and toil and suffer incredible hardships, and some of them have found little gold properties and silver properties and lead properties. Now, when they have found them after these hardships and risks—perhaps 1 out of 40 groups will find anything—then they have organized a corporation. The people that had been grubstaking them would take their interest, and perhaps they might sell it to one of the smelters or to one of the large mining companies. What protection do they have if they sell? Would they have to pay a tax and if so, how much?

Dr. MAGILL. If the provisions of this bill go through, they would come under the provision for the taxation of gains from the sale of capital assets, I presume.

Senator KING. What would be the gain there? Would it be the entire value of the property, the selling price?

Dr. MAGILL. It would depend. Under the terms of that provision, it would depend on how long they had held the property.

Senator King. Oh, they have just held it here within 2 years.

Dr. MAGILL. One hundred percent.

Senator KING. Or 1 year.

Dr. MAGILL. They would be taxed on 100 percent of the gain, subject to the regular surtax rates. Now, the general feeling of the Treasury about it, I think, is this: That so far as oil wells are concerned, as you already know, we are confronted now with overproduction, so we are not interested any more, really in pushing the frontiers forward in order to bring in additional wells.

Senator GORE. Not at the moment; that is sure.

Dr. MAGILL. Not at the moment. I do not know about the mining situation.

Senator KING. The Treasury is apparently very anxious to get gold, since they are paying a premium.

Dr. MAGILL. I doubt whether there is such a broad possibility of large profits in the case of mines as there might be in the case of oil wells.

The CHAIRMAN. Well, why can't we pass this over? The Senator from Oklahoma seems to be insistent about this matter.

Senator GORE. I want to make this suggestion. I think it is fair to the committee. I offered this before, and I think the Treasury construed it too liberally. I will say that very frankly, because it was intended originally to benefit the man who brought in a discovery well on a structure, and I think the Treasury Department allowed other people having adjacent leases to claim the benefit of it. Now, I think if that regulation has not been modified it should be, so that it should apply to only one discovery on property on a single geological structure. I would not object to limiting it to an acreage not exceeding 160 acres, because a man might have a $1,200 lease. Of course, in theory, you would apply that to the whole, but out in our country, they usually run 160 acres, and I would not seriously object to putting it back to 20 percent. That was the original provision.

Senator WALSH. Why don't you ask the Treasury to prepare an amendment for you, Senator?

Senator GORE. I will suggest they fix it so that Tom, Dick, and Harry, three men, cannot claim this benefit at the same time on the same structure, because that never was the intent.

Mr. PARKER. You mean, Senator, you are only going to allow one discoverer in a pool?

Senator GORE. Yes; that is it, on one structure; yes, sir.

The CHAIRMAN. But, Senator, you do not desire to go back to the old 20 percent. You desire to leave it at the 16 percent.

Senator GORE. I would rather have it 16, yes.

The CHAIRMAN. How?

Senator GORE. I would rather have it 16.

The CHAIRMAN. Sixteen? That is what is in the present law, isn't it?

Dr. MAGILL. Yes.

Mr. PARKER. No, under the present law, you might have 50 people get the advantage of this.

The CHAIRMAN. I understand.

Senator GORE. That never was intended.

Dr. MAGILL. But the law is 16 percent of the gross.

Senator GORE. I offered the amendment myself. That was not my intention, and if you will just bear with me for a second, a person who worked in the Treasury Department came to me. He was going to make a speech before some national tax association in Madison, Wis. He prepared a speech and brought it to me to O.K. it, and to say that when I offered it, I intended that these other people on the structure should have the benefit of this provision. I would not do it, because it was not the fact. I had no such intention. It was for the real discoverer on a single structure, and there never was any reason for extending it to anybody else, and I think still the language should be fixed so it would be limited.

The CHAIRMAN. Without objection, we will pass that for the present and the experts can get up an amendment that Senator Gore desires to offer, carrying out that idea.

Senator GORE. That will be all right.

Senator KING. I want the experts also to take into account the suggestions I have made to protect these pioneer men, who are endeavoring to discover gold metal mines.

Senator WALSH. What is next, Mr. Chairman?

The CHAIRMAN. What is the next page?

Dr. MAGILL. Shall we go back?

The CHAIRMAN. What is the matter with taking up the Capital Gains and Losses now?

Senator REED. All right.

Mr. PARKER. I think it would be a good plan. We went over Capital Gains and Losses in a general way the other day. Perhaps it would be simpler if we would put it on the blackboard.

Senator REED. What page is it on, in the bill?

Mr. STAM. Page 113.

Mr. PARKER. I have put some figures on the blackboard that will show how this capital gain and loss provision proposed in the bill will be computed. In the first column we have listed the name of certain items, corporation stock, bonds, Government bonds, real estate, and profits from short sales on the stock market. On the first item we have a gain in a transaction in capital stock of $5,000, if that

stock has been held for 9 months, then the gain we take into account is 100 percent of that or $5,000 gain.

Now, the second item is on bonds. We assume that we have a $4,000 loss. If the time held is 1½ years, the bracketed rate is 80 percent and the loss taken into account is 80 percent of $4,000 or $3,200.

On the third item, Government bonds, we have assumed a gain of $1,000. The bonds have been held 2½ years. We only take 60 percent into account, or a gain of $600. In real estate, we have taken a loss of $3,000. We have held the real estate for 6 years. Only 40 percent of the loss is recognized, and it amounts to $1,200. We have a gain from short sales of $2,000. We take 100 percent into account or a gain of $2,000.

Senator WALSH. What do you include in short sales?

Mr. PARKER. The term "short sales" is the technical expression used on the market, where a man sells something he hasn't got. He is a borrower of stock.

Senator REED. Where is your definition of that in the bill?

Dr. MAGILL. On page 115, subdivision (e).

Senator BARKLEY. Is that blackboard illustration taken from the law as it is written?

Dr. MAGILL. This is under the amendment.

Mr. PARKER. This is the new amendment.

Senator REED. Now, just let me interrupt you gentlemen on that short sales business. If you were on a steamer or traveling in Europe, and you wanted to sell something you had locked up in a box in America, the only way you would do so would be, technically, by a short sale. It is a perfectly bona fide transaction. You would deliver your own stock the moment you got home and could get it. If one of us here cannot get to his home, he makes a short sale, sells something that he has locked up in his safe-deposit box back in his home town. It is a perfectly legitimate transaction. It is not a gambling affair at all; and yet your definition is broad enough to include it.

Mr. BEAMAN. All the definitions, Senator, say that the gain or loss from the transaction is the question of loss from the sale.

Senator REED. No. It says it shall be deemed to be held for 1 year or less.

Mr. BEAMAN. I said, Senator, we had an amendment proposed for that, and the amendment is proposed to take out that 1-year proposition so far as short sale is concerned.

Senator REED. That is all right. I am not a mind reader.

Senator CLARK. What is that amendment you are going to propose?

Mr. BEAMAN. That the paragraph be amended so that we simply say, for either short sales gains or losses, they shall be considered gains or losses on capital assets, without undertaking to say over what period.

Senator REED. You take a gamble and short-sell. Of course, the man only holds the property while he is making his delivery. He is clearly within the 1-year provision.

Mr. PARKER. We have attempted to fix that.

Senator REED. I think that would fix that.

Mr. PARKER. Now, to continue with this case. When we total the gains taken into account, we get $7,600, but the loss taken into

account is $4,400, the difference between the gains and losses, $3,200, will be taken over into net income and subjected to the normal tax and the surtax, just as if the $3,200 was ordinary income. Now, this result, of course, differs from what would occur under existing law.

Senator KING. Most of those transactions have been completed within the fiscal year, or the taxable year, rather.

Mr. PARKER. They have been completed in the taxable year. The thing that governs, of course, is the date of sale or the exchange.

The CHAIRMAN. Now, Mr. Parker, why can't you give us that under the present law, just to give us the difference?

Mr. PARKER. Well, under the present law, if this was the entire net income of the taxpayer, there would be a $1,000 gain.

Mr. BEAMAN. No; you mean the little fellow.

Mr. PARKER. Yes; if this was his entire net income, that is, if he did not come within the 12½-percent provision, then he would be taxed on the difference between his losses and his gains, and he would be taxed only on $1,000 instead of $3,200, so, of course, in this particular case we would get more tax. However, if he had a lot of outside income and was in the higher surtax brackets, then all the Government bonds and real estate at least would be under the capital gain and loss provision, and there would be a net loss of $2,000, which would be subject to the 12½-percent loss limitation, which, of course, would increase his tax, inasmuch as the short-term gains would be taxed in full.

Senator BARKLEY. Mr. Parker, let me ask you this, now, to complete the illustration while you are on it: If you reverse those figures and give him $4,400 net gain, and $7,600 net loss, and you subtract the one from the other and get $3,200 as a loss for the year, you would make no allowance; he cannot claim that?

Mr. PARKER. That is right. That is what I was going to do next. Just suppose these gain and loss columns reversed, in both instances; then under the bill, the new plan, you would work it out in the same way, only, of course, in this case the losses would be $3,200 in excess of the gains, and that $3,200 would be disallowed as a deduction from other income.

The CHAIRMAN. Well, now, reverse that under the present law and what result do you get?

Mr. PARKER. Under the present law, in the first place, we have a limitation in section 23 (r) that limits 1-year losses in stocks and bonds to 1-year gains. Now, we have a gain of $4,000 on bonds and a loss of $5,000 on stocks, and a loss of $2,000 on the short sales; so that we would have a total loss, and an excess of losses over gains on 1-year transactions of $3,000.

Senator REED. No, no; your bonds have been held over 1 year. You would have $7,000 of nonallowable.

Mr. PARKER. No; it is a 2-year limitation under the present law. I used the term "1-year transaction" to designate transactions of less than 2 years.

Senator REED. Oh.

Mr. PARKER. Under the present law the limitation applies to stocks and bonds held for not more than 2 years; so that under the present law, you have got a disallowed loss of $3,000. Therefore, what we have left would be a capital net gain of $2,000. Under the

existing law, your $3,000 loss on your short-term transactions cannot be charged off against your ordinary income or against your capital gain and you would be taxed on a capital gain of $2,000 under the existing law. This would be a case where the new law would be better than the old—old as far as the taxpayer is concerned.

Senator BARKLEY. According to that set-up, just looking at it in a common-sense, curbstone way, the result is that the Government approves of these so-called "gambling" transactions to the extent that if you gain, the Government wants more of it. If you lose, the Government frowns on it, and makes you no allowance at all. Isn't that about the way it is?

Mr. PARKER. We give a man 100 percent of his loss on his gambling transactions if he has got any gains to charge it off against.

Senator BARKLEY. But he has got to make some gains in order to get a credit for it. If he has had a loss, he has got to keep dipping in so he can get a gain, so he can offset his gain at the end of a year.

Mr. PARKER. That is true, Senator, in a general way. I have just pointed out that under our proposal in this case, where there is a net loss, the taxpayer would lose the opportunity to credit this $3,200 of excess loss against his other income, but it is certainly much fairer than the existing law which would tax him on a profit of $2,000, although he really has got an actual loss. It seems to me that this is a good case to show that our new method is to be preferred over the old rule. It is hard to justify a tax when you get a loss.

Senator BARKLEY. Suppose he has not been dealing in all those different items, capital stock and bonds, and Government bonds, and real estate and short sales. Just suppose he has bought and sold, whether it is stocks or whether it is real estate. Of course, you haven't got a combined list. You have got one simple transaction where a man has tried to make some money buying and selling. We will assume he has not sold short at all.

Mr. PARKER. One transaction in the year?

Senator BARKLEY. No; not one simple transaction, but a series of the same kind of transactions, so that there is no complication of the figures. Under the present law, he can offset his losses under certain circumstances against his ordinary income?

Mr. PARKER. Not if they arise from transactions in stocks and bonds, all in one year.

Senator BARKLEY. Well, if they are short transactions within a year?

Mr. PARKER. No; if those transactions are in stocks and bonds, he couldn't charge any excess of losses he had on the aggregate of his transactions against his ordinary income.

Senator GORE. That is under the act of 1932?

Mr. PARKER. That is correct.

Senator WALSH. What principle did you apply in reaching the percentage 80, 60, and 40?

Mr. PARKER. The general principle behind the percentages is that the tax ought to approximate what the tax would have been if the gain had accrued rateably over the period for which the asset has been held. The surtax increases in the case of a gain, by realizing the profit all in one year, when as a matter of fact, it may have accrued over a series of years.

Senator WALSH. In other words, the total tax for the period of 6 years would be equivalent to what the tax should be, levied upon the gain of each year, on that increased value?

Mr. PARKER. That is the principle adopted, Senator. Of course it doesn't work out just that way mathematically. We considered a large number of cases, and tried to arrive at what was fair. It was the Treasury's view that the percentages shown in the bill were proper, I used a similar basis in the case of the subcommittee report, and I got slightly different results.

Senator WALSH. How much increased revenue does the Treasury expect to get?

Mr. PARKER. We expect to get about 30 million dollars. This is one of the major changes and amounts to a substantial item.

Senator WALSH. Is there any opposition to this, Mr. Chairman?

The CHAIRMAN. I do not think anybody understands it.

Senator WALSH. I mean, are there any letters of protest?

The CHAIRMAN. No.

Mr. PARKER. So far as the law itself is concerned, while this looks more complicated at first sight, it is really less complicated than the existing law. If you have an income around 16 to 30 thousand dollars, with this 12½ percent provision, you have got to make two complete computations of your tax to see whether or not you want to use the 12½ percent provision. In the case of a gain, it is optional with you, but, of course, you want to figure it out and see which one will produce the least tax. In the case of a loss, you must also make two computations.

The CHAIRMAN. Why do the banks raise an objection to this proposition?

Mr. PARKER. Well, the banks want to be exempted from this provision because they claim their business is not speculative, they have divorced themsleves from the security companies, and almost all of their transactions are what they call "dollar transactions." They hold obligations on which they will get face value or else a loss. They have a mortgage for which they will get face value or a loss, and they very rarely make a profit, except the profit represented by interest. They claim, in other words, that their profits on their investments are negligible and that they always have losses. That matter was not presented to the Ways and Means Committee in the public hearings. A subcommittee did hear a representative, I think, of the First National Bank of Boston, in executive session, but it was about 1 or 2 days before the bill passed the House, and they did not feel that they had time to go into an amendment there. As to what the sentiment of the committee was, I could not accurately judge, but believe it was not especially unfavorable.

Senator REED. I think the bank's case is particularly strong where they call attention to the fact that they buy bonds at a premium, understanding that that gives them such and such an interest basis, and then they are not allowed under this to deduct the loss of that premium when the bond is finally redeemed at par. That is certainly a good case for the bank.

Senator WALSH. Was that representative Mr. Stockton? Do you remember his name—the representative of the bank?

Mr. PARKER. I do not exactly recall the gentleman's name. I think it was Denio.

Senator WALSH. He is one of their experts on tax matters.

The CHAIRMAN. If this should discriminate against the banks in view of the situation all over the country, would it be possible to make an exception in that case?

Senator WALSH. I think they have presented some amendments, if I recall now, and I have had some correspondence with them, some moderate amendments.

Senator REED. Some insurance companies?

Mr. PARKER. We never did tax life insurance companies on capital gains.

Senator REED. You do tax fire insurance companies, though?

Mr. PARKER. Fire insurance companies, yes.

Senator WALSH. We might submit that correspondence to the Treasury and see what they say about this amendment.

The CHAIRMAN. I want to read a memorandum on this to show the viewpoint on this thing.

Mr. PARKER. I do not think that the committee wants to make an exemption which would cost any substantial amount of money, but I do not think it would cost very much money to exempt banks. I did not figure that the banks would get caught very often by section 117 on account of their tax-exempt income, but once in a while they will get caught, and when they do, this will hurt, of course.

The CHAIRMAN. You think this is a simplification of the present law, do you?

Mr. PARKER. I think it will be when people get used to it.

The CHAIRMAN. What do you think about this, Dr. Magill?

Dr. MAGILL. Well, we went over this, in the general provision at the time it was presented to the House, and it was not our original recommendation, but came in with others from the subcommittee.

Senator REED. The joint committee recommended it several years ago.

Dr. MAGILL. I believe they did.

The CHAIRMAN. Did the joint committee recommend this particular proposition, Mr. Parker?

Mr. PARKER. Yes, I think I made a report on this in 1929, with the same basic idea.

Senator GORE. That was the 10-year program, though, wasn't it?

Mr. PARKER. Yes, it had more brackets and it recommended no tax on gains and no allowance for losses after 15 years.

Senator GORE. Is one of your reasons, Mr. Parker, for changing it that the 10-year period makes too many brackets and too many changes?

Mr. PARKER. Well, at this time it was a question of the revenue to be provided.

Senator GORE. Of course the 10-year period got away from taxes entirely after 10 years.

Mr. PARKER. Now we want to get as much revenue as we can but I think perhaps the original proposal was fairer to the taxpayer than this proposal.

Senator GORE. Yes, I think so too.

Mr. PARKER. However, we cannot go too far in being fair at this time, with the very small revenue that we are obtaining from the income tax.

Senator GORE. We have just got to be fairly fair at this time.

Mr. PARKER. And the very great need of the Government for revenue must be taken into consideration.

Senator GORE. Now, let me ask you about this bank business. Is one of the reasons underlying their desire for exemption, that, when they have a collateral loan, it would apply to this, and they have to sell the securities and take a loss on them; whereas there is never a gain on that sort of transaction because they would not sell the securities? If they were worth more than the loan, there couldn't be a gain, and, if there was, it would go to the borrower instead of to the bank.

Mr. PARKER. That is right. In the case of a collateral transaction, though, some complications arise. I am rather inclined to think that most of those transactions divide themselves into two parts—one part of the loss would probably be a bad debt and the other part a capital loss.

The CHAIRMAN. Would the committee like to hear just a brief statement from the American Bankers Association on this to give their viewpoint?

Senator COSTIGAN. Certainly.

The CHAIRMAN. So then we can get the reaction here of Dr. Magill and Mr. Parker. It says:

Referring to H.R. 7835, known as the "Revenue Act of 1934", our attention has been drawn to the provisions of section 23, subsection J, Capital losses on page 21, which refers to section 117 (d), Limitation on capital losses, which states: "Losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges."

In examining this bill our attention is also drawn to subsection (b) of section 117, "Definition of capital assets", the definition of which raises the question in our minds as to whether the House bill as now drawn would exclude securities held by a bank for investment as distinguished from securities held for the purchase by or sale to customers. As member banks of the Federal Reserve System are prohibited by the Banking Act of 1933 from continuing the practice of selling securities, to the public, except in the case of Government, State, or municipal securities, it would seem that under the provisions of the bill as now drafted, banking institutions could only deduct losses sustained from the sale of stocks or bonds to an amount equal to their profits from the sale of like securities.

If our interpretation of this bill is correct, we desire to respectfully request that your committee give consideration to this phase of the bill which is now under consideration by your committee.

The Revenue Act of 1932, under section 23 (r) provides as follows:

(1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

(2) Losses disallowed as a deduction by paragraph (1) computed without regard to any losses sustained during the preceding taxable year, shall, to an amount not in excess of the taxpayer's net income for the taxable year, be considered for the purposes of this title as losses sustained in the succeeding taxable year from sales or exchanges of stocks or bonds which are not capital assets. (This paragraph was repealed by the National Recovery Act of 1933.)

(3) This subsection shall not apply to a dealer in securities (as to stocks and bonds acquired for resale to customers) in respect of transactions in the ordinary course of his business, nor to a bank or trust company incorporated under the laws of the United States or of any State or Territory nor to persons carrying on the banking business (where the receipt of deposits constitutes a major part of such business) in respect of transactions in the ordinary course of such banking business. (All the language after the word "Territory" was repealed by the National Recovery Act of 1933.)

It will be noted that paragraph (3) of subsection (r) of section 23 of the Revenue Act of 1932 provides that banks and trust companies incorporated under the

laws of the United States or of any State or Territory are exempted from the provisions respecting capital gains and/or losses.

Banking institutions buy for their own account securities for long term investment and in the course of examination by Federal authorities, such as examiners of the Comptroller of the Currency, Federal Reserve examiners and examiners of the Federal Deposit Insurance Corporation, as well as examinations conducted by the State Banking Commissioners, are required to write down the depreciation in their securities account which, at the direction of such examining authorities, are actually charged out of the assets of the banks. This procedure is necessary in order that the true financial condition of the institutions can be ascertained and is in the interest of sound banking.

It is true that where depreciation in securities is charged off losses can only be taken through actual sales in these securities which heretofore have been allowed as deduction against gross income without limitation as to profits from like source. In this respect, we believe the principles contained in the provisions of the Revenue Act of 1932 should be continued in the Revenue Act of 1934, as it seems only fair that where banking institutions are required to make these charge-offs by the Federal or State authorities they should be permitted to take these deductions from gross income without reference to capital gains from like source, as it is not for the purpose of evading tax that these charge-offs are made but in the interest of sound banking and in order that Federal and State authorities may determine the true financial condition of the institutions. We believe also that it might have a detrimental effect upon the Government bond market, as practically all Government issues are selling at a premium and such premium, being amortized in accordance with sound practice, could not be deducted from gross income.

We are not aware as to whether you have received comments on this provision of the House bill from the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the State banking authorities, or the Reconstruction Finance Corporation, which is now a larger owner of the capital of banks in the United States. It is our belief that the Government has made much progress toward strengthening the capital structure of the banks in this country and to deny banks the right to deduct these losses from gross income would have a retarding effect upon the continued strength of the capital structure of the banks and would seem to be contrary to the expressed intention of the Government.

Assuring you of our appreciation of your careful consideration of the points involved in this communication and that if there is any further information you would like us to furnish on this subject we shall be happy to comply. I remain.

The CHAIRMAN. Shall I turn that over to you, Mr. Parker, for your consideration?

Mr. PARKER. I will be glad to study it, Senator. There is a new proposition here, though, as I understand it, that the banks want to be allowed to take off losses on these stocks and bonds before they sell them.

Senator REED. Oh, no.

Senator WALSH. Oh, no.

Mr. PARKER. I thought you read something about that.

Senator WALSH. No; you're mistaken.

Mr. PARKER. Well, they stated something about losses required by the bank examiners.

Senator WALSH. The intimation is they might be forced to do that if this law were to go into effect.

Mr. PARKER. Oh, I see.

Senator WALSH. The fact that they are charged off might force them to. Why shouldn't a bank or a company dealing in securities, like the First National Bank of Boston, which handles a tremendous percentage of all the municipal, State, and national bonds, sells them to other banks all over the country, why shouldn't they be treated as a separate business? What it receives in profits, put to its gross income, and what losses it sustains in the total transactions of the

year, charge against its income. Why should they have to make gains and losses on their every single transaction?

Mr. PARKER. Do I understand you, one bank has the——

Senator WALSH. In Boston. A very interesting question arises now, if they are not able to continue after the 1st of July, there won't be any known established banking institution in this country that makes a specialty of handling Government, State, and municipal bonds.

Mr. PARKER. I thought the security companies had to be divorced from the banks as of July 1.

Senator WALSH. As of July 1, and there is a bill here which the Treasury is going to approve, asking for an extension of time, because it has been impossible for it to do it, but if that company has to go out of businesss, there will be no central agency in this country which specializes in the handling of Government bonds.

Mr. PARKER. What I understood, was being asked for, was that the national banks and trust companies, which would not be affiliated with the securities companies, would be exempted from the operation of the new capital gain-and-loss provision. If they have a security company that perhaps used to be affiliated with a bank, but is now separate, those companies can, plainly in my mind, qualify as dealers in securities.

Senator WALSH. Yes.

Mr. PARKER. They will report on an inventory basis, and the capital gain and loss provision, as now written, does not apply to dealers in securities; so I think we would be all right in respect to a security company or a company dealing exclusively in bonds.

Senator WALSH. Do you mean this tax would not apply?

Mr. PARKER. Not to a security company formed on that basis.

Senator WALSH. The letter the chairman read seeks to make that principle apply to all banks, if I understand it.

Senator REED. That is right.

The CHAIRMAN. That is right.

Senator WALSH. I think there is a distinction between dealing in securities solely as a loan as a separate business, and banks buying and selling securities.

Mr. PARKER. I am inclined to think it is better to exempt the banks than to have a bank go on an inventory basis, which would be very difficult on account of the different classes of property held by banks. That is my reaction.

Senator REED. His letter is a little obscure about the business of actually registering losses, but I do not think he attacks the important changes in that in reading it over the second time.

Mr. PARKER. Yes, Senator; that is my understanding.

Senator REED. In other words, in view of that fact, Dr. Magill, we would ask you what the Treasury thinks about it?

The CHAIRMAN. Let me ask, why don't you gentlemen take these letters and the other letters that have come to the committee with reference to this subject and consider them, and give the committee your reaction, because that is a very important proposition.

Mr. PARKER. Well, we have considered the matter. I have had a number of talks with some of the representatives that appeared in Executive Session of the Ways and Means Committee.

Senator COSTIGAN. What is your recommendation, Mr. Parker.

Senator WALSH. Well, first of all, this letter suggests that you talk not merely with the Treasury, but with those agents of the Government that are holding stocks of these banks, and the effect it will have on the value of the Government stocks, as I understand it.

The CHAIRMAN. Yes, the Reconstruction Finance Corporation, for instance.

Senator WALSH. Yes.

Mr. PARKER. I think the banks are in a different class from the ordinary taxpayer. I think that their losses will always exceed their gains, if they are conducting legitimate transactions in connection with the regular banking business. That is the history, even in 1928 and 1929, the losses of the banks exceeded the gains, because of the fact that they were dealing in dollar obligations. If they get their loan back, they get it back 100 cents on the dollar. They never get any more, but they may take less, and they do take, everybody knows, substantial losses, if they are going to loan to industry.

The CHAIRMAN. Of course, I really think that a bank—I know in my State, a bank has to pay proportionately more State taxes than any other institution, because they have to pay on the capital stock and surplus and undivided profits, and the average fellow owning property, you know, puts it in at about a third or a fourth, and he pays on that basis, so they pay on full value, so far as the State is concerned.

Senator BARKLEY. Mr. Chairman, would it be possible to take the sense of the committee on this capital-stock provision as it is written, subject to any exception that might be recognized?

Senator REED. Let us first hear from Dr. Magill and see what the Treasury thinks of it.

Senator WALSH. Yes.

Dr. MAGILL. I will state it very briefly. Our general position is that we are agreeable to the provision as it is now drawn. It is some simplification of the present law. I think there is no doubt about that, although I am sure you do not think so after this morning, but it would actually work out, and I think it pretty clearly is.

The main points that the Treasury has been interested in are these: In the first place, we are quite clear that gains from selling capital assets should be subjected to taxation, and we cannot afford to let that source of revenue go. In the second place, our experience has been in the last few years that losses from the sales of capital assets must be put into a separate category along with the gains from such sales, or otherwise the income tax will be enormously reduced, and both of those things are accomplished here, consequently we are agreeable to the provision as it is drawn.

Senator CONNALLY. Doctor, let me stop you right there. The last thing you suggested, if they do not balance the one against the other, there would be a lot of losses. Unless we do what you suggest, you will continue these bases we want repealed, where men had very large incomes from a member of other sources and yet they absorbed it all in this kind of losses, and consequently paid no tax at all, although they did in fact, have very large incomes.

Dr. MAGILL. That is true.

Senator CONNALLY. Unless you do what you suggest now, wouldn't that continue?

Dr. MAGILL. That is right; it would.

Senator REED. I am sorry to delay you, but there is something here that is really important, Dr. Magill, this 12½ percent tax which we permitted, at the taxpayer's option on gains from assets held over 2 years, proved, in practice, to be beneficial only to the taxpayers with the larger incomes, did it not?

Dr. MAGILL. That is true.

Senator REED. The little fellow with, say, 20 or 30 thousand dollars income, got no advantage whatever from that?

Dr. MAGILL. That is true. It gave him nothing.

Senator REED. Now, one advantage of this method is that it gives a proportionate advantage to the little fellow as well as the big fellow, doesn't it?

Doctor MAGILL. That is true.

Senator REED. I think it is important to keep that in mind in contrasting the two systems. There is another thing, however. We found that that 12½ percent tax did loosen up capital transactions immensely, didn't we?

Doctor MAGILL. I don't know whether we did or not, Senator. It is usually hard to tell in view of the great changes in business which have occurred in the last few years, to tell whether tax had any effect, or whether it was other things that had an effect.

Senator REED. It was a peculiar coincidence that when we adopted this 12½ percent rule, the revenue went up.

Dr. MAGILL. I believe that is true.

Senator REED. Now, you take the taxpayer with the largest income, whose tax is 63 percent normal plus surtax, under this new bill, at the very best, if he wants to sell a long-held capital asset, he has got to pay 63 percent on 40 percent of his profit.

Dr. MAGILL. Pay approximately 25 percent?

Senator REED. He pays approximately 25 percent, so we are doubling the tax on the big taxpayers, who make capital gains from long-held assets.

Dr. MAGILL. That is right.

Senator REED. If you put another bracket in there of 20 percent, you would leave the tax where it now is, and if this present tax is a beneficial thing, as some of us think experience has proved here, we would continue that benefit by putting in the 20 percent provision for assets held a long time, and we, at the same time, would give the little taxpayer a proportionate advantage, wouldn't we?

Dr. MAGILL. You give the taxpayer below the very top bracket a very large advantage if you reduce it to 20 percent.

Senator GORE. How is that? I did not understand that you said.

Dr. MAGILL. Well, what I said was this: If the present brackets give that amount of capital gains and losses which are to be taken into account in the 40 percent, that means——

Senator WALSH. In longer than the 5 years?

Dr. MAGILL. Yes, sir. That means that if the taxpayer is in the highest bracket, which is 63 percent at the present time, it works out that he would actually pay approximately 25 percent tax with respect to a capital gain. Now, Senator Reed's suggestion is that an additional bracket should be added with respect to assets held more than 8 years.

Senator REED. Or 10 years.

Dr. MAGILL. Or 10 years. This bracket would be 20 percent. Well, the effect of that, then, would be that with respect to the man in the top bracket, his tax would, in fact, be 12½ percent on the capital gains.

Senator WALSH. If he held it over this period?

Senator REED. If he held it over 10 years.

Dr. MAGILL. If he had held it over that period.

Senator REED. Changes him to a new basis, if he holds it over 2 years.

Dr. MAGILL. That is true. It meant that the man, so far as the $10,000 income or transaction is concerned, would pay a very small tax indeed.

Senator REED. In other words, it would benefit the little fellow, who can't pay that, the present 12½ percent. That is right?

Dr. MAGILL. It would.

The CHAIRMAN. What do you think of that, Mr. Parker?

Mr. PARKER. I was looking up another matter in respect to Senator Reed's question. Will you please repeat the question?

The CHAIRMAN. Well, he suggested to make another bracket, to the "40 percent if the capital asset has been held for more than 5 years", to say "20 percent if the capital asset has been held for 10 years." That would cut it down to 12½ percent now if the fellow holds it over 2 years.

Senator REED. I might say that that was the recommendation to the subcommittee over in the House.

Dr. MAGILL. Yes; that is true.

Mr. PARKER. Of course, I felt that we were pretty unfair in this new provision and that we should approach the British system. The proposed system is much more severe than the British system.

Senator GORE. Much what?

Dr. MAGILL. The proposal is much more severe than the British system.

Senator GORE. They don't have any.

Mr. PARKER. This 20 percent bracket would help a man, of course, if he had a long-term gain, it would give him a lower tax. On the other hand, the Government would gain in case he had a loss.

Senator KING. What is the understanding on this? Senator Reed's proposal or the other basis?

Dr. MAGILL. Senator Reed's is a suggested change.

Senator KING. Yes. I know that, but I was wondering.

Mr. PARKER. My original recommendation to the subcommittee was 20 percent, so I have already committed myself.

The CHAIRMAN. Why did the full committee override the subcommittee's recommendations with reference to that?

Mr. PARKER. The Treasury had two arguments: First they thought it would produce more revenue, and second they thought it would be more consistent.

Senator REED. But the Treasury forgot that this cuts it both ways and that you cannot register off big losses on property held over these long periods. It is not the loss to the Treasury.

Dr. MAGILL. Well, as I have indicated, our statisticians around here are not so much worried about that. They think we are now likely to be going into a period of gains rather than losses, and that

it is the gain side to which we should give greater attention to the effect of that proposal.

Senator REED. Dr. Magill, let me answer that. In all the 21 years since we have had an income tax, there have been many more years when the losses exceed the gains than there have been years when the gains exceed the losses.

Dr. MAGILL. I am not sure about that. Of course, the net result has been a great excess of gains. The net is about 14 billion dollars more gain in the taxes than losses.

Senator REED. Through the boom time?

The CHAIRMAN. What is the difference on the revenue proposition?

Senator REED. Nobody can tell.

Dr. MAGILL. No estimate has been made. I can tell you about what the rates would be that you referred to. Senator Reed's proposition is worked out on page 8 of the Secretary of the Treasury's statement. It means in the case, for example, of a taxpayer with a $40,000 income——

Senator CLARK. On page 8, Doctor?

Dr. MAGILL. On page 8 of the Secretary's statement. If you will look at that last column at the right that is calculated on the 20-percent basis and you will observe there, for example, in the case of the taxpayer with a $40,000 income, he would pay a tax of only 5 percent on any capital gain which he had.

Senator REED. Well, if it is fair to cut down the rich man to 12½ percent, it is certainly fair to cut down the moderate sized fellow somewhat.

Dr. MAGILL. That is true.

Senator REED. I would suggest, Mr. Chairman, we put this in, and let the Treasury study it, and we can clear that up when the bill gets on the floor of the Senate.

The CHAIRMAN. There is this about it. If you would put this new bracket in, it throws it into conference, and would delay it that much more. I do not think it is the desire of the Committee to increase taxes now, but if it is 12½ percent now, if held over two years, there isn't any necessity to increase that particular proposition.

Senator REED. We are increasing it very decidedly. We are increasing the period. A man would have to hold it ten years in order to get the benefit of it.

Senator GORE. Don't you think it would freeze these assets in the hands of the owner where it confines the transactions too strictly?

Mr. PARKER. I happen to have the figures here on that, and it should be remembered that from 1917 to 1921 we had very high tax rates. Now, during those years we did not have any capital gain and loss provision. All I do know is that the losses exceeded the gains by about three billion dollars in that period. In 1922, we put the 12½ percent provision into effect.

Senator GORE. In 1923?

Mr. PARKER. In 1922.

Senator GORE. In 1922, yes.

Mr. PARKER. We put it in the Revenue Act of 1921, but it was effective as of 1922, and in the following eight years the gains exceeded the losses by about seventeen billion dollars. Now, for 1930 and 1931 losses exceeded gains again by about a billion dollars.

Senator WALSH. In 2 years?

Mr. PARKER. Yes. After the capital gain provision was adopted there was a great increase in the volume of capital transactions. Apparently such transactions will not take place if there is a tax of 50 or 60 percent on the gain realized.

The CHAIRMAN. Well, why can't the committee approve in principle this provision and we can take up later the question of whether or not we are going to make the banks accept it, whether or not, after the Treasury looks into it further with the experts, whether we add this new provision.

Senator CONNALLY. You mean the provision in the bill?

The CHAIRMAN. Yes.

Senator WALSH. With Senator Reed's suggestion?

The CHAIRMAN. Yes. I do not mean to adopt Senator Reed's suggestion, but we will take that up, yes, but to adopt this feature in principle.

Senator BARKLEY. Before we do, I think, Mr. Chairman, I would just like to make this statement: From the practical standpoint of a money-raising provision to meet the needs of the Treasury, I am going to support this provision, but I do not want it understood that in so doing, I recognize that there is any moral question in the relationship between a man and the Government, between a man who loses and the man who gains. I am supporting it purely as a practical proposition and I do not think that as a matter of morality between the Government and the taxpayer, there is any difference between its relationship to the man who happens to lose and the man who happens to win. I am doing it purely as a money-raising proposition.

The CHAIRMAN. I agree with your philosophy.

Senator KING. It is assumed beyond the peradventure of a doubt that the Treasury Division will, by enlarging for a number of years, increase the revenue?

Dr. MAGILL. The estimate which has been made here of 36 millions is Mr. Parker's estimate. Of course, that kind of an estimate is exceedingly difficult to make, as Mr. Parker would tell you, because we do not know how many of these transactions are going to be had, or what business is going to be like.

Senator GORE. Have you reached any conclusion that bears on this point? In 1929, when stocks were so high, and the high tax that people would have to pay if they sold, restraining them from selling, whereas a lower tax would have permitted them to sell and their selling would have kept these prices from soaring so high?

Dr. MAGILL. Well, I think that argument has been frequently made. I think Mr. Mellon's book was largely devoted to that thesis. So far as I recall, there has never been any impartial study that has been made that has established the truth of that argument. We all know of cases where people did not sell, where they thought they would have to pay too big a tax, but whether or not it would have had any effect on the market, I do not know. There is now a real study being made on that subject.

Senator KING. There is?

Dr. MAGILL. I know of no other that supports this argument.

The CHAIRMAN. Dr. Magill, while we have got a pretty full attendance, we will pass from this, with the idea we have accepted in principle this proposition and we will pass on these provisions later.

Senator BYRD. Has anybody requested hearings on this?

The CHAIRMAN. Yes; I read before you came in, Senator, a letter from the American Bankers Association with reference to the viewpoint of the banks on this proposition.

Senator BYRD. Could we pass on it before we have the hearings?

The CHAIRMAN. We are not passing on it finally, just tentatively.

Senator WALSH. They are not against the principle. That is for a modification so far as the banks are concerned. We are leaving that question open.

Senator KING. We just accepted the basis without details.

Senator BYRD. I am not prepared to accept the basis. I want to hear the arguments on it. I think it is a very radical change.

The CHAIRMAN. We haven't had any communications, I think, that are objecting particularly to the principle involved here, the change.

Dr. MAGILL. No.

Senator COSTIGAN. You mean, Mr. Chairman, approving it in principle?

The CHAIRMAN. Yes, that is right.

Senator WALSH. The matter can go over, so the Senator can have a chance to read the record of this morning's proceedings.

The CHAIRMAN. Now, Doctor, will you proceed, insofar as the foreign credit proposition is concerned?

Dr. MAGILL. That is on page 125, section 131. It starts on page 124. The situation on that can be stated very briefly.

Senator COSTIGAN. What page again, Doctor?

Dr. MAGILL. It starts on page 124. The change is made on page 125. At the present time an American concern doing business abroad is allowed a credit with respect to income taxes paid to the foreign country against the amount of its American tax, with the limitation that the amount of the credits so taken must not exceed the proportion that foreign income bears to the American income. In other words, if the concern derives three fourths of its income from Great Britain, and one fourth of its income from the United States, it may take a credit against its American tax which would be based on the entire income to the extent of three fourths of the American tax.

Senator CONNALLY. Provided they paid, of course?

Dr. MAGILL. That is right, yes, sir.

The CHAIRMAN. Well, suppose, for instance it pays $100,000 tax for the United States. That would be the tax, and it paid $75,000 to England, then it would only pay $25,000 taxes. Is that right?

Dr. MAGILL. That is right, under the example I have given.

The CHAIRMAN. That is the present law?

Dr. MAGILL. That is the present law.

The CHAIRMAN. All right. Proceed.

Dr. MAGILL. The subcommittee of the Committee on Ways and Means was of the opinion that this credit should be entirely eliminated. If that were done, the company in the case which we have given, would receive a deduction for the amount of its British taxes, but no a credit, and as I think you understand, the deduction would be very much less beneficial to them than the credit.

The CHAIRMAN. Illustrate that.

Dr. MAGILL. That would mean that in the computation of their net income subject to the American tax, they would be allowed to deduct this $75,000 that they paid Great Britain.

Senator COUZENS. The same as any other ordinary expense?

Dr. MAGILL. The same as any other expense, but that would, instead of reducing their American tax by $75,000 reduce it by, say, $7,500 or the like.

Senator CONNALLY. What does the bill provide?

Dr. MAGILL. The bill is simply a compromise between the two provisions. The bill cuts the credit in half.

Senator KING. As a deduction or as a credit?

Dr. MAGILL. As a credit.

Senator KING. As a credit.

Dr. MAGILL. You are allowed a credit, but only to the extent of one half of what you could previously get.

The CHAIRMAN. Well, in other words, the illustration that I just gave—$100,000 taxable in the United States and $75,000 in Great Britain, he would now have to pay the United States $50,000?

Senator CONNALLY. Sixty-two and one half.

Dr. MAGILL. No; $162,500.

The CHAIRMAN. Oh, I see. They would get the other half.

Dr. MAGILL. Now, as a matter of fact, in many cases, it would work out that that credit would be no better to the taxpayer than the deduction. We have some cases of that sort. In some cases it would be worth more to him than a deduction.

Senator KING. Then, by and large, there isn't very much difference in the amount received by the Treasury?

Dr. MAGILL. Between a credit and a deduction? The credit provided by the bill and a deduction?

Senator KING. Yes.

Dr. MAGILL. I do not think so. I think the credit probably in most cases will be more beneficial to the taxpayer than a deduction, so I think there is some revenue involved here.

Senator CONNALLY. It would be in all cases a question, Doctor. The credit would certainly be more than the deduction, because the deduction is merely from income, and the credit is from the tax.

Dr. MAGILL. I know; but as the thing works out, we have an actual case this morning of an individual who is the beneficiary of an English trust which his father created. He has no power to change the trust at all. It is necessarily continuing as an English trust. Now, in his case, he has worked it out that if this House provision goes through it would be better from his point of view to take the British tax as a deduction than as a credit.

The CHAIRMAN. Well, let us take the case of the United Fruit Co., for instance. There was a gentleman spoke to me about that. Their business depends largely on having interests in the Central American countries in order to carry on their fruit business and so on. This discriminates largely against a company like that, doesn't it?

Dr. MAGILL. Yes. If they pay income taxes to those foreign countries.

The CHAIRMAN. Yes.

Dr. MAGILL. This is only a credit with respect to foreign income taxes. If what they pay down there is property tax it is a deduction now and not a credit.

Senator GORE. How is that?

Dr. MAGILL. I say, if the taxes which are paid to the foreign country are property taxes for example, not income taxes, even now they are only allowed as a deduction. This credit is simply with respect to foreign income taxes paid.

Senator WALSH. Do they have to pay income taxes in those South American republics?

Dr. MAGILL. I do not know, in Nicaragua and those other places where the fruit company does business, I can get you that information, but I do not know now.

Senator REED. I have been told that they do not.

Dr. MAGILL. Do not have income taxes?

Senator REED. A great many of them have export taxes, so much per bunch of bananas.

Senator GORE. They do not have any income, do they?

Senator REED. No income tax.

Senator WALSH. They are allowed to deduct, I assume from what you said.

Doctor MAGILL. Yes.

The CHAIRMAN. If they have losses it operates just the same.

Dr. MAGILL. Yes.

The CHAIRMAN. They can take the losses under the usual rule.

Dr. MAGILL. Yes, sir.

Senator BARKLEY. Professor Parker has got another example yonder on the board illustrating this.

Mr. PARKER. I didn't quite finish it. I thought you might want to know how we compute it. If we have $2,000 income in the United States and $1,000 in Great Britain, we bring those incomes together. The net income that we start with is combined income of $3,000. We figure a tax on that at 13¾, what we might call a tentative tax. It is not the tax assessed. In this case the tentative tax would be $412.50. Now, under the present law, we take the ratio of the foreign income, $1,000, and the total income, $3,000, multiply that by the total tax, which is $412.50 and that gives us a tax credit of $137.50. So the final American tax is $275. The British tax at 25 percent would be $250. The tax credit is one third of the total tax.

Senator CONNALLY. $137.50.

Mr. PARKER. He would get a tax credit of $137.50, which would leave him a total tax of $275. Now, all this really amounts to the same thing, as if we had applied the 13¾ percent to the American income. This occurs where the foreign income tax rate is greater than ours. We would not get the same result if the foreign country had a tax rate less than ours. Now, the new rule is simply to take one half of the foreign income of $1,000, or $500, in computing the credit, which would, of course, cut this tax credit right in half, wherever the rate of tax in the foreign country is greater than our own, or, you might say, in a practical way, that under the provision in the bill we are going to tax one half of the foreign income at our tax rates, in all foreign countries where their rates exceed ours, but in case the foreign rates are less than one half ours then they are not penalized to that extent.

Senator GORE. That leads to a tax war. Who could stand the war the longest?

Mr PARKER. There would be no tax war that I can see. Our citizens, our concerns, are affected. It does not affect the foreign companies at all.

Senator REED. These provisions were adopted in order to build up or encourage foreign trade, weren't they?

Mr. PARKER. Yes, sir.

The CHAIRMAN. Mr. Parker, have you or has the Treasury given any consideration to the proposition that you might classify these American industries that are doing business abroad? For instance, I can conceive in the case of certain industries that it is necessary for them to do business abroad, like the United Fruit or the National Telephone & Telegraph. They have got to have a business abroad in order to sustain business here. But you take General Motors, for instance; it is not necessary for them to put a plant over in Spain and so on. They could make the goods here and ship the goods there.

Senator GORE. If Spain would let them in.

Mr. PARKER. But the trouble is, it is very difficult to properly define such a policy in our law.

The CHAIRMAN. Well, we can appreciate that.

Mr. PARKER. But, if we did, they will form a foreign corporation under the laws of the foreign country. The effect will be, although the stock of that company will be held over in this country, that they will keep their earnings over there and we will get no tax.

Senator KING. Well, they might have a trustee living there holding the stock.

Mr. PARKER. What are we going to do about it? We haven't got any jurisdiction.

Senator GORE. It shows you cannot make prohibition work the world round.

The CHAIRMAN. Well, anyway, we have got some letters here from people who want to be heard on this proposition. I don't think we ought to take action finally on this. Now, can you go into the reorganization features of this bill?

Dr. MAGILL. Yes, Senator, if you want to pass over section 131 for the time being.

The CHAIRMAN. Yes; I think we ought to give these people who have requested it an opportunity to be heard.

Dr. MAGILL. I might say here that the Department of Commerce would like to express their viewpoint on certain phases of this foreign situation.

Senator WALSH. Mr. Chairman, I would like to put into the record a letter from a company at Worcester, Mass., on this subject.

The CHAIRMAN. Yes.

Senator KING. Wouldn't it be better to wait until we have the hearings, and put it in when you have the public hearings, when the witnesses are here?

Senator WALSH. Very well, I will withdraw it.

Dr. MAGILL. The Department of Commerce has expressed an interest in this, and asked yesterday afternoon whether or not you would wish an assistant to the Secretary of Commerce to appear.

The CHAIRMAN. We have got to give them an opportunity. We have got some requests from the Secretary of War on some feature,

and the Secretary of Commerce, and we have got to give them an opportunity to be heard before we pass upon this matter.

Dr. MAGILL. Would it be agreeable, then, for me to tell Mr. Dickinson that he may be heard?

The CHAIRMAN. That he will be heard before we finally pass on these propositions.

Dr. MAGILL. Then, we can proceed with the reorganization provisions, which are on pages 85 and 86. The reorganization provisions, which are now in the law, have remained substantially in this form since 1924, during which period a large number of reorganizations have been carried through. The subcommittee of the Committee on Ways and Means recommended that the exchange and reorganization provisions should be stricken out completely. Their view being, essentially, that in the case of any exchange or reorganization it was desirable to tax the profit or allow a deduction for a loss immediately rather than to defer it in any way. The effect of the reorganization provisions, as I think you know, is this, that if the stockholder receives a share of stock in the course of reorganization, that comes within the statutory definition, he is not subject to tax under these provisions at the time he receives the shares of stock, but he only becomes subject to a tax or only has the deduction for a loss, when he finally disposes of the shares, which may be some years later.

Well, now, the result here, as in any other cases, was to attempt to cut out of the reorganization provisions the provisions which so far as our experience showed had led to abuses, in that astute lawyers had been able to use these provisions to transform what were in substance sales into reorganizations within the statutory definitions.

The most important change is the change in the definition of reorganization. The change on page 85 is of less importance, and is sort of a subsidiary matter.

Senator KING. You are speaking of subdivision (a), are you?

Dr. MAGILL. Subdivision (g), the stricken out subdivision (g). The provision there provided that if corporation A——

Senator KING. You are speaking of the old provision?

Dr. MAGILL. The old provision.

Senator KING. Yes.

Dr. MAGILL. It provided that if corporation A transferred assets to corporation B in exchange for the stock of B, and then distributed the stock of B to its shareholders, that the shareholders would realize no gain or loss in connection with that transaction. The trouble with that has been this: Suppose corporation A has accumulated profits of a million dollars. If the profits as such were distributed to the shareholders they would, of course, be subjected to the graduated surtaxes. Under this provision, corporation A may transfer that surplus to corporation B and distribute the stock of B to its shareholders, and if the shareholders then sell the stock and have held their original stock for 2 years or more, they will pay only the 12½ percent tax in lieu of the graduated surtax. There is no question that the type of transaction described in subdivision (g) would be subject to tax under the Supreme Court decisions, were it not for the subdivision. And because of the fact that it appeared that this was essentially a loophole, it was thought desirable to take it out.

Senator REED. Well, now, is it a loophole? If the stockholder got cash as a result of this reorganization, that would be treated the same as a liquidation of his original investment, and he would pay 12½ percent or the surtaxes in accordance with the length of time he had held it.

Dr. MAGILL. Well, it is true, under the law as it is in the bill, that the corporation shareholders have considerable discretion as to how they will be taxed, in that they may determine whether to liquidate or whether they will distribute a dividend, or whether they will reorganize.

Senator REED. It remains true under this?

Dr. MAGILL. It remains true now except that we have changed the method of taxing liquidating dividends.

Senator REED. Aren't we really just impeding the natural flow of business without getting ourselves any additional revenue by these steps?

Dr. MAGILL. I think in that, it seems to me, you get into a large question of policy. The theory of these provisions in the 1924 law, I think, was that a reorganization might be accomplished in a great variety of ways and that the desirable policy was to permit the reorganization to be accomplished in any one of the ways which it might normally take.

Senator REED. Isn't this the fact, that the stockholder becomes subject to the tax the moment he takes his money out of the enterprise, that the only way he can avoid taxes is by continuing his investment in the reorganized enterprise?

Dr. MAGILL. That is true. Of course, in the case I have given, he may sell out his stock in the new subsidiary and retain his stock in the old company.

Senator REED. Well, but the moment he sells——

Dr. MAGILL. The moment he sells out he is subject to tax. In this connection, the most important plug we have is the change in the provisions as to liquidating dividends, which have not yet been discussed.

Senator REED. I do not see any objection to thus stiffening up on the liquidating dividends. It seems to me you are merely choking off business, not increasing the revenue, when you prevent the absorption by one corporation of another.

Dr. MAGILL. Well, I may say personally I am not so much interested in this particular change as I am in the change in the definition of reorganization. We made this because essentially the transaction, if necessary, can be carried out in ways that are still permitted by the law, and this particular paragraph seemed to open the door to some kinds of evasion which we wished to stop.

Senator COSTIGAN. Have there been any reorganizations to take advantage of the old law?

Dr. MAGILL. Undoubtedly, a great many.

The CHAIRMAN. And you have had a lot of lawsuits about that?

Dr. MAGILL. Well, not so many lawsuits, I think. We have lost a good deal of revenue.

The CHAIRMAN. The question always arises whether the transactions would have occurred and whether you would have gotten any revenue if the law had been different.

Dr. MAGILL. Exactly, but; of course, as you know, the point that has bothered me about these reorganization provisions for 10 years, has been the great number of honest-to-goodness sales that have been carried out in the guise of these provisions, not really reorganizations at all. They were sales.

Senator COSTIGAN. There have been distributions of surplus also, have there not, under this?

Dr. MAGILL. Yes.

Senator REED. You allow a merger or a consolidation to remain, a reorganization?

Dr. MAGILL. Yes.

Senator REED. And there is no tax or gain recognized there?

Senator GORE. Where, Senator Reed?

Senator REED. In the definition of reorganization they continue to include a merger or a consolidation. Now, what is the practical difference whether company A merges and consolidates with company B so that stockholders of both become stockholders in the common enterprise, or whether company A sells all its assets to company B and takes stock for it?

Dr. MAGILL. In many cases, I think there is none. On the other hand, if you leave, speaking now with respect to definition—I take it you want to go on to that.

Senator REED. Yes.

Dr. MAGILL. If you leave in these provisions here in the stock type of reorganization which I have seen go through in practice, you simply permit the sales to be made without any tax.

Senator REED. You mean sales for cash?

Dr. MAGILL. Yes.

Senator REED. Well, isn't the way to correct that, then, to put into this definition in parentheses "including the acquisition by one corporation in exchange for its own securities of at least a majority of its stock."

Dr. MAGILL. Something of that kind would help a great deal. What we are trying to obtain, I think, is the sort of result which the Supreme Court spoke of in its decision in one of the recent cases, the Pinellas case; that is, that as an essential part of a reorganization, there should be this idea of continuity of interest.

Senator REED. That is exactly what I mean.

Dr. MAGILL. And that is accomplished, at least in part, by the thing which I have indicated.

Senator REED. The stockholders of the two companies being allowed to come together and remain partners in the consolidated enterprise?

Dr. MAGILL. Yes.

Senator REED. That is the thing we don't want to prevent, because business goes ahead faster if we permit that, but I agree with you that real liquidations ought to be taxed, no matter in what form they occur.

Dr. MAGILL. Yes.

The CHAIRMAN. What do you think of this, Mr. Parker?

Mr. PARKER. I think this is an improvement over the existing law. I do not think it is perfectly satisfactory. We have worked on it several months, as much time as we could devote to it; we haven't got the right answer yet.

Senator REED. What do you think of that situation?

Mr. PARKER. Perhaps with another revenue bill, we can do better.

Senator REED. What do you think of the proposition of putting in the "acquisition in exchange for its own securities"?

Mr. PARKER. I could not give you any answer without sitting down and figuring 7 or 8 different kinds of cases that will come up under it, Senator.

Senator REED. All right, will you do that then, please?

Mr. PARKER. Yes, sir.

Senator REED. I hadn't thought about it, nobody suggested it to me, but it seems to me that that puts the grease where the squeak is, and does not interfere with legitimate transactions.

The CHAIRMAN. Well, suppose you discuss that situation.

Mr. PARKER. We will do that.

The CHAIRMAN. And then we will pass on. Is there something else we can discuss?

Senator REED. It is 12 o'clock, Mr. Chairman.

Doctor MAGILL. The next subject will be "Liquidating dividends" if you want to discuss it.

The CHAIRMAN. Well, it seems to me there is no objection to that principle, is there?

Dr. MAGILL. In part, that depends on what you do with the capital gains and losses. If you have tentatively agreed to adopt the capital gain and loss provision, and then if you are agreeable to this proposition Senator Reed was speaking of, that gain on a liquidation should be taxed under that schedule, that will cover the distribution and liquidation.

The CHAIRMAN. What is your reaction as to that?

Dr. MAGILL. I think it is right as we have it here.

The CHAIRMAN. Suppose we accept that in principle then, and an amendment be drawn accordingly.

Senator REED. Where is that that you are speaking of?

Dr. MAGILL. That appears on pages 104 and 105.

The CHAIRMAN. "Distributions in liquidation."

Dr. MAGILL. Subdivision (c), commencing in line 15, page 104, and continuing over onto page 105.

Senator REED. We will have to look up the cross-reference to see what that means.

Dr. MAGILL. Well, I can give you the effect of that. The purpose of that is to make the profit on a liquidating distribution subject to whatever surtaxes the shareholders have to pay.

Mr. BEAMAN. And normal taxes.

Dr. MAGILL. Normal and surtaxes.

Senator GORE. And that is not true, now?

Dr. MAGILL. That is not true now, at the present time the liquidation may be treated as a capital gain or loss.

Mr. PARKER. It is a very substantial change.

Senator REED. Yes, but if we take this new schedule on treatment of capital gains, the only difference then becomes the subjection of this liquidating dividend to normal tax.

Dr. MAGILL. Under this more than that? This protects it.

Mr. BEAMAN. No matter how long you have held the stock, it goes into the 100-percent gain.

Mr. PARKER. And it is taxed in full.

Senator GORE. Now?

Mr. BEAMAN. Under this bill.

The CHAIRMAN. You would not apply the same rule we adopted on the other?

Senator REED. It ought to be treated like capital gains.

Mr. PARKER. Well, the trouble is, a lot of that surplus has never been taxed at the surtax rates.

The CHAIRMAN. Well, that is an important proposition. You had better pass that over.

Senator REED. You could argue a long time on both sides of that.

Dr. MAGILL. Unless you want to go back over this, you might as well stop.

The CHAIRMAN. Let me ask the committee, as tomorrow is Saturday, I would like to finish up as far as we can. I think we have gotten over most of the knotty problems here, haven't we?

Senator GORE. No.

Mr. PARKER. We have got a general understanding of the bill.

The CHAIRMAN. We have got the general proposition and a general understanding of it. We have the explanation. This is a knotty problem, you have got on capital gains and losses.

Mr. PARKER. We have been over the proposition, not wholly satisfactorily, but we have discussed it. I think we will have to go over it again after the hearings.

Senator REED. Why don't we call it off until we can have the hearings, and allow the people to come in and then finish it up in executive session?

The CHAIRMAN. Are there many more knotting problems here?

Dr. MAGILL. No, sir; I think not. The only other changes of great significance are these amendments to prior acts and so on, on page 212.

The CHAIRMAN. Those are administrative changes?

Dr. MAGILL. Those are administrative changes for the most part. On one or two of them that I think of, the people have objected. One of them is this coconut-oil affair.

The CHAIRMAN. Of course, that is a problem.

Dr. MAGILL. And the other one is a change in the administration provisions with respect to the gasoline and lubricating oil clause.

Senator REED. We cannot discuss coconut oil until we have heard the witnesses.

The CHAIRMAN. No, we have got to hear the witnesses. Suppose we recess then until 10 o'clock Monday morning.

Dr. MAGILL. Then the next session at which you will want us, I take it, will be Thursday.

The CHAIRMAN. Unless you want to have somebody here to listen in.

Dr. MAGILL. We will have somebody here.

(And thereupon the further hearing upon H.R. 7835 was recessed until 10 a.m., Monday, Mar. 12, 1934.)

CONFIDENTIAL

REVENUE ACT OF 1934

HEARINGS

BEFORE

THE COMMITTEE ON FINANCE
UNITED STATES SENATE

SEVENTY-THIRD CONGRESS

SECOND SESSION

ON

H.R. 7835

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

PART 5

MARCH 16, 1934

UNREVISED

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REVENUE ACT OF 1934

FRIDAY, MARCH 16, 1934

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

The committee this day met at 10 a.m., in the committee room, Senate Office Building, Senator Pat Harrison, chairman, presiding.

Present: Senators Harrison (chairman), King, George, Barkley, Connally, Gore, Costigan, Clark, McAdoo, Byrd, Lonergan, Reed, Couzens, Keyes, Metcalf, La Follette, and Walcott.

Also present: Mr. J. Howard Marshall, Petroleum Administrative Board, Messrs. Magill, Stam, Parker, Bartholow, Beaman, and other representatives of the Treasury, Joint Committee on Internal Revenue Taxation, and the staffs of the Senate and House legislative counsel.

The committee had under consideration H.R. 7835.

The CHAIRMAN. Mr. Secretary, we will hear you now. The committee has closed its public hearings, and we understood that you wanted to give the committee your views with reference to certain provisions of this tax bill, as it passed the House. We are glad to get them.

STATEMENT OF HON. HAROLD L. ICKES, SECRETARY OF THE INTERIOR

Secretary ICKES. Senators, members of the committee, I am particularly interested in a proposal to levy a small tax on oil, for the purpose of financing the oil administration.

The CHAIRMAN. Let us get that. What is that provision?

Senator COUZENS. Is there any provision in the bill now, Mr. Secretary.

Secretary ICKES. Yes, Senator.

Senator COUZENS. What provision is it, do you know?

Secretary ICKES. Sections 604 and 605 of the House bill No. 7835. That provides for a levying of a tax of one tenth of a cent on the production of crude petroleum and one tenth of a cent on the refining of crude petroleum.

The CHAIRMAN. Section 604.

Senator REED. Page 245.

Secretary ICKES. As originally drafted, this tax was a stamp tax. We had consulted with the Treasury and agreed upon a stamp tax, at the suggestion of the Treasury. I have been advised, however, that upon further consideration by the solicitors of the Treasurer's office and those in the Interior Department, this feature is now regarded as impracticable, and it is proposed to abandon it, under an amendment which we have suggested here.

As redrafted, the tax is imposed upon the producer, as before, but is payable each 30 days, at the time a return is required to be made. The return is to be made through the producer of crude petroleum, who for the purpose of the tax is made the agent for collection. What actually happens is, or what will happen if it is passed, is that the producer will deduct the amount of the tax from any payments which are due the producer for the oil which he buys. In cases, however, where the crude petroleum is placed in storage and where the transporter and refiner are the same party as the producer, the tax is paid at the time of production by the producer.

It is estimated that the tax will produce approximately $1,700,000 a year. Now, as to the purpose of the tax: The primary purpose is to finance the work of administering the code of fair competition for the petroleum industry. There are other purposes. It will force the disclosure of illegally produced oil. It is estimated that from 40,000 to 75,000 barrels of oil are now being illegally produced daily. The disclosure of the "hot-oil" production will be brought about because of the reports and returns that will be required under a penalty, and the agents of the oil administration will have authority to go upon the premises of the company.

The CHAIRMAN. That is the main object of the provision? It is not a revenue bill?

Secretary ICKES. Well, I think that is a very important object. Involved in that, also, is the payment of the gasoline taxes. There are great evasions there.

The CHAIRMAN. Do you think this will help in getting a larger revenue by way of the gasoline tax?

Secretary ICKES. Oh, yes; it will help, there. Also, instead of the Federal Government paying for this oil administration, which is benefiting the industry, the industry itself will pay for it. There is no reason why the Government should pay for it.

Senator REED. It will bring benefit to the legitimate members of the industry?

Secretary ICKES. Yes; exactly.

Senator REED. To the law-abiding individuals?

Secretary ICKES. Oh, yes; and there is no substantial opposition to this proposed tax, on the part of the industry, as I understand it.

The CHAIRMAN. You have a committee, as I understand it, administering this oil proposition?

Secretary ICKES. Yes.

The CHAIRMAN. Do they feel that this is a good proposition?

Secretary ICKES. Oh, yes; all are strongly in favor of it.

Senator REED. You are also in favor of section 605, the tax on gasoline, are you not?

Secretary ICKES. Yes.

Senator REED. I want to call your attention to that. I have not seen it until this morning, but it appears to me that there is a little unfairness there in taxing the natural-gas gasoline at a different rate from gasoline produced from crude, and you see, that is the effect of the bill. On page 249, line 12, a tax is imposed of one tenth of a cent per barrel on crude petroleum that is refined. The tax is not measured by the gasoline produced, but by the raw material that goes into it. Then, on line 15, the tax on natural-gas-gasoline is

based on the product. Would it not be better to make them the same?

Secretary ICKES. May I consult my solicitor?

The CHAIRMAN. Yes.

Secretary ICKES. Why is that different, Mr. Marshall?

Mr. MARSHALL. Mr. Chairman and Senators, it is impossible to measure the tax, as far as natural-gas gasoline, which is made from say 1,000 cubic feet of natural gas, going through a processing plant, which will yield perhaps one fifth of a gallon, or two thirds of a gallon of natural gasoline. It is not made from crude petroleum, which is measured in barrels.

Senator REED. I quite understand.

Mr. MARSHALL. The only way you can get at it, I think, is to measure it by the products that come out of it.

Senator REED. Yes. Well, why do you not do that, then, on the tax imposed on gasoline made in the ordinary way?

Mr. MARSHALL. The tax is not imposed upon gasoline. It is imposed upon a barrel of crude oil, that is processed; the purpose being there, in addition to getting revenue, to provide a means of checking the crude oil which flows from the producing property to the refiners; the refiners being the "throat" through which practically all crude oil has to go. It gives you an additional check-back on the source of production.

Senator REED. Here is what we are driving at. You have got a tax, which is borne in the long run by the gasoline, in most cases.

Mr. MARSHALL. Well, not exactly such.

Senator REED. Oh, yes. The money comes out of the consumer of the gasoline, ultimately, doesn't it?

Mr. MARSHALL. That is assumed, that gasoline is the only revenue-producing product of crude petroleum. It is, as a matter of fact, probably the main revenue-producing product; but actually of course, enormous revenue is derived from fuel oils, from gas distillates, and from the 101 products which are secured from a barrel of crude oil.

Senator REED. All right, but what I am driving at is, that by the time 2 barrels of gasoline reach the market, 1 of them has carried a heavier tax than the other, and that is not equitable.

Mr. MARSHALL. You mean, in the case of natural gasoline?

Senator REED. Yes.

Mr. MARSHALL. In the case of natural gasoline?

Senator REED. It is taxed less than gasoline produced in the usual way.

Mr. MARSHALL. That is probably true.

Senator REED. I am not quarreling with your method of taxing.

Mr. MARSHALL. It is very nominal, of course.

Senator REED. Yes; but nevertheless there is an inequality, and I would suggest that to make it fair, we should increase the tax on the natural gasoline slightly, so that the two taxes will be comparable.

Mr. MARSHALL. No objection.

Secretary ICKES. That would be all right.

Senator REED. Say a tax of fifteen one-hundredths of a cent instead of ten one-hundredths. You will get a more equitable result.

Secretary ICKES. That would be quite satisfactory to us, Senator.

Mr. MARSHALL. Won't you be burdening natural-gas gasoline, in that case, more?

No; you are correct. You are right. I see what you mean.

Senator REED. I am arguing that, with modern cracking—and I am not an expert on this—you could get perhaps 30 gallons of gasoline out of a 42-gallon barrel of crude, of the average type.

Mr. MARSHALL. The average is about 48 percent, throughout the United States.

Senator REED. Is that all?

Mr. MARSHALL. Yes.

The CHAIRMAN. What is the proportion of gasoline, from crude and from natural gas?

Mr. MARSHALL. It depends entirely on how you refine it, as to that, Senator. The average is between 45 and 48 percent, at the present time, gasoline; 33, out of a barrel of crude oil.

The CHAIRMAN. I am not talking about that. I am talking about the United States, the production of gasoline. What percent comes from the crude, and what percent from the natural gas?

Mr. REED. At least 90 percent, isn't it?

Mr. MARSHALL. Well, over 90 percent. I do not have the exact figure in mind. I would guess 95 to 96 percent.

The CHAIRMAN. Of the crude?

Mr. MARSHALL. Yes, sir.

The CHAIRMAN. So that, as a matter of fact, out of the natural gas, it is as much of an important proposition, as out of the other.

Secretary ICKES. No.

Mr. MARSHALL. That is correct, sir. It is used for the purpose of blending. It is somewhat more volatile than the gasoline that you get from crude oil, and it makes the motor start easily in the wintertime, and all that sort of thing, and you use it for blending purposes, primarily. It is too volatile, generally, to use directly in a motor, without blending. You would not keep it in the tank very long.

The CHAIRMAN. Has any attention been raised to this situation?

Secretary ICKES. I beg your pardon?

The CHAIRMAN. Has there been any attention raised, by any of the interests, to this?

Secretary ICKES. No. I think it is fair to say there is none.

Mr. POOL. No. They proposed that tax, themselves.

Senator REED. Do you think that they would resent or resist such a change as I am suggesting now, making the tax on the natural gasoline fifteen one hundredths of a cent?

Secretary ICKES. They are willing to have sufficient tax made for the purpose of administration. I do not think they are particularly concerned about the way it is distributed.

Mr. MARSHALL. I do not think there would be any substantial objection, sir. You might get some.

Senator REED. We might put it in that way, and change it in conference, or on the floor, if we find it is an injustice.

Mr. MARSHALL. Yes.

The CHAIRMAN. Senator Connally is very much interested in this idea, and I understand that the producers of gas and oil have no objection to this.

Senator CONNALLY. I did not know that Secretary Ickes was to be heard the first thing. I was detained at the Post Office Department. I would have been here promptly, Mr. Secretary, had I known that

you were to be called upon first. I thought Dr. Manning was going on first.

The CHAIRMAN. It is section 604 and section 605. They think it would enable them to detect illegal gasoline.

Senator CONNALLY. You are talking about one tenth of 1 cent?

Senator REED. Yes, that is it.

Senator CONNALLY. Well I will say that I favor the retention of that tax. My people are divided on it. The State railroad commission are 2 opposed and 1 for it. It rather puts me "on the spot" to do it, but I think that with that provision, we can probably give you 100 percent enforcement down there, because, Mr. Secretary, I want to call your attention to the fact that since we last talked, the legislature has passed three bills. I do not know whether you are familiar with that or not.

Secretary ICKES. In a very general way. I knew they had passed additional legislation.

Senator CONNALLY. They passed 3 bills, 1 of which levies a similar tax to this, 1 of which puts all of the refiners directly under the control of the State Railway Commission.

Secretary ICKES. I knew about that.

Senator CONNALLY. They can go in and regulate them and pro rate them.

Secretary ICKES. Yes.

Senator CONNALLY. I forget what the other bill was, but I believe that with those three measures, and with this, we can possibly get along without any further Federal legislation.

Secretary ICKES. Well, this will be of a good deal of assistance in stopping the running of "hot" oil.

Senator REED. Mr. Secretary, Mr. Parker has just called to my attention an interesting point here. You tax the crude twice, once under section 604 and once under section 605.

Secretary ICKES. Yes.

Senator REED. Yes. So that it really bears a total tax of a fifth of a cent a barrel.

It is divided into a tenth here and a tenth there.

Senator REED. A fifth of a cent a barrel; whereas your natural gasoline is only taxed once and bears a lower tax, as I have explained, than gasoline produced from crude.

Secretary ICKES. We have no objection to an equalization, as between the two.

Senator REED. You have no objection?

Secretary ICKES. No.

Senator REED. You have no objection to some effort on our part to equalize the taxes between the two products?

Secretary ICKES. None at all, Senator.

The CHAIRMAN. Thank you very much, Mr. Secretary.

Senator CONNALLY. Mr. Secretary, before you leave, may I ask, why you have it in two places? Is it on a different basis, the tax in 604? That is the crude, of course.

The CHAIRMAN. That is the natural gas. The other is one from crude, and one from natural gas.

Senator REED. No, one is on production, the other is on refining.

Secretary ICKES. We felt, Senator, that we needed one fifth of a cent per barrel crude, in order to give us sufficient revenue to adminis-

ter the oil or petroleum administration; by dividing it this way, it gives us a total check, in order to stop "hot" oil, and that sort of thing.

Senator CONNALLY. Of course, that is all oil, everywhere in the United States?

Secretary ICKES. Yes, sir. It is a matter of policy.

Senator CONNALLY. Yes.

The CHAIRMAN. Thank you very much.

Senator CONNALLY. Mr. Secretary, there is one other question I want to ask you. What is your view with regard to the extension of the excise tax on crude oil from its present limitation? You know, it expires in 1935 under the law.

Senator MCADOO. You mean the 21-cent tax?

Senator CONNALLY. Yes. Don't you think that should be extended in this tax?

Secretary ICKES. I haven't any view on that. It really does not concern our oil administration.

Senator CONNALLY. Well, it concerns your oil administration to this extent, that with production, or a limitation of production, if we then lift the excess duty on oil, and permit foreign oils to come in, it would be a hardship on oil?

Secretary ICKES. Yes, that would be true.

Senator MCADOO. Yes, permitting it to come in free?

Senator CONNALLY. Permitting it to come in free. And don't you think it would be wise to extend that a few years?

Secretary ICKES. When I say it does not concern us, I mean it is a matter of major policy. It is not a matter of administration. It would perhaps make our administration more difficult. That should be taken into consideration in determining the major policy.

Senator BARKLEY. Do you know how much oil this 21-cent duty has kept out?

Secretary ICKES. I do not.

Senator CONNALLY. Mr. Secretary, what about the provision in this bill giving the President power to embargo foreign oil and to prevent dumping?

Secretary ICKES. I think that is a feasible provision.

Senator CONNALLY. Well, would you mind having your solicitor, or somebody in your department, draft an amendment? We could probably have it drafted by our draftsmen.

Sectetary ICKES. I would be very glad to.

Senator CONNALLY. I should like to get your views in the record, on that.

Secretary ICKES. Yes.

Senator CONNALLY. Don't you think the President should have power to embargo this foreign oil?

Secretary ICKES. Yes, I do, Senator.

Senator CONNALLY. To prevent their dumping it in here?

Secretary ICKES. I do.

Senator MCADOO. I think it would be wise if the Secretary would draft the proper amendment.

Secretary ICKES. I will be very glad to do it.

The CHAIRMAN. The only trouble is that you have got four items that are wrapped up in that proposition—copper, lumber, oil, and coal. If you deal with one, you have got to deal with all four of them,

and it is going to be a very complicated proposition, especially when it doesn't expire until 1935.

Senator COUZENS. I suggest we let that go until next year.

The CHAIRMAN. Well, anyway, that seems to be all the questions.

Senator MCADOO. I would like to ask the Secretary one question. I saw in the papers, or somewhere, that you have recommended 41 or 42 cents a barrel tax, on crude. Is that correct, Mr. Secretary?

Secretary ICKES. That proposition was raised before the House Committee. I did propose it tentatively, but I am persuaded the best way to handle it is to give the President power to raise the tax and prevent dumping.

Senator BARKLEY. Don't you think that that is important, Mr. Secretary?

Secretary ICKES. Yes; yes, I am in favor of that.

Senator BARKLEY. Well, would you have your solicitor draw us an amendment on that?

Secretary ICKES. I should be very glad to, and that amendment will be submitted.

The CHAIRMAN. Thank you very much, Mr. Secretary.

(The clerk will here insert the proposed amendment, to be drafted by Secretary Ickes and supplied for the record later.)

Senator GORE. Did Secretary Ickes explain this one tenth of 1 cent?

Senator BARKLEY. Yes. That is provided in two places, one fifth, in all.

The CHAIRMAN. All right, Secretary Dern. We understood that you wanted to discuss certain provisions of this legislation. The committee will be very glad to hear you.

STATEMENT OF HON. GEORGE H. DERN, SECRETARY OF WAR

Secretary DERN. Mr. Chairman, on February 15, 1934, I sent you a letter for the consideration of your committee which I presume has been made a part of the record of these hearings. In that letter I expressed briefly my views relative to the provision contained in section 602 of H.R. 7835, which imposes an excise tax of 5 cents per pound on coconut oil.

The CHAIRMAN. I saw this letter. It will be handed to the reporter, and may be placed in the record, following the Secretary's remarks.

Secretary DERN. With the approval of the President, I now desire to supplement my statement contained in that letter, and to reiterate my recommendation that this provision be eliminated from the bill. Our trade relations with the Philippine Islands are governed by provisions contained in successive tariff laws relating to this trade.

Prior to 1909, there was a tariff of 75 percent on Philippine products entering the United States. The provision of the treaty of peace with Spain, that permitted Spanish ships and goods free entry into the islands for a period of 10 years, was an obstacle to free trade. At the expiration of this 10-year period, however, free trade, with certain limitations or quotas on sugar, tobacco, and rice, was established under the Tariff Act of 1909.

Senator GORE. Can you give those, respectively?

Secretary DERN. The items referred to?

Senator GORE. The quotas.

Secretary DERN. No, I haven't the figures here. The Tariff Act of 1913 removed all of the limitations imposed by the Tariff Act of 1909, and provided practically for free trade between the islands and the United States. The provisions of the 1913 act are contained in subsequent tariff acts and have remained continuously in force, as an apparently settled national policy in dealing with the Philippine Islands.

Under that policy, trade between the Philippine Islands and the United States has been greatly stimulated to the mutual advantage of both people. The history of our occupation of the Philippine Islands during the past 35 years constitutes a brilliant chapter in the accomplishments of the United States. The administration of the islands, under the United States, has been of immeasurable benefit to the Philippine people. It presents to the world an entirely new philosophy in dealing with overseas dependencies. The great progress made in their general economic development, has been largely due to the policy of free and unrestricted trade between the islands and the United States. This trade has been the principal means of developing the present standard of living in the Philippines, from that of the surrounding areas. For example, according to the statement of a former Governor General of the Philippine Islands—

> The standard of living of the Philippine laborer is at least 300 percent higher than that of his neighbor in China, and it is much higher than that of any similar labor in other surrounding countries, like Java and Singapore.

The coconut industry is one of the vital factors of Philippine life. Coconut oil and copra, from which the oil is made in the United States, are the product of the second industry of the Philippine Islands. Coconut oil, produced in the Philippine Islands, and coconut oil produced in the United States from Philippine copra, constitute 68 percent of the coconut oil consumed in the United States, and the remainder being made from copra brought in from foreign countries, duty-free.

Senator GORE. What percent?

Secretary DERN. Sixty-eight, from the Philippines. The proposed excise tax, if collected in full on the amount of coconut oil received from the Philippine Islands in 1933, would amount to about $29,732,000, which is as much as the entire revenues received by the insular government for 10 months of the same year, which were $29,685,767. This would certainly be a heavy burden to place upon a single industry in any part of our country. The imposition of such a tax would not be in keeping with the policy which Congress, up to now, has uniformly followed, in the enactment of legislation affecting the vital interests of the islands.

The proposed tax will impose a burden on several million Filipinos, far out of line with the benefits that may be expected to accrue to the people of the United States.

It is contrary to the principle of reciprocal trade. I do not believe the situation in the United States demands undue sacrifices on the part of any of our overseas dependencies, except insofar as the principle of fair and equal treatment to all areas under the American flag may demand sacrifices.

Due to the existence of free trade between the United States and the Philippine Islands, the bulk of the external trade of the islands is with the United States, the total of about 72 percent. Over 81

percent, on a 5-year average, of the Philippine exports are sent to the United States, and about 63 percent of the external purchases of the Philippine Islands are made in the United States, thus showing a good reciprocal trade relationship.

The Philippine Islands stand first as purchasers of the United States dairy products, with which coconut oil is alleged to compete. Our dairy industry should not overlook this fact when it advocates an excise tax which presumably will adversely affect our export market for dairy products themselves.

Senator GORE. Do you have the amount of dairy products exported from this country?

Secretary DERN. I have not. I believe General Cox has the figures here.

Senator GORE. Figures given the other day covered both pork and dairy products, and they were not segregated figures.

Senator BARKLEY. Mr. Secretary, did you mean that we shipped more dairy products to the Philippines than we shipped to any other country in the world when you said they stood first?

Secretary DERN. Yes.

General COX. The amount is nearly two millions—$1,893,000 of dairy products alone.

Senator GORE. That is, in excess of the amount of coconut oil we imported from them for edible uses?

Senator MCADOO. Is that correct, that that is in excess of the amount of coconut oil imported into this country from the Philippines for edible purposes?

Secretary DERN. No.

Senator COSTIGAN. Was the figure given by General Cox one that represented the amount in excess of all the coconut oil imported for edible uses in the United States?

General COX. The dairy products alone do not. They are much less, but they are our first purchaser of that product.

Senator GORE. The other day we were given the figures on the amount of coconut oil imported, $1,600,000, and, for all purposes, seven million——

Senator KING. Differentiate between edible purposes and other purposes. Some part of coconut oil is imported here for edible purposes.

Mr. COX. The value of coconut oil imported from the Philippines for edible purposes was around $3,800,000, and the aggregate for all purposes from the Philippine Islands was around $10,400,000 in 1932, including oil from Philippine copra crushed in the United States.

Senator GORE. Ten million? Somebody gave us a different figure.

Senator KING. I wish you would examine your data on that again, if you have any data on that, because my recollection was that the amount of coconut oil imported and used for edible purposes was less than what you have just indicated.

Mr. COX. The total amount used for edible purposes was about 172,000,000 pounds, of which 74 percent, or 127,967,000 pounds, came from the Philippines either as oil or copra, at about 3.03 cents per pound (1932 price), which runs around $3,877,000, as the value I have here.

Senator REED. Oh, no. How many pounds?

Mr. Cox. For edible purposes.

Senator REED. How many?

Mr. Cox. One hundred and seventy-two million from all sources.

Senator MCADOO. General, did you give the figures of the total imports of coconut oil into this country from the Philippines and the total value of it?

Mr. Cox. Yes, sir; I have that.

Senator MCADOO. I mean, for edible and unedible purposes?

Senator BARKLEY. While he is looking that up, Mr. Secretary, what was the 29 millions of a moment ago that you referred to?

Secretary DERN. That was the amount of the tax. This tax would amount to about $29,000,000 a year.

Senator BARKLEY. Five cents a pound on the total amount?

Secretary DERN. The proposed excise tax, if collected in full, would amount to about 29 millions.

Senator MCADOO. It would probably be half of that, wouldn't it?

Secretary DERN. And this is equal to the total revenue received by the Government.

Senator MCADOO. The total value of the imports, then, if it is 2½ cents a pound, would be about half that; is that right, General Cox?

Senator BARKLEY. Of course, if it is selling at 2½ cents a pound, and the exise tax is 5 cents, the amount of the taxes collected would be twice the value of the oil imported.

Senator MCADOO. Exactly.

Senator COUZENS. 200 percent ad valorem tax.

Mr. Cox. Yes; 200 percent ad valorem tax.

Senator MCADOO. Yes. I just wanted to confirm the figures. That was my understanding, but I wanted to be sure.

Mr. Cox. The total amount of the oil in 1933, that came in from the Philippine Islands, that arrived in the United States, exclusive of copra was 141,000 long tons, which was valued at $8,155,000. There were in addition 204,714 long tons of Philippine copra, valued at $5,951,227.

Senator BARKLEY. That is from the Philippines alone?

Mr. Cox. From the Philippines; yes, sir.

Senator MCADOO. Now, the tax on that?

Senator COSTIGAN. Both edible and inedible.

Mr. Cox. That is oil for all purposes from the Philippines.

Senator MCADOO. Now, the 5-cent tax on that would be what?

Mr. REED. $100 a ton.

Mr. BARKLEY. That is long tons that he is talking about. These are long tons here.

Mr. Cox. I would have to express it in terms of pounds including the copra; the total amount coming from the Philippine Islands in 1933 would have been 594,000,000 pounds, and you multiply that by 5 cents, and it gives $29,700,000.

Senator MCADOO. What was the market value?

Mr. Cox. The market value, 2½ cents, on that, too.

Senator MCADOO. Well, that would be fourteen and one half millions?

Senator BARKLEY. You would not figure 2½ cents on the copra?

Mr. Cox. More than 14 millions.

Senator CONNALLY. Of course, that is on the assumption there would be no limitation on imports and they would still all come in?

Mr. Cox. Yes, sir.

Senator CONNALLY. You cannot shut it out and tax it both at the same time, can you?

Secretary DERN. No. That is assuming that that amount would come in. If you put the tax on it, that is what it would amount to.

Senator CONNALLY. Yes; that is what I am saying. In the argument here it is said in one minute that it won't come in, and in the next minute it is said that the tax will be so much. It cannot do both.

Mr. Cox. We do not believe it will come in.

The CHAIRMAN. All right, Mr. Secretary.

Secretary DERN. The Ph lippines also stand first in the purchase of United States cotton textiles. Other items of importance are tobacco products, paper, rubber, iron and steel, electrical and sugar-mill machinery, automobiles, chemicals, drugs, books, and so forth. A complete list of the articles imported into the Philippine Islands from the United States would embrace almost the entire list of articles raised and produced in this country. All of these goods are admitted to the Philippine Islands free of duty, while imports from other countries are forced to pay an average of approximately 20 percent ad valorem. I repeat that any restriction in the use of coconut oil in the United States would have a correspondingly adverse effect on Philippine purchases from the United States. Coconut oil ranks second in value of the Philippine products sent to the United States.

March 2 the President sent a message to Congress relative to public, No. 311, Seventy-second Congress, Philippine Independence Act, which has been again introduced in the Congress with certain proposed amendments, S. 2936 and H.R. 8424. With reference to the economic provisions of that act the President said, "To change at this time the economic provisions of the previous law would reflect discredit on ourselves."

Section 6 (b) thereof authorizes an annual quota of 200,000 tons of coconut oil to be shipped into the United States and, of course, contemplates that this oil shall have free access to our markets, except as provided in the act. Imposing an excise tax on this product of the Philippine Islands and on duty-free cocoa from foreign countries is equivalent to levying a tariff thereon. Such action would in effect, change the agreement implied in section 6 (b) of public, No. 311, Seventy-second Congress, to the detriment of the Filipino people.

Senator CONNALLY. The Filipino people have not accepted that act yet, have they?

Secretary DERN. No; but we are still offering it to them, as I understand it. When accepted, the terms of this act presumably become a sort of contract between the two countries, which should not be changed without mutual agreement. This fact would seem of itself to be a firm objection to placing an excise tax on coconut oil at this time.

A careful study of this subject leads to the following conclusions:

(1) The following interests would thereby be adversely affected: (*a*) Several million—I understand three or four million—Filipinos, who are dependent on this industry for a livelihood. Eight provinces of the Philippine Islands depend almost exclusively on coconuts. Thirty out of the 49 provinces of the islands would be crippled in their first or second industry. Obviously, the property tax revenues of the Philippine Government and of its subdivisions would be seri-

ously affected, causing embarrassing fiscal problems. Schools would probably have to be closed and other public services discontinued or curtailed.

(*b*) The American shipping interests would suffer. The round trip of oil tankers carrying mineral oil and other oils to the Orient return loaded with coconut oil, which makes these trips profitable. Other cargoes help to fill ships resulting from purchases made in the United States from the proceeds of coconut oil and copra.

Whatever benefits might accrue to the United States from this tax would be at a burdensome cost to the Filipino people. Have we the moral right to try to build up one group of our producers by tearing down another group which also lives under the American flag?

In view of the declared purposes of this Government as regards Philippine independence, the Filipino people have the right to expect of us fair and considerate legislation that will enable them to work out the formula for the establishment of a free and independent government under which their economic, political, and social institutions as developed under American guidance shall have a reasonable chance to survive. We have the responsibility of helping them to work out this formula of independence. In the meantime the Filipinos are under American sovereignty and are entitled to fair trade relations. The enactment of this provision relative to coconut oil would be out of line with the policy which Congress has uniformly followed, namely, that of according fair and equal treatment to all areas under our flag.

I have here a number of radiograms received from the Governor general of the Philippine Islands which, if they have not already been included, I recommend be made a part of the record of these hearings.

The CHAIRMAN. That will be done, Mr. Secretary. The committee thanks you very much.

Senator REED. Mr. Secretary, are we to understand that in substance, then, you are speaking for the President, and that he and you wish this tax to be taken out?

Secretary DERN. Yes, sir.

Senator CONNALLY. May I ask one question, Mr. Secretary? You spoke of the imports from the Philippines, and our exports to them. Is it not true that we import about twice as much from the Philippines as we export to them?

Secretary DERN. I read those figures here, didn't I?

Senator CONNALLY. Did you?

Mr. COX. That is true. We import about twice as much as they take from us.

Senator CONNALLY. Twice as much as they take from us?

Mr. COX. Yes.

Senator BARKLEY. We are more than twice as big, too.

Senator GORE. Mr. Secretary, if we levy a 200 percent tariff or tax on goods—coconut oil—imported into this country from the Philippines, wouldn't it be fair to let the Filipinos impose a 200 percent tax on cotton goods and dairy products exported from this country into the Philippines?

Secretary DERN. I should think so.

Senator GORE. Now, let me ask you this: This Independence Act fixed a quota of 200,000 tons, I believe?

Secretary DERN. Yes.

Senator GORE. Now, would that be subject to the same objection, from your point of view, as this tax?

Secretary DERN. I did not catch that, Senator.

Senator GORE. Would that be subject to the same objection as this proposed tax? If we substituted for this tax in this bill the quota contained in the Filipino Independence Act, of 200,000 tons a year, what would be your reaction to that?

Secretary DERN. I do not think there could be any serious objection to that so far as coconut oil is concerned because that is part of the offer, but it would result in placing a tax on copra not contemplated in the proposed Independence Act.

Senator GORE. Now, here is the only argument, from my point of view, in favor of this act, Mr. Secretary: We have been turning under cotton and cottonseed, to cut down the volume raised, and to stimulate the price, and we have been slaughtering hogs with the same view, to cut down production of lard and, directly or indirectly, to raise the price. Now, there is a real argument. If we are going to do that, if we are going to spend millions for that purpose, and then allow these foreign oils to come in and take the place of these, that constitutes the only argument, from my point of view, in regard to a tariff and a tax. That is vital.

Senator KING. But, Senator, having made that statement which you just made or having given that reason, I do not think it is quite fair to eliminate these Philippine Islands. They are under the flag. They have got the same rights to ship into the United States as Oklahoma has to ship into Utah.

Senator CONNALLY. And they have the same right to reduce their production.

Senator KING. We are reducing their production, by taxes.

Senator GORE. They are a part of this country, and there is a moral right. I think there is a moral restraint upon people not to plunder people who are in chains.

Senator BARKLEY. There is a difference, even in principle, at least in policy, between turning under a part of a yearly crop that can be immediately reproduced the following year, and doing the same as turning under a grove of coconut trees that cannot be reproduced under 10 or 12 years.

Senator GORE. But that is not the point. I did not have in contemplation cutting down the coconut trees.

Senator BARKLEY. No, I understand, but if it be true that the exclusion of this oil from the United States will ruin the coconut farms of three or four million people, the effect would be just the same as if you did turn them under.

Secretary DERN. If we have the right to impose the quotas upon the people of the Continental United States, we have a right to impose quotas upon the people of the Philippines. That quota, of course, is included in the pending independence bill.

Senator CONNALLY. Mr. Secretary, isn't it true that the production of copra and oil in the Philippines has very greatly increased in recent years? I have figures here, in which it is claimed that in 1910 there were only 400,000 acres, and that today there are 1,236,000 acres.

General COX. Yes sir, that is correct.

Secretary DERN. Perhaps General Cox can answer those questions better than I can.

Senator CONNALLY. They are bringing in about 58,000,000 more trees, aren't they?

General Cox. They estimate now that there are about 65,000,000 bearing trees in the islands, according to one estimate that I have, and there are 1,363,000 acres in coconuts, in the estimate I have here.

Senator CONNALLY. Yes; and are there not about 37,000,000 new trees that are now coming in, or that will be coming in within the next few years?

General Cox. It is stated that the number of bearing trees, when all the planting has arrived, will reach nearly 100,000,000.

Senator CONNALLY. 100,000,000 trees?

Secretary DERN. Yes.

General Cox. But there are some 35,000,000 not yet bearing.

Senator CONNALLY. The reason I asked you that is to illustrate that while we are restricting production here, the Filipinos are greatly expanding their production of coconut oil and copra.

Senator GEORGE. Senator, that will be undoubtedly true, if we, by law, actually restrict the production, say, of cotton, cotton seed, and cotton seed oil. That is proposed, right now, in this Congress.

Senator CONNALLY. It is being done.

Senator GEORGE. It strikes me we are very much more solicitous about the welfare of the Filipinos than we are about some of our own people.

General Cox. Should the independence legislation pending go through——

Senator GEORGE. Well, it would be several years before they could get any results on that.

General Cox. From the institution of the Commonwealth Government under the act, then, the quotas would become effective at that time. The intervening period would permit them to get adjusted to these conditions, under fairer circumstances to them.

The CHAIRMAN. Well, thank you very much.

Senator CONNALLY. One other question, Mr. Chairman. This is very important. It seems to me that since these gentlemen are assuming to speak for the administration, we have a right to develop the matter a little further than we would with an ordinary witness. Now, the favorable trade conditions here in the United States, for the Filipinos, makes this their best market, doesn't it?

General Cox. Yes, sir.

Senator CONNALLY. Free entry, and all that sort of thing, and the more we could produce, here, the more we are begging them to expand; is not that true?

General Cox. That has been the case in the past, Senator.

Senator CONNALLY. That has been the case in the past,; yes, sir. That is what we are supposed to look to for guidance in the future, the experience of the past. Now, the prices of copra and oil are very cheap now, aren't they, cheaper than in many cases? And this tax would not be so burdensome, as far as the price here in the United States is concerned. As far as the price in the Philippines is concerned the Filipibos would be protected. The testimony here, by the soap people, is that they are going to require this oil, no matter what the price.

Senator KING. Or produce inferior quality soap.

Senator CONNALLY. Well, if they produce soap—and people who want coconut oil soap would certainly pay for it—and if the coconut oil still comes in, the Filipinos are not going to be materially hurt, they? That is, if it still comes in, and the tax is paid?

General COX. If the coconut oil still comes in.

Senator CONNALLY. Yes.

General COX. We do not believe it will come in.

Senator CONNALLY. Then you are contradicting most of the witnesses on your side, because most of them testified that they cannot do without it.

Senator BARKLEY. That was testified to by only one witness. That was a witness representing the Procter & Gamble Co. at Cincinnati. The other witnesses as I recall it, did not claim that it would all come in any more.

Senator CONNALLY. I did not say "all."

Senator MCADOO. I understood it would result in a serious curtailment of imports of coconut oil, unless they should pass on the increased price of the finished product to the consumer, and I should think it would naturally have that effect.

Senator KING. General Cox, in the consideration of this question, should we not consider the fact that by law we have prohibited the Philippine Islands from imposing tariffs upon other countries, so we have forced them to compete with all other nations on a tax free basis?

General COX. The Philippine Islands may impose tariffs upon foreign goods but such legislation cannot become effective until approved by the President. As regards trade relations with the United States such trade relations are governed exclusively by laws of Congress.

Senator KING. Yes.

Senator BARKLEY. We are the only nation that has a free market in the Philippines for our product.

The CHAIRMAN. Are there any more questions?

Senator CONNALLY. How many troops are there in the Philippines, do you know?

Senator REED. Seven or eight thousand, isn't it?

Senator KING. No.

General COX. There are of the Regular Army 4,600 Americans; 6,465 Philippine Scouts.

Senator CONNALLY. Many of these exports you talk about are included in supplies we send to the Army, there, too; isn't that a fact?

General COX. Nothing was said on that, in the statement I made. I am not sure whether they are included. Presumably they are.

Senator BARKLEY. The Army carries its own supplies across, doesn't it? It used to, in transports.

General COX. Yes. They purchase a good many supplies, however, in that locality—generally under contract, as I understand it.

Senator BARKLEY. They purchase a lot of native supplies, don't they? They do not ship everything from the United States?

General COX. To what extent, I do not know. But they use a lot of native things, of course, in their normal life; those things that are suitable.

Senator MCADOO. The point you are making is that our exports to the Philippines do not include the exports to our own Army in the Philippines.

Senator CONNALLY. He just said that they are presumably included.

General Cox. In response to a question by a Senator, I present for the record a statement of the quotas fixed by the Tariff Act of 1909, on shipments from the Philippine Islands, as follows:

Section 5 of the United States Tariff Act, August 5, 1909, provided for the following limitations on duty-free shipments from the Philippine Islands:

Sugar, full tariff on all in excess of 300 gross tons. Tobacco, full tariff on all in excess of—

Wrapper tobacco, 300,000 pounds; filler tobacco, 1,000,000 pounds; cigars, 150,000,000 cigars; rice, full tariff on all rice.

(The letter written by Secretary Dern to the Chairman Committee on Finance on Feb. 15, 1934, is as follows:)

WAR DEPARTMENT,
Washington, February 15, 1934.

Hon. PAT HARRISON,
Chairman Committee on Finance, United States Senate,
Washington, D.C.

DEAR SENATOR HARRISON: H.R. 7835 entitled "A bill to provide revenue, equalize taxation, and for other purposes", introduced in the House of Representatives on February 9, 1934, contains a provision (sec. 602) imposing a processing tax of 5 cents per pound on coconut and sesame oils.

Coconut oil and copra from which coconut oil is made in the United States are the products of the second largest industry in the Philippine Islands. Under present conditions practically all of the coconut oil produced in the Philippine Islands is shipped to the United States. Copra, being on the free list, about 44 percent of that used in the mills in the United States comes from the Philippine Islands, the remainder from the Netherlands East Indies, British Malaya, British Oceania, and French Oceania.

It has been alleged by those interested in the coconut-oil business in this country that a processing tax of 5 cents per pound on coconut oil would effectually prevent its use in all products made in the United States in which substitutes can be used. If this claim is well founded, the principal purpose of the tax—presumably to raise revenue—will be defeated.

I believe the imposition of such a tax would work a serious injury to a vital industry of the Philippine Islands.

Should it result, as has been predicted, in preventing or seriously restricting the use of Philippine coconut oil and copra in the United States, it will practically destroy the means of livelihood of the people in the islands engaged principally in this industry. The Governor General, in a message dated March 8, 1932, stated that this will affect from 1,500,000 to 2,000,000 Filipinos. Governor General Murphy, in a radiogram of October 20, 1933, stated that over 90 percent of the coconut production in the Philippine Islands is from small farms averaging less than 10 acres and that coconut cultivation is the first or second most important crop in 30 out of the 49 Provinces in the islands. It follows, also, that anything that will curtail the present already depressed purchasing power of the Philippine Islands will have an unfortunate curtailing effect on our own trade, although not to the same vital extent as it will affect the Philippines.

I desire to urge that Congress do not tax one of the principal and vital products of the Philippine Islands so as to jeopardize the welfare of more than on one seventh of the population of those islands, and thus lay the United States Government open to the charge of not according fair and equal treatment to the people of the Philippine Islands.

The Organic Act of the Philippine Islands, approved August 29, 1916, provides that "the trade relations between the islands and the United States shall continue to be governed exclusively by laws of the Congress of the United States." Since 1913 Philippine products have entered the United States free of duty and United States products have entered the islands free of duty. It is hoped this policy will be continued, as indeed no other policy toward the people of our insular dependencies can be justified so long as these islands remain under our flag.

It is recommended that the bill be amended so as to eliminate the provisions contained in section 602 thereof imposing a tax on coconut oil.

A letter similar to this one was sent to the Chairman of the Committee on Ways and Means of the House of Representatives on January 29, 1934, when the bill was being drafted by that committee.

Sincerely yours,

GEO. H. DERN, *Secretary of War.*

(The radiograms referred to by Secretary Dern, with the recommendation that they be incorporated in the record, are as follows:)

MANILA, *October 20, 1933.*

The SECRETARY OF WAR,
Washington, D.C.,

There is local concern as the result of rumors, dispatches, and private advices to the effect margarine manufacturers may agree to use no fat or oil ingredients in manufacture of margarine except fats and oil produced from animals or vegetables raised or produced in continental United States. In reference this danger confronting our second largest industry, I direct attention of officials concerned to historical background of coconut industry in the Philippines, with special reference to oil manufacture.

(1) Production and export of copra has been an important activity since the middle of nineteenth century, but its growth to present proportions and development of the oil-extracting branch of the industry were largely automatic result of factors beyond local control.

(2) Prior to establishment of free trade in 1909 there were no coconut oil mills in the islands and the bulk of cured copra was shipped to Europe where the oil was extracted and a considerable fraction exported to the United States for soap-making, the oil-milling profit remaining in Europe.

(3) Because of its high glycerine content coconut oil became an important war material, attaining an attractive price level which stimulated production. During the 4 years 1910 to 1914, largely as a result of European demand for oil and with official encouragement, six mills were established in the Philippines.

(4) After the United States entered the war the Philippines was definitely encouraged to expand production to meet allied and American war-time requirements. As a consequence, during the period 1915 to 1921 there were built 31 new mills, increasing daily oil capacity from 280 to approximately 1,000 metric tons.

(5) As the result of the slack of war demand and because of lower prices 28 mills were either closed or merged in spite of the stimulation offered by unrestricted free trade and United States tariff of 2 cents per pound on oil and three tenths of a cent per pound on cake or meal. Daily capacity was reduced to 880 tons. This constituted a definite reorganization, particularly in view of the fact that the United States continued to take increasing quantities of the copra for extraction of oil in mills located in the States.

(6) Copra today remains on the United States free list and only forty-odd per-cent of the total supply imported by mills in the States is taken from the Philippines, while approximately 60 per cent comes from the South Sea Islands, Straits, Celebes, Borneo, Sumatra, etc.

(7) Over 90 percent of coconut production is from small farms averaging less than 10 acres, ownership mainly by heads of families whose members directly engage in collecting nuts and making copra. Cultivation is wide-spread, being first or second most important crop in 30 out of the 49 Provinces in the islands.

(8) Taxation on coconut trees and land devoted thereto amounts to over 50 percent of taxes on real property in 8 provinces and to between 20 and 50 percent in 13 provinces and to between 10 and 20 percent in 6 provinces. For the entire Philippines, excluding the chartered cities of Manila and Baguio, taxes on coconut property constitute 15 percent of all real-property taxes.

(9) As bearing on the subject American dairy interests should note that the Philippines is the largest overseas customer of American tinned milk, 1932 imports amounting to over 25,300,000 pounds. Any action which would eliminate Philippine peasant income from coconut production would react to curtail consumption of dairy products and many other United States goods which make milk fall within the luxury class for these people.

From this general situation arises local opinion on the proposed restriction of use as follows:

(1) Limitation of use of Philippine coconut oil after its arrival in the United States is considered discriminatory and contrary to the spirit of reciprocal free trade.

(2) It is less acceptable than the previously proposed export limitation at 2,000,000 tons.

(3) It might be acceptable if counterbalanced by action placing equivalent duty on raw copra, thus assuming to Philippines entire United States market, whether in form of oil or copra for the coconut oil used for soap and other non-edible purposes or reexploited.

Until every means for nationalization of the industry has been exhausted and a fair hearing accorded Philippine interests no discriminatory action should be taken affecting use in the United States of products of this Philippine industry.

MURPHY.

MANILA, *February 3, 1934.*

SECRETARY OF WAR, *Washington, D.C.:*

(Par. 2.) Local experts have called to my attention two elements in the discussion of the proposed excise tax on coconut oil:

(a) Unless the excise tax is extended to cover African palm oil the result will be greatly enhanced importation of this commodity from without flag area in substitution for coconut oil and copra produced in Philippines.

(b) Every reduction of 1,000,000 bales in United States cotton production will mean corresponding reduction of 50,000 tons of cottonseed oil. The net result of reduction in cotton crop and reduction through excise taxes of copra and coconut-oil importation may create serious deficit in United States supply of vegetable oils.

I suggest that the above be given very careful consideration.

MURPHY.

MANILA, *February 6, 1934.*

SECRETARY OF WAR, *Washington, D.C.*

Efficacy of proposed coconut-oil excise tax as protection to American farmer is seriously questioned here on following point: Assuming United States imports of coconut and sesame oils radically curtailed there remain many foreign oils not included in the excise tax the importation of which might easily check the anticipated price improvement of United States continental fats and oils. The following foreign oils and fats are either on the United States free list or carry United States customs duties: List B, palm-kernel oil, 1 cent pound; C, palm-kernel oil, denatured free list; G, tallow, soya-bean oil, 3½ cents pound; E, whale oil, 1 cent pound; F, sunflower oil, denatured free list; G, tallow, one half cent pound; H, cottonseed oil, 3 cents pound; I, cottonseed, one third cent pound, with extraction about 17 percent would yield oil at duty 2 cents a pound.

I suggest earnest consideration this viewpoint. Greatly fear precipitate action will sacrifice the prosperity of an American territory to little or no advantage to anyone under the flag and merely to the profit of foreign producers of the above-listed cheap oils.

MURPHY.

MANILA, *February 9, 1934.*

SECRETARY OF WAR, *Washington, D.C.:*

Please present to proper authority my firm conviction that the excise tax on coconut oil in the form proposed will work incalculable harm to the Philippines without advantage to continental United States interests and in addition will be to the advantage of African palm-oil and other foreign oils, especially those listed in my radiogram 49. The proposed tax is equal to 200 percent of the current price of the product and is more likely to destroy the Philippine coconut industry than to produce any substantial revenue.

For the Philippines the excise tax will mean the practical destruction of its second largest industry and the impoverishment of our 3,000,000 farming people or one fourth of the population.

Financially this means the bankruptcy of 8 important Provinces mainly dependent on the coconut industry and the questionable success of 10 others. The resulting decline in revenues will imperil essential government services and interest payments on provincial bonds in the area affected. Economically it will cause a decrease in purchasing power here and a corresplnding decrease in imports from the United States. Socially it will entail widespread distress and dissatisfaction among the people. It is suggested that any benefit that may accrue to domestic interests from such a measure cannot outweigh or equalize the wholesale harm and distress that it will cause here.

In my opinion sudden and extreme action crushing to the Philippines and profiteering foreign-oil producers does not meet our plain responsibility of a people under the flag. The people of the Philippines dependent upon us and unable to legislate for themselves in matters of this kind must rely upon our moral obligation and responsibility to them for the protection of their welfare.

We should not impair the work of 30 years for their social and economic advancement.

It is earnestly requested that action on the excise tax be withheld until we can exchange full information and views by letter.

MURPHY.

FEBRUARY 24, 1934.

SECRETARY OF WAR,
Washington, D.C.:

Please convey to the President my deep concern in the matter of the excise tax on coconut oil. My position is expressed in the following radios of previous date: No. 374, October 20; 45, February 3; 49, February 6; 57, February 9; 62, February 12.

Intimate contact with the situation locally forces on me the conclusion that the unlimited application of the tax will provoke a new disaster in the economy of the Philippines. The general feeling is pronounced against the moral right of the United States to legislate so severely against a territory under the flag as practically to destroy an industry on which more than 3,000,000 people are directly dependent.

MURPHY.

FEBRUARY 27, 1934.

SECRETARY OF WAR
Washington, D.C.:

Communication received from Associated Steamship Lines, comprising 29 steamship lines operating between Philippines and United States. I am submitting five pertinent paragraphs for utilization as your judgment dictates in further effort to indicate the adverse effects upon islands and also American exporters that I believe will be experienced by the application of excise tax upon copra and coconut oil.

1. That copra and coconut oil shipments combined constitute the second largest homeward movement of cargo from the Philippines to the United States of America.

2. That this copra and coconut oil movement is a year-round movement and not essentially seasonal, thus making it possible for various steamship lines to maintain a regular service between ports in the United States and the Far East, including the Philippines, at reasonable freight rates.

3. That all the steamship lines engaged in trade between the Philippine Islands and the United States pay income tax and tonnage dues as well as other taxes in both countries, and Panama Canal tolls to a far greater degree than tolls to Suez; furthermore, that the regular activities of steamship lines in this trade benefit all allied trades, including pilots, stevedoring companies, terminal companies, petroleum companies, customs brokers, ships chandlers, ship repair yards, and any number of other industries in seaports which are dependent upon a regular flow of trade to and from such ports.

4. That any serious curtailment of the copra and coconut oil movement from the Philippines to United States would most surely result in a corresponding curtailment of shipping services to the detriment of American exports and Philippines imports.

5. That, as pointed out already by the Governor General and various trade bodies of the Philippine Islands, the imposition of the proposed excise tax on coconut oil would surely curtail the movement of copra and coconut oil to such an extent that the buying power of millions of people would be drastically reduced to the serious disadvantage of the American exporter and incidentally would thus affect all Philippine business, including interisland shipping and the revenues derived by the Philippine customs and harbor authorities.

I wish to reiterate my past personal statements relative to adverse effects of the application of the excise tax. It should not receive approval. I know you are doing everything possible. If you have any suggestions that in your opinion would be of aid, please advise.

MURPHY.

MARCH 8, 1934.

SECRETARY OF WAR,
Washington, D.C.:

The following resolutions were approved by the Philippine Coconut Planters Conference and upon their request am forwarding to you with request that copy of the resolutions pertaining to President Quezon and his mission, and the resident commissioners, be transmitted to them. The balance is self-explanatory and I know sincere:

"Resolved by the Philippine Coconut Planters Conference to express to President Quezon, and the members of his mission, and to the resident commissioners, its satisfaction for their efforts exerted since the beginning to prevent the approval of the excise tax on Philippine copra and oil;

"Resolved further to express the hope that they would continue their effort on behalf of the coconut industry until final success is attained.

"Resolved by the Philippine Coconut Palnters Conference to express through His Excellency, Governor General Frank Murphy, to Secretary of War Dern, its deep gratitude for his personal appearance before the Senate Committee in Washington, to oppose on behalf of the Filipino people the excise tax on copra and oil. The coconut industry represents the economic efforts of 4,000,000 Filipinos continued for generations. It is in the hands of small landholders whose economic ruin would destroy their only means of livelihood and seriously affect their purchasing power and their capacity to pay the taxes. The ruin of the coconut industry might also effect the stability of the Government.

"Resolved further to request the Secretary of War to express to the President of the United States the earnest and sincere hope that he will endeavor to maintain the spirit of open cooperation between America and the Philippines by fostering a mutually beneficial trade, which is the lasting foundation of cordial amity between the two peoples.

"Unanimously approved in Manila on the fifth day of March, 1934.

MURPHY,

Hon. ROBERT L. DOUGHTON,
Chairman Committee on Ways and Means,
House of Representatives, Washington, D.C.

DEAR MR. DOUGHTON: I am advised that your committee has under consideration an excise tax of 5 cents per pound on coconut oil.

Coconut oil and copra from which coconut oil is made in the United States are the products of the second largest industry in the Philippine Islands. Under present conditions practically all of the coconut oil produced in the Philippine Islands is shipped to the United States. Copra being on the free list, about 44 percent of that used in the mills in the United States comes from the Philippine Islands, the remainder from the Netherland East Indies, British Malaya, British Oceania, and French Oceania.

It has been alleged by those interested in the coconut-oil business in this country that an excise tax of 5 cents per pound on coconut oil would effectually prevent its use in all products made in the United States in which substitutes can be used. If this claim is well founded, the principal purpose of the tax—presumably to raise revenue—will be defeated.

I believe the imposition of such a tax would work a serious injury to a vital industry of the Philippine Islands.

Should it result, as has been predicted, in preventing or seriously restricting the use of Philippine coconut oil and copra in the United States, it will practically destroy the means of livelihood of the people in the Islands engaged principally in this industry. The Governor General, in a message dated March 8, 1932, stated that this will affect from 1,500,000 to 2,000,000 Filipinos. Governor General Murphy, in a radiogram of October 20, 1933, stated that over 90 percent of the coconut production in the Philippine Islands is from small farms averaging less than 10 acres and that coconut cultivation is the first or second most important crop in 30 out of the 49 Provinces in the islands. It follows, also, that anything that will curtail the present already depressed purchasing power of the Philippine Islands will have an unfortunate curtailing effect on our own trade, although not to the same vital extent as it will affect the Philippines.

I desire to urge that Congress do not tax one of the principal and vital products of the Philippine Islands so as to jeopardize the welfare of more than one seventh of the population of those Islands, and thus lay the United States Government

open to the charge of not according fair and equal treatment to the people of the Philippine Islands.

The Organic Act of the Philippine Islands, approved August 29, 1916, provides that "the trade relations between the islands and the United States shall continue to be governed exclusively by laws of the Congress of the United States." Since 1913 Philippine products have entered the United States free of duty and United States products have entered the Islands free of duty. It is hoped this policy will be continued, as indeed no other policy toward the people of our insular dependencies can be justified so long as these islands remain under our flag.

Sincerely yours,

GEO. H. DERN, *Secretary of War.*

FEBRUARY 6, 1934.

SECRETARY OF WAR,
Washington, D.C.:

Efficacy of proposed coconut oil excise tax as protection to American farmer is seriously questioned here on following point: Assuming United States imports of coconut and sesame oils radically curtailed there remain any foreign oils not included in the excise tax the importation of which might easily check the anticipated price improvement of United States continental fats and oils. The following foreign oils and fats are either on the United States free list or carry United States customs duties; list B palm kernel oil 1 cent pound; C palm kernel oil denatured free list; G tallow soybean oil 3½ cents pound; G tallow one half cent pound; H cottonseed oil 3 cents pound; I cottonseed one third cent pound with extraction about 17 percent would yield oil at duty 2 cents pound.

I suggest earnest consideration of this viewpoint. Greatly fear precipitate action will sacrifice the prosperity of an American territory to little or no advantage to anyone under the flag and merely to the profit of foreign producers of the above listed cheap oils.

MURPHY.

FEBRUARY 9, 1934.

SECRETARY OF WAR, *Washington, D.C.:*

Please present to proper authority my firm conviction that the excise tax on coconut oil in the form proposed will work incalculable harm to the Philippines without advantage to continental United States interests and in addition will be to the advantage of African palm oil and other foreign oils, especially those listed in my radiogram 49. The proposed tax is equal to 200 percent of the current price of the product and is more likely to destroy the Philippine coconut industry than to produce any substantial revenue. (Par.)

For the Philippines the excise tax will mean the practical destruction of its second largest industry and the impoverishment of our 3,000,000 farming people or one fourth of the population. (Par.)

Financially this means the bankruptcy of eight important provinces mainly dependent on the coconut industry and the questionable success of 10 others. The resulting decline in revenue will imperial essential Government services and interest payments on provincial bonds in the area affected. Economically it will cause a decrease in purchasing power here and a corresponding decrease in imports from the United States. Socially it will entail widespread distress and dissatisfaction among the people. It is suggested that any benefit that may accrue to domestic interests from such a measure cannot outweigh or equalize the wholesale harm and distress that it will cause here. (Par.)

In my opinion sudden and extreme action crushing to the Philippines and profiting foreign oil producers does not meet out plain responsibility of a people under the flag. The people of the Philippines dependent upon us and unable to legislate for themselves in matters of this kind must rely upon our moral obligation and responsibility to them for the protection of their welfare. We should not impair the work of 30 years for their social and economic advancement. (Par.)

It is earnestly requested that action on the excise tax be withheld until we can exchange full information and views by letter.

MURPHY.

The CHAIRMAN. Mr. Quezon.

STATEMENT OF MANUEL L. QUEZON, PRESIDENT OF THE PHILIPPINE SENATE AND CHAIRMAN PHILIPPINE INDEPENDENCE DELEGATION

DISCUSSING SECTION 602, TAX ON OILS

Mr. QUEZON. Mr. Chairman, and gentlemen of the committee. In the first place, I wish to thank you, Mr. Chairman and gentlemen of the committee, for this great privilege of addressing you in executive session. I do not wish to use all your time, and since I heard the statement of the Secretary of War, every bit of which I thoroughly endorse, some of the things that I was going to say, which have already been stated by him, I am going to admit.

I also wish to say that the representations made by Senator Quirino, before the committee, and Secretary Singson of the Agricultural Department of the Philippine government, receive my full endorsement. There is only one point therefore that I wish to emphasize this morning, and that is this: The trade relations between the United States and the Philippine Islands have been established by an act of Congress. We have nothing to do with these trade relations. As a matter of fact, when Secretary of War Taft first recommended that the free-trade relations be established between the Philippine Islands and the United States, the Philippine Assembly protested against that proposal, upon the ground that if the policy of the United States was ultimately to grant independence to the Philippine Islands, the establishment of their free-trade relations between America and the Philippines would naturally create such economic ties between these two countries as to make it difficult, if not impossible, to cut those economic ties abruptly, without destroying the economic structure of the islands, when the time for the political separation of these two countries came.

In spite of this protest on the part of the Philippine assembly, the Senate of the United States found it proper and convenient to establish these free-trade relations, upon the theory that only thus the United States could help the Philippines economically as well as socially during the time that the islands were under the American flag; and since President McKinley, upon the establishment of American sovereignty over the Philippine Islands, states it to be the policy of America not to exploit the Philippines, but to develop the islands economically, socially, and politically, so that they may, in due time, enjoy the heritage of freedom. The War Department and Mr. Taft and President Roosevelt insisted that these free-trade relations should exist. Now, those trade relations have existed, in the beginning, as the Secretary of War said, with certain restrictions, but in the Tariff Act of 1913, or of 1912—I do not remember which of those 2 years—under the leadership of former Congressman Underwood, of Alabama, all restrictions upon trade relations between the United States and the Philippine Islands were eliminated, and that established a precedent.

Now, I have noticed that for the last 3 or 4 years efforts are being made in the United States to curtail the free entrance of our sugar, of our coconut oil, and of our rope, manila rope; and evidently this tax on coconut oil, this exise tax on coconut oil, is in line with these attempts.

Now, Mr. Chairman, you have heard what my colleagues and the Secretary of War has stated about that before your committee, namely, that the imposition of this tax on coconut oil will destroy the second largest export trade of the Philippine Islands, the coconut industry. That is true.

It is not only going to deprive 4 million men, women, and children of their means of livelihood, but it is going to actually bankrupt at least 4 provincial governments, all the municipalities constituting it, and seriously reduce the revenues of about 11 or 12 more provincial governments. I want to explain this a little bit more, because I do not think that any of those Filipinos who have addressed the committee have made any concrete statement upon this fact. The Philippine Government is constituted into one national government. It is called the "Insular Government", and then the provincial governments, each provincial government is constituted by municipalities.

The insular government is supported by revenues from internal revenue. The provincial and municipal governments are exclusively supported from taxes levied on land. I mean, land taxes. That is all they have, except perhaps for some minor municipal licenses. This tax, the land taxes, pay for the maintenance of the provincial governments, of the municipal governments, of the schools, provincial, and municipal roads, so that those provinces which had nothing but the coconut industry, if this tax is imposed in the amount that it is provided in the law, these provinces will not be able to pay their land taxes, because they have no other means of income, with the result that we would have to close 4 provinces, closing all the schools, and disbanding the municipal police of those provinces.

Now, this is not an exaggeration. This is a statement of a positive fact.

Now, what I was going to say was this: If the United States, if the American people find it not to their interest to continue with these free-trade relations between the United States and the Philippine Islands, I believe it is only fair that one or two things be done—grant the Philippines independence, which naturally would terminate the free-trade relations between the two companies. If, as a result of that, there should be some economic upheaval or distress in the Philippine Islands, the responsibility is not as serious as it would be if the economic disturbance in the Philippines is created by your own laws, and while you are still keeping the Philippines under the American flag, and making the Filipinos take into the islands, free of duty, American products, articles, and goods.

The President of the United States, however, in his message to Congress, has stated that it would be an injustice to the Filipino people, a denial of independence itself, to let the islands go now, and his reason is because of these trade relations, these economic ties that have been built up between the United States and the Philippine Islands by acts of Congress, and it will be necessary for the Filipino people to have some time to adjust their economic condition, to the situation that will be created, when complete independence is granted and the free-trade relations are terminated.

Well, if that is the view of the President, and that is the view of the Congress, as it evidently is, because of the acts which you passed last year, which did not grant immediate independence, but provided

for independence at the end of 10 years; if that is the view of the President and of the Congress, that you cannot grant the Philippines immediate independence, on account of these economic conditions, prevailing at present in the Philippine Islands, may I ask, Mr. Chairman, how could it be justified to impose such taxes upon Philippine products coming into this country, when the imposition of these taxes would result in practically closing the American market to these products?

I think that it would be, if it is unfair as the President says, to let the Philippines go now, on account of their economic dependency, from the United States, it seems to me that it would be perhaps worse, if they are kept under the American flag, and these taxes were imposed upon their goods coming into this country.

Now, Mr. Chairman, I do not wish to impose upon the time of the committee, and I just want to say to you that this really is a very serious matter for the Filipino people and the Philippine Government. This is more serious to us than the question of the limitation on sugar. The limitation on sugar affects the great landed estates of the Philippines, the lords. This coconut oil affectes the small farmer, because this is an industry which is owned by small families, each having 2 or 3 acres, 4 or 5 acres of land, while these people have absolutely no recourse, and as to this industry shall have been destroyed. They will have absolutely no other means of livelihood. In my own parlance—perhaps I am a little bit interested——

Senator GORE. What was their means of livelihood before this industry was established?

Mr. QUEZON. Beg pardon?

Senator GORE. What was their means of livelihood? How did they maintain themselves, prior to the establishment of this industry and these large imports?

Mr. QUEZON. Well, this industry, Mr. Senator, has been established in the Philippines about 50 years ago.

Senator GORE. I know, but these large imports have only been coming in here during the last 3 or 4 years, in such large quantities.

Mr. QUEZON. No; we had large imports into the United States in 1917, more than we have now.

Senator GORE. You did?

Mr. QUEZON. Yes, sir.

Senator GORE. It has been declining for about 5 years. About 1928 or 1929 was the peak period.

Mr. QUEZON. No, sir; 1917 and 1918, I think was the peak period.

Senator GORE. Well, that was owing to the war.

Mr. QUEZON. Yes, yes. Since that time, it has been going down, and of course, we have been planting more coconut trees. I heard the Senator from Texas ask the question as to the number of trees that we have now in the Philippines. We have been planting. You must remember that the coconut tree requires from 7 to 14 years to grow. Well now, 7 years ago, we did not know, in the Philippines, that there was going to be a depression. We did not know that the United States is going to resent our exporting here some of those products. As a matter, of fact, we knew that the Government of the United States was almost compelling us to develop that country economically, and therefore we got busy and planted more trees; but we are suffering the consequences from that. We are today

receiving less price for our copra than we ever did, even under the Spanish regime. We only get one peso, one peso and a half, and two pesos—that is, 50 cents gold, $1 gold, for each pito of copra in the Philippine Islands. I do not know how many pounds that is, but the copra has never been as low as it is today.

The CHAIRMAN. Well, the committee thanks you very much, Mr. Quezon.

Senator BARKLEY. You started to say something a moment ago about your own Province.

Mr. QUEZON. Yes; that is my province, Fayabay. The province of Fayabay is just going to be wiped off the map, if this thing is enacted. We haven't anything else there except copra.

Senator KING. Do you find much of a market in other countries?

Mr. QUEZON. Well, we cannot tell. We have no markets in any other countries, Senator, and the reason is simply this, you cannot sell where you cannot buy, and we cannot buy from any other country, on account of our free-trade relations with the United States.

Senator KING. We prevented you from developing other markets?

Mr. QUEZON. Yes, sir.

Senator KING. By forcing you to trade exclusively with us?

Mr. QUEZON. And by the way, Senator, I just want to call the attention of the committee to this fact, that 3 years ago we noticed that, as a result of the policy adopted in foreign countries, getting off the gold standard, they were able to compete by sending their exports into the Philippine Islands in competition with American exports. The Philippine Legislature immediately proceeded to pass three different acts to make this protection to American products. We compelled these countries to pay in gold. At that time, you had not gotten off the gold standard yet. We compelled them to pay in gold, the tariff duties. We made them pay in gold, first. Second, we raised the duties, and third, we passed an antidumping law. That is what we did only 2 years ago, in order to continue protecting the American goods.

Senator CONNALLY. Mr. Quezon, let me ask you about the cultivation. After you plant these trees, is there a great expense in cultivating them?

Mr. QUEZON. After you plant them?

Senator CONNALLY. Yes.

Mr. QUEZON. No, no; except to clean it every year.

Senator CONNALLY. How?

Mr. QUEZON. Except the cleaning of the land, continuously, every year.

Senator CONNALLY. Once planted, how long do they live? How long are they productive?

Mr. QUEZON. Well, 40 or 50 years, about.

Senator CONNALLY. 40 or 50 years?

Mr. QUEZON. At least; yes.

Senator CONNALLY. Practically no cultivation at all?

Mr. QUEZON. Not while they are not bearing fruit, but when they begin to bear fruit, then you have to attend them more, and, during the first 3 years, you have to clean the land every year, every 4 months, something like that, because, in the Philippines, being a tropical country, that must be done.

Senator REED. On account of the vegetation?

Mr. QUEZON. The vegetation grows very rapidly.

Mr. GORE. When do you gather them?

Mr. QUEZON. I beg your pardon, Senator?

Senator GORE. When do you gather these nuts?

Mr. QUEZON. Four times a year, in some provinces, and in others three times.

Senator GORE. Four times?

Senator QUEZON. Yes, sir, and every 3 months, in some provinces. Every 4 months, in others.

Senator BARKLEY. Does that mean that there is an entirely new crop every 3 months?

Mr. QUEZON. Yes, every 3 months.

Senator BARKLEY. And you strip the trees completely when you gather them?

Mr. QUEZON. Yes.

Senator BARKLEY. And then, in 3 months, you have got another tree full?

Mr. QUEZON. Yes.

Senator BARKLEY. But the same tree?

Mr. QUEZON. Oh yes, yes. I remember one very witty and very scholarly Filipino said, one of the worst curses of the Philippines was the coconut tree, because it helped the Filipinos to be lazy.

Senator BYRD. What do you regard as the cost of production per pound of coconuts?

Mr. QUEZON. The cost of production of the tree?

Senator BYRD. A pound, of coconut oil. What do you think it costs you to produce it?

Mr. QUEZON. In the Philippines?

Senator BYRD. Yes.

Mr. QUEZON. Well, that is a pretty hard question to answer, Senator, because you have to take into consideration the value of the land, the number of years that you devote, that that land is idle, giving absolutely no return, the labor that you have put into that land, in those years.

Now, as I said, there are Provinces, which in several years, in the Province of Tayabas, where we have a very great amount of coconuts, and there is land where in 7 years, you already have some fruits. In other Provinces, it takes 14 years, so it is very difficult to say what really is the cost of that, because you have an idle capital there, for a number of years. You have land, and you have land taxes, and they work. It is very difficult, and it depends, but the price that we are getting now for our copra in the Philippines does not pay—I mean, we are getting a losing price. We do not get what we should get for our copra.

Senator WALCOTT. That is, the money that is invested there now, in copra, is not getting any returns?

Mr. QUEZON. Absolutely, on the contrary.

Senator WALCOTT. It is a loss?

Mr. QUEZON. It is loss; yes.

Senator BYRD. But, eliminating the cost of the land, and so forth, the actual cost of operation is very little, is it not ? All you have got to do is to gather them and keep the vegetation down?

Mr. QUEZON. Yes. Well, you mean the labor.

Senator BYRD. Yes.

Mr. QUEZON. Yes; the labor, it is very little when the tree is already producing, but prior to that time the labor is big, because you have some of this land, and other things.

The CHAIRMAN. Well, thank you very much.

Senator LONERGAN. I want to ask a question, Mr. Chairman.

The CHAIRMAN. Yes.

Senator LONERGAN. You say there are 4 million people dependent on this industry?

Mr. QUEZON. Yes, sir.

Senator LONERGAN. Now, of the 4 million, how many are represented by owners and workers, exclusive of children and women who might be dependent?

Mr. QUEZON. Owners and workers?

Mr. LONERGAN. Yes.

Mr. QUEZON. Well, I guess about one fourth, or 800,000 owners and workers.

Senator LONERGAN. What is that?

Mr. QUEZON. I suppose there are about 800,000 or 1,000,000, but we have actually—there is really no labor in those coconut plantations, Senator, because the men who own the coconut land work it themselves, or the man works for somebody who owns the land and divides the profit, and is not paid that in money. The custom in the Philippines is to divide the product with the owner.

Senator KING. My recollection of the ownership of lands is that substantially all of the coconut lands, and, for that matter, nearly all of the lands that are farmed, are owned by the landowners in from 2 or 3 or 4 acres up to 5 or 6 or 10 acres.

Mr. QUEZON. Yes. This is what we do, in planting the coconuts——

Senator KING. Small landowners, in other words.

Mr. QUEZON. The man who owns the land invites some people to plant the coconuts, and after the coconut bears fruit, they divide both the coconut and the land between the owner and the man who had worked, so the man who had worked became already an owner, after the crop.

Senator WALCOTT. It is crop-farming?

Mr. QUEZON. Yes.

Senator BARKLEY. As we call it, farming "on shares."

Mr. QUEZON. Yes.

Senator BARKLEY. Let me ask you this: You spoke of 800,000 or a million of the workers. Is it a fact that not only the head of the family works, but that the women and the children work in the gathering season?

Mr. QUEZON. Oh, yes, everybody—everybody. I thought that question was referring to men Yes, everybody works there, of course.

Senator BARKLEY. Everybody who is old enough and big enough does his share of the work?

Mr. QUEZON. Yes, sir.

Senator BARKLEY. Well now, who buys the coconuts from the family, the producer?

Mr. QUEZON. The agents for the exporters.

Senator BARKLEY. The agents go around through the country and buy up the coconuts?

Mr QUEZON. Yes, sir.

Senator BARKLEY. For the corporations that export?

Mr. QUEZON. Yes, sir.

Senator BARKLEY. And to what extent do they process coconut before it is sent to the United States as copra?

Mr. QUEZON. They just dry the coconut.

Senator BARKLEY. Dry the coconut?

Mr. QUEZON. That is all.

Senator BARKLEY. And what proportion of the import to the United States comes in copra, and what proportion in finished oil?

Mr. QUEZON. Well, I cannot answer that question. I do not know.

Senator BARKLEY. Is there any appreciable quantity of coconut oil ready for use coming from the Philippines?

Mr QUEZON. Very little. Not quite 200,000 tons. I think the maximum that we have sent is about 148 or 158.

Senator BARKLEY. So that the great bulk of it comes in copra?

Mr. QUEZON. Yes, sir.

Senator BARKLEY. And is manufactured in this country into oil?

Mr. Quezon. Yes, sir; but when you impose the tax on the oil you will be indirectly imposing the tax on that copra.

Senator CONNALLY. Mr. Quezon, aren't there any large plantations in the Philippines, devoted to the raising of coconuts?

Mr. QUEZON. I don't suppose there is more than really one or two, and those are American plantations, American owned plantations. The Columbus Sugar Estate has about 30,000 trees, or 50,000 trees—about 50,000 trees, but Filipinos do not own more than 10 or 20 thousand trees.

Senator CONNALLY. I believe you said there were four crops a year?

Mr. QUEZON. Yes.

The CHAIRMAN. Congressman Whittington, will you object if Senator Tydings makes a short statement before you speak?

Congressman WHITTINGTON. Not at all.

STATEMENT OF HON. MILLARD E. TYDINGS, UNITED STATES SENATOR FROM MARYLAND

RELATIVE TO SECTION 602, TAX ON OILS

Senator TYDINGS. Gentlemen of the committee, you all know that the Filipino Independence Act, which was passed in the last Congress, was rejected by the Filipino Legislature. Subsequent to that, Mr. Quezon and a new mission came back to Washington, and, after conferring several times everyone is in agreement upon a new Filipino bill, substantially like the old bill, with a modification of the military clause, as probably the only material change in the bill.

Senator REED. What is that modification?

Senator TYDINGS. That we give up the military basis, simultaneously with the advent of actual and complete Filipino independence.

Senator REED. And as to the naval base?

Senator TYDINGS. Concerning the naval base, we negotiate a treaty if we want to with them, after independence. It has been submitted to the Navy Department and the War Department, and everyone is in agreement on it. Prior, however, to agreeing to go along with this bill, cablegrams were went to the old mission, to a large number of the Filipino leaders, including General Aguinaldo, to the leaders in the senate and house, and so on. Every man, now, that has been communicated with, has pledged his support to the acceptance of the new Filipino bill.

Only yesterday I received cablegram from Manila, saying that a majority of the members of the house of representatives, and the majority of the senate, were now in favor of the new bill. Now, that is how far we have gotten with Filipino independence, and still is on the calendar in both the House and the Senate.

While this is going on, the sugar curtailment bill is being written in the House of Representatives. The Filipinos now produce about 1,300,000 or 1,400,000 tons a year, of sugar for export to this country. The highest figure in any bill is to allow them to send 1,037,000 tons in place of what they are now sending, so we are going to cut that down, and that is cut down right at the very time that these negotiations are pending. On top of that, we now come along and tax coconut oil 5 cents, in the middle of these negotiations.

Senator GORE. Five cents? Two hundred percent?

Senator TYDINGS. Five cents a pound, right in the middle of these negotiations. Now, after having gotten this whole thing in shape, and after all, they are just as much a part of the United States as Maryland or Pennsylvania or Virginia is today——

Senator CLARK. I deny that the Philippines are as much a part of the United States as Missouri. I do not know what the Senator from Maryland has to say.

Senator TYDINGS. Well, they have equal protection and equal rights under our laws, is what I am undertaking to say.

Senator KING. We got Missouri by purchase with money. We get the Philippines by aggression, so that is the difference.

Senator CONNALLY. Your statement is not quite accurate. We could not alienate Maryland. We could not cede it away.

Senator TYDINGS. Certainly you could. What is to stop you?

Senator KING. By treaty?

Senator TYDINGS. All you need is to get the agreement of the other States.

Senator CONNALLY. That is a slight matter, of course. Probably there wouldn't be much difficulty in getting that.

Senator GEORGE. What is the limitation in the bill on coconut oil?

Senator TYDINGS. No limitation, just the tax.

The CHAIRMAN. Two hundred thousand tons is in the independent bill, on the coconut.

Senator TYDINGS. If they are not as much a part of the United States as these other States, that is all the more reason why we should give them what the other States can get for themselves through their own representation. They have no respresentation here, and they are absolutely dependent upon us to treat them fairly. Now, every man here knows this is nothing more than a proposition to tax one commodity for the benefit of another commodity. It is not a revenue

measure. It is done simply to put one thing down and another thing up. Now, let us look at the other side of the picture.

The Filipinos are the largest users of American milk in the world. They import more milk from the United States than any other country on the face of the earth.

Senator COUZENS. Only a drop in the bucket, however, isn't it?

Senator TYDINGS. No; it is quite a large exportation, Senator. It is very high. I haven't the figures here.

Senator COUZENS. Less than two millions?

Senator TYDINGS. How?

Senator COUZENS. Less than $2,000,000?

Senator TYDINGS. Yes, less than $2,000,000, but how much do your imports amount to? Not two millions?

Senator BYRD. Ten millions.

Senator COUZENS. More than that, eight millions.

Senator TYDINGS. Well, eight millions. I may be wrong about that. They are the largest buyer of our cotton goods—one of the largest buyers of our cotton goods in the world. They wear nothing but cotton clothes, and they get their cotton from the United States.

Now, if we are going to help the cotton farmer, every dollar that we cut down, of their income, cuts down their purchasing power, to buy the cotton which we now have as a glut on the market, which we are plowing under, and for which we have lately been paying our American farmers.

Now, there is no economic justification in helping the cotton farmer through a process of this kind, and it will be absolutely impossible to negotiate any kind of an independence bill in an atmosphere of friendliness and mutual helpfulness if Congress is continually, while this is going on, going to cut down all of the things that the Filipino people sell to us, without permitting them to cut down the things which we sell to them. As a matter of absolute justice, that thing cannot be justified.

Now, the Secretary of War and the Governor General of the Philippines have sent numerous memoranda up here, and I would just like to read one letter.

The CHAIRMAN. The Secretary appeared before the committee this morning.

Senator TYDINGS. I know he did. I only want to read one excerpt.

Senator REED. He read the whole letter, I think.

Senator TYDINGS. He probably did not read this one, because the questions propounded by the committee, at least, show that they are not familiar with this fact. Should it result, as has been predicted, in preventing or seriously restricting the use of Filipino coconut oil and copra in the United States, it will practically destroy the means of livelihood of the people of the islands, engaged principally in this industry. The Governor General, in his message dated March 8, 1932, stated that this will affect from 1,500,000 to 2,000,000 Filipinos.

Governor General Murphy, in a radiogram of October 20, 1933, stated that over 90 percent of the coconut production of the Philippine Islands is from small farms averaging less than 10 acres, and that coconut cultivation is the first or second most important crop in 30 out of the 43 provinces in the island.

Now, that is the extent of the harm we will do these people. We will only lose in export trade everything we cut down in import trade, and I am going to ask you gentlemen, in view of the fact that the Filipino bill cuts off 40 percent of the sugar importation from the islands, the minute they accept it, even though they are still a part of the United States, we are going to take 40 percent of their sugar market away from them, pending the transitory period. I do not believe the common justice and decency can justify that, and if we were to go into these other commodities and put still a heavier burden upon them; and therefore, inasmuch as we are taking 40 percent of their sugar market away from them, the minute they accept this independence bill, and will keep it away from them for 10 years although they are still under our flag, I am asking the committee to make it possible to get an independence bill through in an atmosphere of friendship and fair play, that we do not single out one of their products and tax it still further when we have already taken 40 percent of their market away from them on their basic and primary commodity.

Now, I have got a lot of statements and figures here, concerning the amount of the imports and exports, that have all been given you, but I would like to ask be put into the record, and I am going to conclude with the final appeal that this thing be looked at from their viewpoint. Remember that we are taking 40 percent of their market away on sugar. Gentlemen, is it fair to take that market away, first of all? We have taken it away during this transitory period; why, I don't know. We have put all kinds of burdens on them, in the way of export taxes, in order to collect money to repay our loans, when we get at it. We have written the ticket; in Heaven's name let us be fair enough with these people, who have no representation and vote here, not to single out this other commodity and to put a heavier tax on that commodity than we have put on the other related commodities during this time. I hope the committee will take this provision out of the bill.

Senator GEORGE. Let me ask a question: Does the independence bill restrict the imports of coconut oil?

Senator TYDINGS. No, but it restricts sugar imports, Senator, to 850,000 tons.

Senator GEORGE. I understand that.

The CHAIRMAN. It puts 200,000 tons of coconut oil, as an annual quota.

Senator TYDINGS. Oh, yes; I thought you meant in the tax.

Senator GEORGE. No, no, not the tax; I am talking about the independence bill.

Senator TYDINGS. Yes, sir; it restricts it.

Senator GEORGE. Restricts it to what?

Senator TYDINGS. I haven't the figures in mind.

The CHAIRMAN. Two hundred thousand tons.

Senator TYDINGS. I think it is 200,000.

The CHAIRMAN. Nine hundred and fifty-five thousand tons of sugar.

Senator TYDINGS. Yes, long tons.

Senator CONNALLY. That does not reduce the production of coconut oil, does it?

The CHAIRMAN. Yes, it is some reduction from last year, because last year it was a larger importation.

Senator CLARK. The Filipino people seem to want immediate independence, don't they?

Senator TYDINGS. That is right.

Senator CLARK. Is there any reason why there should be economic advantages given to the people of the Philippines if they want immediate independence?

Senator TYDINGS. Well, Senator, we are compelling them to take independence, and giving them economic disadvantages with it. Your question is not founded on the facts.

Senator BARKLEY. They do not get immediate independence either.

Senator TYDINGS. It is not immediate, either.

Senator BARKLEY. There are some of us in favor of Senator King's substitute.

Senator TYDINGS. I am too, if you can work it out without revolution; but no man yet is ready to work it out without a revolution. You cannot take the trade of a people overnight and cut it up and expect them to go on and be happy and prosperous unless you want to land in the Army and continue on with that for 50 or 100 years.

Senator CLARK. That seems to be the desire of a majority of the Filipino people, does it not? They have turned down the Hawes-Cutting bill.

Senator TYDINGS. Well, I think the Hawes-Cutting bill "as is", the new bill, is not fair to the Filipino people. It is fairer to the people of the United States than it is to the people of the Philippines, and I think they were justified in turning that down.

Senator CLARK. They demanded immediate independence, didn't they?

Senator TYDINGS. No.

Senator CLARK. I understand that to be the demand.

Senator TYDINGS. They sent a mission there, Senator, which worked for 2 years on this bill, and accepted it, and all of the Filipino leaders accepted it. When it came up to the legislature is was found that there was a military clause in the bill which they said they did not like. Now that has been eliminated, and they say if that is eliminated, notwithstanding the bill is unfair, they will accept it as it was passed in the last Congress.

Senator CLARK. I simply want to make it clear that I am going to vote against this item in this revenue bill, for a different reason. I want to make it clear in the record that I am not voting for it; voting to cut it out of the bill, on the basis of any claim that the Filipino people have. I am voting against it because I think it is bad legislation.

Senator TYDINGS. Senator, you have asked me a question, and, with the permission of the chairman, let me ask you one. Do you think it would be fair to allow the Filipino people to pass tariff acts restrictive of the exports that we send from this country to them?

The CHAIRMAN. All right.

Senator CLARK. I think the Filipino people should be given their independence.

Senator TYDINGS. I did not ask you that. I asked you if you thought it was fair to allow them to restrict in any way the exports of the United States to the islands.

Senator CLARK. I still make the same answer. I insist that the Filipino people should be given their independence.

Senator TYDINGS. Well, that answers my question.

Senator CLARK. And that they should be given any rights that any independent people have today.

The CHAIRMAN. Thank you very much, Senator Tydings.

Senator TYDINGS. Mr. Chairman, I present at this time certain supporting documents, which I should like to have incorporated into the record.

The CHAIRMAN. Very well. That will be done.

(The matter above referred to is as follows:)

Imports of copra and coconut oil from Philippine Islands, 1933

[Source: U. S. Department of Commerce]

Month	Copra (pounds)	Coconut oil in copra	Coconut oil (pounds)	Total oil as such and oil in copra from islands
January	14,633,207		28,135,587	
February	33,724,119		13,147,961	
March	14,112,000		29,651,477	
April	18,764,410		20,209,670	
May	29,871,097		32,676,741	
June	28,982,989		29,776,099	
July	59,613,147		13,025,650	
August	43,904,620		22,726,575	
September	42,133,406		33,887,302	
October	52,073,766		36,202,502	
November	62,244,233		40,667,795	
December	42,111,082		15,970,756	
Total	442,168,078	282,988,000	316,078,115	599,066,115

Copra contains 64 percent oil.

	From Philippine Islands	From other countries	Total
Coconut oil as such	316,078,000		316,078,000
Coconut oil in copra	282,988,000	139,970,000	422,958,000
Total	599,066,000	139,970,000	739,036,000
Percent	81.1	18.9	100.0

WAR DEPARTMENT, WASHINGTON

Hon. MILLARD E. TYDINGS,
Chairman Committee on Territories and Insular Affairs,
United States Senate, Washington, D.C.

DEAR SENATOR TYDINGS: I am enclosing herewith a copy of a letter, dated January 29, 1934, which I forwarded to the Chairman of the Committee on Ways and Means when H.R. 7835, entitled "A bill to provide revenue, equalize taxation, and for other purposes", was being drafted by that committee.

The bill as introduced in the House contains a provision (sec. 602) imposing an excise tax of 5 cents per pound on coconut oil. The importance of this industry to the people of the Philippine Islands is indicated in my letter.

I am now writing to ask you if you will be good enough to introduce an amendment to the bill to eliminate the provision imposing a tax on coconut oil when this bill comes to the Senate for consideration. This provision is of such vital importance to the people of the Philippine Islands, and legislation of this nature is so out of line with the long-established policy of this Government of according fair and equal treatment to the people of the Philippine Islands, that I cannot urge too strongly that it be eliminated from the bill.

I am also enclosing for your information copies of messages received in this Department from the Governor General of the Philippine Islands bearing on this subject. It will be noted that the reference in my letter to the Chairman of the Committee on Ways and Means relative to the number of people affected by this legislation, refers to a message from the Governal General dated March 8, 1932, whereas Governor General Murphy's message of February 9, 1934, indicates that 3,000,000 Filipinos will be affected by this legislation, which is a much larger proportion of the population than was estimated in the figures of 1932.

A letter similar to the enclosed copy of letter addressed to the Chairman of the Committee on Ways and Means has been sent to the Chairman of the Senate Committee on Finance.

The information contained in this letter and its enclosures has been furnished the Chairman of the Committee on Insular Affairs of the House.

Sincerely yours,

GEO. H. DERN, *Secretary of War.*

Three enclosures: 1. Copy letter to Mr. Doughton; 2. Copy PI radio no. 49; 3. Copy PI radio no. 57.

THE AMERICAN LAUNDRY SOAP MANUFACTURERS' ASSOCIATION,
Washington, D.C., March 10, 1934.

Senator MILLARD E. TYDINGS,
Senate Office Building, Washington, D.C.

DEAR SENATOR TYDINGS: I desire to lay before you four paragraphs giving the principal reasons as to why an excise tax on imported coconut oil, as embodied in the pending revenue bill, will not benefit the American farmer.

The livestock farmer.—The livestock farmer cannot be benefited because he sells every pound of tallow he produces at the meat price. A 1,000-pound steer yields 5.36 pounds of tallow (see photostat). If tallow could be used in place of coconut oil in soap, rubber, or leather tanning, which it cannot, the maximum benefit reflected on the value of a 1,000-pound steer would be 2⅔ cents per steer. This calculation involves merely the multiplication of the tallow tariff of one half cent per pound by the tallow yield of a 1,000-pound steer. Tallow is not a farm product, but a refuse material of the cities.

The cottonseed oil producer.—When a soap maker purchases coconut oil he buys it because of its lauric acid content. Neither cottonseed oil nor any other domestically produced oil or fat contains lauric acid. Hence none of them, cottonseed oil included, have the property of making soap lather. If soap will not lather freely, it is useless for the major portion of the usages for which it is employed. Cottonseed oil is America's premier edible oil but its least satisfactory soap oil.

The hog raiser.—Coconut oil is not used in the manufacture of lard substitutes. The amount so used constituted less than 1 percent of the oils and fats so employed in 1932. If coconut oil cannot be used in lard substitutes, it is idle to contend that it competes with lard, of which we export a surplus of about 600 million pounds annually.

The dairyman.—The soap and rubber-tire makers or the tanner cannot object to the tax being levied upon edible coconut oil which is used in the manufacture of butter substitutes. It is contended that the dairy industry will benefit in the increased cost of butter substitutes. We believe that the opinion of the dairy economists will bear more weight than ours in this matter. We submit herewith a reproduction from a book entitled, "The Tariff on Dairy Products", written by a leading agricultural economist and edited by three members of the faculty of the University of Wisconsin, who are among the outstanding agricultural economists in America. They say that a tax on coconut oil will be of no benefit to the dairymen whatever.

Respectfully submitted.

F. H. MERRILL,
President Los Angeles Soap Co.,
Representing American Laundry Soap Manufacturers.

Tallow yields.—The following test is one which indicates in a general way the yield of tallows which are obtained from cattle: Edible tallow, 1.13 pounds per head; prime tallow, 4.41 pounds per head; no. 2 tallow, 0.95 pound per head; brown grease, 1.23 pounds per head. Total inedible tallow yield is 5.36 pounds per head.

COCONUT OIL

Seventy percent of the coconut oil which is consumed in the United States is consumed in the soap industry. In this industry it is absolutely essential and is not in competition with any domestic oil or fat, as it is the only oil which is possessed of properties which will enable it to lather in the presence of water of any degree of hardness. A considerable amount of coconut oil is used in the manufacture of accelerants employed in the vulcanizing of rubber auto tires by the various large rubber companies. The use of coconut oil in this direction shortened the time of vulcanizing tires from 9 hours down to only 2 hours.

Rather than to force the soapmakers and other technical users who consume more than 70 percent of the coconut oil consumed in the United States to double the price of soap and other industrial products in which coconut oil is employed by the levying of an excise tax which would increase the price of coconut oil 200 percent, it would be preferable to change the form of the excise tax as now proposed in committee. The tax as proposed by Governor Shallenberger applies to all kinds of coconut oils. Before coconut oil can be used for edible purposes it must be refined and deodorized, a very intricate process. This processing is carried on by a type of manufacturer called a vegetable-oil refiner.

Before the vegetable-oil refiner can render coconut oil an edible product he must first refine same, eliminating the free fatty acids making the product neutral; he must then bleach the oil and finally he must deodorize it. Coconut oil in the crude state, such as used by the soapmaker, would have the effect of castor oil if used for food purposes.

If the committee has the objective in view of placing an excise tax on the edible usages of coconut oil, this objective can be attained by the following amendment to Governor Shallenberger's original proposal:

"There shall be levied on refined, deodorized, edible coconut oil an excise tax of 5 cents per pound, which shall be collected at the first domestic processing of all refined, deodorized, edible coconut oil when such processing is conducted by the manufacturer of food products for human consumption."

WAR DEPARTMENT,
Washington, March 1, 1934.

Hon. MILLARD E. TYDINGS,
Chairman Committee on Territories and Insular Affairs,
United States Senate, Washington, D.C.

DEAR SENATOR TYDINGS: I am pleased to transmit herewith for your information a copy of a radiogram received in the Bureau of Insular Affairs of this Department from the Governor General of the Philippine Islands, dated February 27, 1934, relative to the proposed excise tax of 5 cents per pound on coconut oil.

The views of this Deparment are contained in an inclosure (no. 1) which accompanied my letter to you dated February 15, 1934.

Sincerely yours,

GEO. H. DERN, *Secretary of War.*

Inclosure: Copy of Philippine Islands radiogram, no. 88.

MANILA, *February 27, 1934.*

SECRETARY OF WAR,
Washington, D.C.:

Communication received from Associated Steamship Lines, comprising 29 steamship lines operating between Philippines and United States. I am submitting five pertinent paragraphs for utilization as your judgment dictates in further effort to indicate the adverse effects upon islands and also American exporters that I believe will be experienced by the application of excise tax upon copra and coconut oil.

1. That copra and coconut-oil shipments combined constitute the second largest homeward movement of cargo from the Philippines to the United States of America.

2. That this copra and coconut-oil movement is a year-round movement and not essentially seasonal, thus making it possible for various steamship lines to maintain a regular service between ports in the United States and the Far East, including the Philippines, at reasonable freight rates.

3. That all the steamship lines engaged in trade between the Philippine Islands and the United States pay income tax and tonnage dues as well as other taxes in

both countries, and Panama Canal tolls to a far greater degree than tolls in Suez; furthermore, that the regular activities of steamship lines in this trade benefit all allied trades, including pilots, stevedoring companies, terminal companies, petroleum companies, customs brokers, ships' chandlers, ship-repair yards, and any number of other industries in seaports which are dependent on a regular flow of trade to and from such ports.

4. That any serious curtailment of the copra and coconut-oil movement from the Philippines to United States would most surely result in a corresponding curtailment of shipping services to the detriment of American exports and Philippine imports.

5. That, as pointed out already by the Governor General and various trade bodies of the Philippine Islands, the imposition of the proposed excise tax on coconut oil would surely curtail the movement of copra and coconut oil to such an extent that the buying power of millions of people would be drastically reduced to the serious disadvantage of the American exporter and incidentally would thus affect all Philippine business, including interisland shipping and the revenue derived by the Philippine customs and harbor authorities.

I wish to reiterate my past personal statements relative to adverse effects of the application of the exicse tax. It should not receive approval. I know you are doing everything possible. If you have any suggestions that in your opinion would be of aid please advise.

MURPHY.

WAR DEPARTMENT,
BUREAU OF INSULAR AFFAIRS,
Washington, February 12, 1934.

Hon. MILLARD E. TYDINGS,
Chairman Committee on Territories and Insular Affairs,
United States Senate, Washington, D.C.

DEAR SENATOR TYDINGS: With reference to the revenue bill (H.R. 7835) now under consideration in the House of Representatives, the provisions of section 602 of which impose a tax of 5 cents per pound on coconut oil, there are enclosed herewith as of possible interest to you copies of certain data relative to coconut oil, etc., which have been compiled in this Bureau from official and other sources considered to contain the best available information.

Similar data have been furnished the chairman of the Committee on Insular Affairs of the House.

Sincerely yours,

(Signed) CREED F. COX,
Chief of Bureau.

Four enclosures:

1. Competition of coconut oil with animal fats.
2. Study on the competition of coconut oil with the dairy industry in United States.
3. Coconut oil in competition with cottonseed oil.
4. Data pertaining to palm kernel and palm oils.

FEBRUARY 8, 1934.

MEMORANDUM ON COCONUT OIL

The following notes were compiled in the Bureau of Insular Affairs from official and other sources considered to contain best available information. The source of the information is indicated in all cases. Any deductions made are based on an analysis of the tables included therein.

COMPETITION OF COCONUT OIL WITH ANIMAL FATS

Introduction.—The total foreign oils imported represented about 16 percent of all of the vegetable and animal fats used in the United States in 1932. Coconut oil constituted 43 percent of the foreign oils imported and represented about 7 percent of all of the oils and fats consumed in 1932.

Points of competition.—The following table compiled from data obtained from the Department of Commerce, Bureau of the Census, report of March 31, 1933; the Department of Commerce Yearbook, 1933; and the Department of Agriculture, shows the points at which coconut oil comes into competition with animal fats:

Consumption of fats and oils in 1932

(1)	(2) Coconut oil	(3) Percent of use	(4) Percent of all oils and fats used	(5) Animal fats	(6) Percent of use	(7) Percent of all oils and oils fats used	(8) Other fats and fats	(9) Percent of use	(10) Percent of all oils and fats used
Food uses:									
Oleomargarine	123,219,000	22.0	74.0	25,552,000	1.0	15	17,927,000	1	11.0
Lard and lard compounds	8,332,000	2.0	1.0	1,911,495,000	76.0	68	888,410,000	46	31.0
Other edible products	40,853,000	7.8	21.0	6,848,000	.2	4	142,364,000	8	75.0
Total edible	172,404,000	31.8	3.2	1,943,895,000	71.2	[1] 77.3	[1] 1,050,701,000	55	19.5
Technical uses:									
Soap	353,527,000	64.6	26.0	695,513,000	25.0	50	326,376,000	17	24.0
Miscellaneous	1,055,000	.2	.2	98,691,000	3.8	20	382,269,000	20	79.8
Total technical	354,582,000	64.2	19.0	794,204,000	28.8	43	708,845,000	37	38.0
Loss, including foot	22,529,000	4.0		228,000			150,027,000	8	
Grand total	549,515,000	100.0	7.4	2,738,327,000	100.0	[1] 68.8	1,909,373,000	100.0	25.8

[1] Including 2,269,000,000 pounds of butter not shown in the column "Grand total", there were 7,406,215,000 pounds of fats and oils consumed in the United States in 1932. This figure was used in computing the percentages in columns 4 and 7 of all oils and fats used.

It will be noted that the points of possible competition between coconut oil and animal fats are in oleomargine, lard, other edible products such as confectionery, salad oils, mayonnaise, etc., and in soap.

Other facts standing out are: (*a*) Animal fats find their greatest outlet in edible uses, while coconut oil finds its greatest outlet in inedible uses.

(*b*) Coconut oil represents 3.2 percent of the edible oil consumed in 1932.

(*c*) In its greatest outlet, technical uses, coconut oil represents 19 percent of the entire amount of oils used.

(*d*) That the consumption of coconut oil represents 7.4 percent of all fats and oils consumed in the United States in 1932.

Competition in margarine.—The following table shows the margarine production in the United States:

Margarine production in United States by calendar years

[Source: U.S. Department of Agriculture—Amounts shown in 1,000 pounds]

Year	Domestic fat margarine		Nut margarine (chief ingredient, coconut oil)		Total margarine
	Pounds	Percent to total margarine	Pounds	Percent to total margarine	
1916	200,502	99.0	1,944	1.0	202,444
1917	269,099	92.5	21,804	7.5	290,903
1918	266,563	75.0	88,974	25.0	355,537
1919	220,619	61.6	142,698	38.4	371,317
1920	174,518	41.1	188,590	51.9	363,108
1921	110,376	52.2	101,290	47.8	211,867
1922	109,564	59.2	75,512	40.8	185,076
1923	128,799	57.1	96,799	42.9	225,578
1924	127,901	55.8	101,130	44.2	229,031
1925	117,906	50.9	113,706	49.1	231,611
1926	117,445	49.2	121,149	50.8	238,594
1927	118,979	43.6	153,623	56.4	272,602
1928	111,620	36.3	196,313	63.7	307,934
1929	120,598	35.2	221,632	64.8	342,230
1930	95,876	30.7	215,879	69.3	311,755
1931	56,872	25.6	165,081	74.4	221,953
1932	41,076	20.8	156,645	79.2	197,716
1933 (6 months)	19,378	17.0	94,522	83.0	113,930

The following table shows the price differential between nut and animal oil margarine:

Wholesale prices per pound, Chicago

Year	Nut margarine	Animal oil margarine (first grade)	Differential	Year	Nut margarine	Animal oil margarine (first grade)	Differential
1920	$0.287	$0.338	$0.051	1926	$0.215	$0.244	$0.029
1921	.221	.229	.008	1927	.182	.238	.056
1922	.194	.197	.003	1928	.172	.240	.068
1923	.202	.223	.021	1929	.176	.250	.074
1924	.212	.234	.022	1930	.170	.235	.065
1925	.212	.258	.046				

The foregoing tables indicate a decided trend toward the replacement of animal fats by coconut oil in margarine. Two reasons are assigned for this: (1) Nut margarine is cheaper. (2) The consumer receives a superior and more palatable product at less cost.

It may be determined from the table on page 1 that if the entire amount of coconut oil in margarine had been replaced by animal fats, not including butter, the consumption of animal fats would have increased slightly more than 4 percent.

If coconut oil were excluded then three possible effects in the margarine industry suggest themselves: (1) An increase in the consumption of butter instead of margarine. (2) An increase in the use of other vegetable oils in margarine. (3) An increase in the amount of animal fats used in margarine.

1. In connection with the first possibility the price differential should be considered. The following compilation from data contained in the Department of Agriculture Year Book for 1933 shows the average price differential based on wholesale prices of butter in five principal cities and of margarine in Chicago:

	Cents
1928	24.5
1929	22.1
1930	14.8
1931	14.9
1932	11.7

2. According to manufacturers of margarine cottonseed oil has been found unsuited as a principal ingredient for margarine. Its main use, according to the United States Department of Commerce report of March 31, 1933, is in the manufacture of compounds and vegetable shortenings and miscellaneous edible products.

3. Margarine made from animal fat, being less expensive than butter, should be benefited. The consuming public would be affected as follows: (*a*) Forced to consume what is claimed to be an inferior product; (*b*) forced to pay an increase of more than 6 cents a pound, as shown by the above table.

Competition in lard.—The table on page 1 shows that but 2 percent of the coconut oil consumed in 1932 was used in lard compounds and that this represented 1 percent of the fats and oils so consumed that year.

It is understood that the small percentage of coconut oil used in lard compounds is not competitive but introduces certain desirable qualities not found in fats and oils produced in the United States.

Competition in confectionery.—In the Tariff Report of March 23, 1932 (p. 169) it is stated in referring to oils in confectionery: "Other oils can be and are to some extent used for some of the same purposes as coconut and palm-kernel oils, but ordinarily the results differ" and further along "in many uses, particularly in certain types of coatings, the special properties of coconut and plam-kernel oils are needed to produce the type of article desired." It would appear from these statements that the substitution of domestic oils for coconut oil cannot in general be made without changing the character of the product.

Competition in soap.—The table on page 1 shows that 64 percent of the coconut oil used in 1932 and 25 percent of the animal fats were consumed in soap and that of the soap made coconut oil constituted 26 percent of the oils and fat used therein.

It is stated in the Tariff Commission Report, March 23, 1932, on the "Production and Transportation Costs of Certain Oils" (p. 145), "only within narrow

limits, however, can tallow and grease be substituted for coconut oil without altering the character of the resulting soap."

In 1932, 34,917,242 pounds of soap was exported by the United States. A large portion of these exports were of the kinds of soap containing coconut oil.

Data on the importation of coconut oil.—The following table, compiled from United States Department of Commerce reports, shows the importation of coconut oil:

SUPPLY OF COCONUT OIL, INCLUDING IMPORTED AND LOCALLY REFINED STOCKS

1924	408, 131, 000	1929	771, 622, 000
1925	462, 540, 000	1930	692, 981, 000
1926	533, 415, 000	1931	613, 679, 000
1927	577, 495, 000	1932	534, 787, 000
1928	606, 889, 000		

It will be noted that the yearly importation shows an increase until 1929 and from then a yearly decrease to 1932 which is the lowest since 1926. The average shipments for 1933 appear to be at about the 1931 level.

The following table shows the monthly importation of coconut oil and copra:

Exports from the Philippines to the United States by months, calendar years 1931–33

[Source: Insular Collector of Customs Monthly Reports]

Month	Coconut oil			Copra		
	1931	1932	1933	1931	1932	1933
	Pounds	*Pounds*	*Pounds*	*Pounds*	*Pounds*	*Pounds*
January	23, 729, 953	11, 544, 582	15, 822, 359	21, 151, 245	13, 280, 345	22, 754, 437
February	18, 790, 095	17, 619, 019	25, 778, 654	25, 388, 509	14, 346, 093	19, 872, 873
March	35, 874, 786	27, 667, 331	24, 571, 975	20, 940, 589	9, 954, 840	23, 310, 064
April	29, 310, 053	18, 528, 060	26, 791, 509	17, 784, 746	10, 398, 155	26, 828, 913
May	29, 832, 696	33, 136, 492	17, 449, 557	20, 727, 713	11, 291, 082	30, 571, 960
June	17, 414, 153	14, 467, 852	22, 690, 519	23, 820, 920	6, 120, 344	50, 775, 329
July	36, 852, 243	20, 733, 024	29, 119, 457	12, 614, 262	12, 532, 226	54, 986, 172
August	28, 846, 258	9, 954, 485	40, 197, 085	36, 596, 034	19, 148, 192	50, 149, 103
September	25, 995, 274	10, 111, 213	[1] 40, 619, 213	18, 782, 762	17, 688, 211	39, 387, 516
October	27, 364, 844	30, 244, 224	[2] 23, 369, 000	26, 853, 018	33, 530, 606	
November	13, 544, 827	29, 881, 806		13, 764, 120	21, 610, 021	
December	40, 341, 488	19, 190, 340		28, 078, 996	12, 462, 998	
Total	327, 896, 670	243, 078, 428	[3] 243, 040, 328	266, 502, 914	183, 043, 114	[4] 318, 636. 367

[1] Latest available report.
[2] Estimated.
[3] 10 months, October 1933.
[4] 9 months, September.

It will be noted that the month by month shipments of coconut oil are highly erratic. No comparison of figures for any month or period of 2 or 3 months will reflect actual conditions.

A STUDY OF THE COMPETITION OF COCONUT OIL WITH THE DAIRY INDUSTRY IN THE UNITED STATES

(Prepared in the Bureau of Insular Affairs)

General statement: Coconut oil is the only oil derived entirely from sources outside the continental United States that is used to any extent in the making of margarine. About half of the coconut oil (54 percent in 1932) consumed in the United States is manufactured in the United States from copra (dried coconut meat) which entered the United States free of duty. About 44 percent of the copra used in 1932 came into the United States from the Philippine Islands, the remainder from the Netherlands East Indies, British Malaya, British Oceania, and French Oceania. About half of the coconut oil comes from the Philippine Islands. Coconut oil carries a duty of 2 cents per pound but none is received from foreign countries.

Source of supply of coconut oil and copra

Year	Importation of coconut oil (in thousands of pounds)		Percentage	Coconut oil manufactured in United States from copra [1]	Percentage
	Philippines	From others			
1924	224,643	128	55	183,369	45
1925	232,498	675	50	229,367	50
1926	245,129	0	46	288,286	54
1927	293,369	0	50	284,126	49
1928	290,636	0	48	316,253	52
1929	411,936	0	53	359,686	47
1930	317,919	0	46	375,062	54
1931	325,174	0	53	288,505	47
1932	249,116	0	46	285,671	54

Year	Total coconut oil supply (in thousands of pounds)			Imports of copra (in thousands of pounds)	
		Philippines	Percent	Foreign	Percent
1924	408,131	238,587	82	52,486	18
1925	462,540	284,059	78	80,016	22
1926	533,415	275,696	60	181,902	40
1927	577,495	341,388	76	109,606	24
1928	606,889	371,889	74	130,101	26
1929	771,622	310,194	54	260,737	46
1930	692,981	336,555	57	258,783	43
1931	613,679	267,471	58	190,475	42
1932	534,787	198,525	44	254,922	56

[1] It is considered that 63 pounds of coconut oil can be made from 100 pounds of copra.

Use of coconut oil: The following figures show the consumption of coconut oil for 1929 (no figures for other years were available to the Bureau).

	Thousands of pounds	Percent		Thousands of pounds	Percent
Food uses:			Technical uses:		
Margarine	171,411	26	Soap	344,205	52
Lard compounds	20,000	3	Other [1]	72,793	11
Other food-salad and cooking oil, confectionery, etc	53,598	8	Total technical	416,998	63
Total food	245,009	37	Grand total	662,007	100

[1] As far as known only important technical use other than in soap is in the preparation of "lotions" and toilet preparations.

Source: United States Tariff Commission report, page 3, of Mar. 24, 1932, to Senate, on production and transportation costs of certain oils.

Coconut oil gives to soap its white color and to soap chips the quality that makes for instant dissolving in hard water. These qualities in soap are greatly in demand in the United States at the present time. Coconut oil is used in confections generally because of peculiar properties for which no substitutes have yet been found.

INDUSTRIES PRIMARILY AFFECTED BY EXCLUSION OF COCONUT OIL FROM UNITED STATES MARKET

At the expense of forcing consumption of inferior products at higher cost the use of the substitutes to replace coconut oil in the manufacture of soaps and oleomargarine would be possible.

In the United States there are about 10 plants at present engaged in the manufacture of coconut oil from copra. These plants would be adversely affected and the laborers therein might be forced to seek work elsewhere.

In the Philippine Islands coconut oil and copra constitutes either the first or second industry in 30 out of 49 Provinces. The Governor General has estimated that this industry sustains approximately 2,000,000 people, one seventh of the population of the islands.

United States shipping would be seriously affected. In 1932 almost five and one half million dollars worth of mineral oil was shipped to the Philippine Islands from the United States. A great portion of oil so shipped is carried in tankers, 33 percent of which are American owned and which bring coconut oil that allows a profitable round trip and permits American mineral oils to compete more successfully with foreign oils in the Orient.

EXPORT OF AMERICAN PRODUCTS MANUFACTURED IN WHOLE OR PART FROM COCONUT OIL

While the export of margarine is negligible, being only about one fifth of 1 percent, much soap and confectionery having coconut oil as an ingredient are exported. This export business would suffer by the exclusion of coconut oil from the United States.

Philippine trade: The Philippine Islands are our best customer for dairy products. During the year 1932 the following dairy products were exported from the United States to the Philippine Islands. Milk, evaporated and condensed, 21, 303, 353 pounds; other milk, 392,258 pounds; butter, 92,311 pounds; cheese, 164,898 pounds; all other, 99,584 pounds, with a total value of $1,810,397 In that year 127,967,000 pounds of Philippine coconut oil was used in the manufacture of margarine, which at an average value of 3.03 cents per pound amounts to $3,877,400. Competition between oleomargarine and butter: The following chart comparing the amounts of butter and oleomargarine produced, exported, and imported shows what a small part the production of oleomargarine plays with relation to butter:

Year	Butter (in thousand pounds)		Oleomargarine (in thousand pounds)		
	Produced in United States	Imported into United States	Exported by United States	Produced in United States	Exported from United States
1924	2,000,548	10,405	8,257	229,031	901
1925	1,993,103	7,212	5,343	231,611	774
1926	2,069,638	8,029	5,483	238,594	1,452
1927	2,098,712	8,460	4,343	272,602	796
1928	2,078,146	4,639	3,898	307,934	645
1929	2,178,248	2,773	3,724	342,230	902
1930	2,167,747	2,472	2,954	311,755	962
1931	2,196,772	1,882	1,984	221,953	547
1932	2,258,843	1,014	1,505	197,716	474

In the main oleomargarine does not appear to compete with butter for two reasons: First, because normally the consumption of both products in the United States practically equals the total production, the exports in each case being negligible (three one hundredths of 1 percent of butter and one fifth of 1 percent of margarine in 1932); and, second, because each article is consumed by a different purchasing class due to the large differential in price.

The peak of oleomargarine production occurred in the years 1919 and 1920 when the wholesale price of butter averaged about 57 cents a pound and the spread between butter and margarine was about 24 cents a pound. In 1921 and 1922 the wholesale price of butter declined to 40 and 38 cents, respectively, and the spread to 18½ cents. In these years the production of margarine decreased rapidly with a corresponding increase in the production of butter.

In 1932 the wholesale price of butter averaged about 20 cents a pound and margarine about 10 cents. Consumers of butter and margarine represent two different classes of purchasers. Butter would have to sell at approximately 10 cents a pound in order to induce the present consumer of margarine to purchase butter.

The following figures of the Department of Agriculture show the margarine production in the United States in thousands of pounds:

Year	Domestic-fat margarine		Nut margarine		Total margarine
	Pounds	Percent to total margarine	Pounds	Percent to total margarine	
1924	127,901	55.8	101,130	44.2	229,031
1925	117,906	50.9	113,706	49.1	231,611
1926	117,445	49.2	121,149	50.8	238,594
1927	118,979	43.6	153,623	56.4	272,602
1928	111,620	36.3	196,313	63.7	307,934
1929	120,598	35.2	221,632	64.8	342,230
1930	95,876	30.7	215,879	69.3	311,755
1931	56,872	25.6	165,081	74.4	221,953
1932	41,070	20.8	156,645	79.2	197,716

The above table shows that since 1924 there has been a steady decline in the amount of domestic fat margarine as compared with nut margarine.

Conclusion: It appears, therefore, that the exclusion of coconut oil from the United States would not cure the ills of the dairy farmer because margarine competes with butter only in a very limited way. It would, however, injure the Filipino farmer, injure our trade with the Orient, our shipping, and industries using coconut oil; and it would deny certain products to the American people which by choice they appear to desire.

COCONUT OIL IN CONNECTION WITH COTTONSEED OIL

The following table extracted from United States Department of Commerce data shows the factory consumption of cottonseed oil in the United States:

[Quantities in thousands of pounds]

	Compounds and vegetable shortening		Oleomargarine		Other edible products		Soap		Miscellaneous		Loss		Total
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	
1931	928,489	81.4	16,027	1.4	84,435	7.4	1,970	0.2	2,188	0.2	107,690	9.4	1,140,799
1932	834,367	76.9	15,096	1.4	100,129	9.3	3,583	.3	1,831	.2	128,953	11.9	1,083,959

Competition in compounds and vegetable shortenings: The above table shows that about 80 percent of the cottonseed oil produced is consumed in compounds and vegetable shortenings.

Cottonseed oil has a high shortening value, is easy to process and the supply is readily available. According to the Tariff Commission report of March 23, 1932, page 162, these are price reasons for the use of cottonseed oil in compounds and vegetable shortenings. On page 164 of the same report may be found the following:

"In ordinary practice, however, they (coconut oil and palm-kernel oil) are used only as a minor ingredient to impart certain desired qualities"; and further on, "The principal reasons given for the sparing use of coconut oil are its low shortening value and its tendency to foam and smoke when used in frying. For these reasons cottonseed oil continues to predominate, even though coconut oil is usually available at a substantially lower price."

From the foregoing it would appear that coconut oil does not compete with cottonseed oil in the major use of the latter but supplements this use.

Competition in margarine: At the present, cottonseed oil is used in margarine for blending purposes. The Tariff Commission report on page 157 states: "Whether an acceptable margarine for table use could be made * * * entirely from cottonseed oil is yet to be demonstrated, for no such margarine has been made commercially."

Commercial interests manufacturing margarine state that they have not up to the present time succeeded in developing a margarine with commercial value from cottonseed oil.

1. Salad dressings: According to page 165 of the Tariff Report, cottonseed oil is the principal oil used in making salad oils and salad dressings. This report gives the requirements for salad oils and salad dressings as follows: "Liquid in form, clear, and unclouded at ordinary winter as well as summer temperatures * * * it is necessary that they keep well, be of medium consistency and readily emulsify when mixed with other materials."

It deals with the competition with coconut oil as follows: "These requirements practically eliminate, on one hand oils hard at ordinary temperatures, such as coconut, palm, and palm-kernel oils."

2. Confectionery: Page 169 of the Tariff Commission report states: "Cotton * * * oils may possibly be used unhydrogenated in cooking and salting nuts, but coconut oil is preferred as much for its keeping qualities and its stability at ordinary room temperature, as for its low price."

Competition in soap: According to the Tariff Report, page 146, cottonseed oil produces the following qualities in soap:

(a) A soft soap, with greater solubility and better lathering qualities than any except coconut and palm-kernel oil soaps.

(b) Its lather is quick, abundant, thick and fairly lasting.

(c) Alone, it makes a yellowish soap, but may be bleached and mixed with tallow or coconut oil to produce a fairly white soap.

(d) Cottonseed and coconut oil together in about equal proportions make a satisfactory white laundry soap.

(e) It has a tendency toward randicity which cannot be entirely overcome.

On page 147 appears the following: "That the technical possible uses of cottonseed oil in soapmaking have been increased by the hydrogenation process seems certain, but so far its price has been too high as compared with other oils to permit it to be hardened for use in soap making. Moreover, changes in its economic position rather than any lack of suitability for soap making arethe principal cause of the decline in its use in the unhydrogentated condition in the soap kettle."

The following table appearing on page 180 of the Tariff Commission's report shows the average monthly prices of different oils in the 5-year period, 1926–30."

[In cents per pound]

Oil	Market	Container	Average price
1. Mainly for edible use:			
Lard	Chicago	Hardwood tube	13.8
Neutral lard	do	Tierces	14.0
Oleo oil	do		12.2
Refined	New York	Barrels	9.8
Crude	Southeast	Tanks	8.3
Tallow, edible	Chicago	Tank cars	8.7
Sesame oil, refined	New York	Drums	12.9
Peanut oil, refined	do	Barrels	13.8
Corn oil, refined	do	Drums	12.0
2. For edible use and for making soaps: Coconut oil.	Pacific coast	Tanks	7.7
3. Mainly for making white soaps:			
Tallow, inedible	Chicago	Tank cars or drums	7.5
White grease	do	Tank cars or returnable drums	7.3
Whale oil, crude:			
No. 1	Coast	Tanks	7.2
No. 2	do	do	6.8
4. Mainly for making colored soaps:			
Palm oils:			
Lagos	New York	Casks	7.6
Niger	do	do	7.2
Yellow grease	Chicago	Tank cars or drums	6.9
House grease	New York	Tierces	6.9
Brown grease	Chicago	Tank cars or drums	6.4
Rosin	Savannah	Barrels of 280 pounds	3.0
5. Mainly for use in paints and varnishes:			
Linseed oil, raw	New York	Tanks	10.5
Perilla oil	do	Barrels	14.0
Soybean oil, crude	do	do	12.0
6. For miscellaneous uses:			
Rapeseed oil:			
Blown	do	do	13.1
Refined	do	do	10.6

Source: United States Bureau of Labor Statistics and Trade Journals.

It will be noted from the foregoing table that refined cottonseed oil averaged 2.1 cents per pound higher than coconut oil

Late market reports in the New York Journal of Commerce give the price of cottonseed oil at 3.75 and coconut oil 2.50 cents per pound, the differential being 1.25 cents per pound.

DATA PERTAINING TO PALM-KERNEL AND PALM OILS

Palm-kernel oil: Palm-kernel oil, which is imported mainly from Germany and the United Kingdom, has, according to the Tariff Commission report of March 23, 1932, about the same properties as coconut oil and may be substituted for coconut oil in almost all of its uses.

Practically no palm-kernel oil is at present used in the manufacture of margarine. Reasons assigned for this are:

(*a*) It is not considered to have quite as good a taste as coconut oil;

(*b*) It is not as readily available as coconut oil;

(*c*) Its present market price is slightly higher than that of coconut oil.

Palm-kernel oil at the present time, finds its chief outlet in the United States in edible products other than lards and oleomargarine, such as confectionery and biscuits, and in the soap industry.

The following figures, extracted from the Department of Commerce, Bureau of the Census, show the consumption of palm-kernel oil, crude, in the United States: 1928, 45,388,754; 1929, 58,324,408; 1930, 54,031,230;[1] 1931, 55,136,909; 1932, 15,974,043, and 1933 (first 9 months), 19,110,676.

The imposition of a tax on coconut oil, without placing a corresponding tax on palm-kernel oil would place palm-kernel oil in such a favorable position that a considerable increase in its importation and use might follow.

Palm oil: Palm oil is imported mainly from the United Kingdom, Sumatra, and French and Belgian African colonies. It enters the United States duty free.

Its main use in the United States is in soap, but it finds outlets in compounds

[1] Tariff of 1 cent a pound on edible palm-kernel oil effective in June of this year.

and vegetable shortenings, oleomargarine, and other edible products, and in the tin-plate industry.

Palm oil differs from coconut and palm-kernel oil as to characteristics.

In comparison with coconut oil the following comparative qualities for soap were noted in the Tariff Commission report of March 23, 1932:

Coconut oil	Palm oil
White	Colored
Quick-lathering	Slow-lathering

According to United States Department of Commerce figures, 262,000 pounds of palm oil was consumed in margarine in the United States in 1932. Palm oil imparts a reddish-yellow color to margarine which is difficult to remove. Yellow margarine is taxed at the rate of 10 cents a pound in the United States.

THE LIVESTOCK PRODUCER AND THE COCONUT OIL TAX

It is urged that the tax will restore to the producers of livestock a market for tallow that could enter into the manufacture of soap.

The domestic fats consumed in the soap kettle now are essentially of the same character as those which were consumed in 1912, viz., inedible tallow produced from refuse materials, collected from the restaurants, hotels, boardinghouses, and retail meat stores, for all of which the meat price has been paid before it reached the hands of the refuse processor or tallow renderer, and the inedible tallow and grease in 1912 constituted 46 percent compared to 45 percent of the total in 1932, showing that the ratio has remained practically constant with respect to its consumption in the soap kettle.

In further connection with the consumption of domestic oils and fats in the soap kettle, we would call attention to the fact that the United States Bureau of the Census shows in its record of factory consumption of oils and fats for the year 1932 that the soap industry consumed practically 900 million pounds of domestic oils and fats. This represents an increase of 50 percent in the consumption of domestic oils and fats for 1932 as compared to 1912. Obviously, such increase as has occurred in foreign oils and fats has not been at the expense of domestic oils and fats. It is apparent that the imported oils and fats have served to carry the domestic oils and fats into consumption in the soap kettle.

Should the tallow renderer be able to participate in any increase of price of domestic fats and oils resulting from the excise tax on coconut oil, it could be only to the extent of the tariff duty on tallow. This duty is one half cent per pound in the 1930 Tariff Act. Any increase in the price of tallow over the world price level in excess of one half cent per pound would invite imports of New Zealand, Australian, and Argentine tallow.

As explained in the memorandum concerning the cotton grower the soapmaker buys coconut oil because of its free-lathering properties which are imparted to it by its high lauric-acid content. Since tallow contains no lauric acid it has no free-lathering qualities and cannot be used to supplant coconut oil in soap. Coconut oil in place of competing with tallow in soap actually carries tallow into consumption in the soap kettle.

The Packers' Encyclopedia, page 131 (photostat attached), shows that the yield of inedible tallow in the packinghouse amounts to 5.36 pounds per 1,000-pound steer. Should, by any possibility, the price of tallow be advanced to the full extent of the one half-cent per pound tariff on same, as a result of the levying of the 5-cent excise tax on coconut oil, the total net return to the meatpacker per 1,000-pound steer could not exceed 2.68 cents.

THE HOG RAISER AND THE COCONUT-OIL TAX

It is urged that the hog raiser will be benefited in that the tax will tend to reduce the existing large surplus of lard.

The inference to be drawn from the contention above noted is that coconut oil competes with lard and lard compounds, whereas, on the basis of statistics compiled by the Bureau of the Census for 1932, coconut oil constituted less than 1 percent of the fats and oils used in lard compounds and vegetable shortenings, which commodities are the only real competitors of lard. Furthermore, it should be pointed out that coconut oil is one of the few oils which is completely lacking in shortening properties, and obviously it cannot be used to any appreciable extent in this field, regardless of price considerations.

The annual exportation of lard amounts to about 600,000,000 pounds. The use of coconut oil in lard substitute in 1932 amounted to less than 1½ percent of this exportation and only one half of 1 percent of the total production.

Lard substitutes, as made in the United States, are composed almost entirely of domestic vegetable and animal oils and fats. In 1932, 77 percent of our domestic cottonseed oil was consumed in this channel. The balance was consumed in salad and cooking oils. Only 0.2 of 1 percent was consumed in nonedible or industrial channels. This was so-called "off-grade" oil unfit for edible usage.

THE COTTON GROWER AND THE COCONUT-OIL EXCISE TAX

It is contended that the cotton grower will likewise be benefited by an increase in the market for cottonseed oil.

This statement does not take into consideration the fact that under present-day conditions cottonseed oil is consumed practically entirely in edible channels and is virtually not used at all in the soap kettle, which is the chief outlet for coconut oil. The consumption of cottonseed oil in the soap kettle in the year 1932 was only 0.23 of 1 percent of the total oils and fats consumed there on the basis of the United States Bureau of the Census figures for factory consumption of oils and fats, despite the fact that during that year coconut oil sold at a materially higher price than did cottonseed oil. Coconut oil averaged during 1932, 3.57 cents per pound in price as compared to 3.07 per pound for cottonseed oil.

Coconut oil is used in the soap kettle because of its very high content of lauric acid, which imparts an extremely free-lathering quality to soap made therefrom. Cottonseed oil contains no lauric acids and, therefore, could not impart any free-lathering qualities to the soap. In addition, it has decidedly objectionable qualities in that it possesses an excessively high quantity of linolic acid which is readily oxidizable and hence promotes rancidity when used in the manufacture of soap. Coconut oil contains no linolic or other acids which are oxidizable. These inherent differences in the chemical make-up of coconut oil and cottonseed oil prohibit any degree of interchangeability of the two oils in the manufacture of soap.

In the essence when a soap manufacturer purchases coconut oil, he is buying lauric acids. He will not buy cottonseed oil when he needs lauric acids, for the simple reason that cottonseed oil contains no lauric acid. Were cottonseed oil to be used in the soap kettle it would be merely as an inferior substitute for inedible tallow. Before it can be so used it must be hydrogenated. This costs at least 1 cent per pound. Since tallow bears a tariff duty of only one half cent per pound it is obvious that it would be far cheaper to import tallow from Australia and the Argentine in preference to processing cottonseed oil to simulate tallow.

According to the records of the Department of Commerce and the Department of Agriculture, the consumption of edible fats and oils in the United States for the year 1932 was equivalent to 73.6 percent of the total domestic consumption. Of this quantity the major portion was made up of three fats, namely, butter, 39 percent; lard, 33 percent; and cottonseed oil, 20 percent; or, in other words, these three oils constituted 92 percent of the total food oils and fats consumed. Another 3.82 percent was made up of oleo oil, oleo stearine, corn oil, peanut oil, edible tallow, and olive oil. The net prices at which these oils and fats (all domestic except the major part of the olive oil) sold for food purposes were materially higher than would have been procured had they been utilized in the soap kettle. In connection with this, we would point out that the 10-year average price of oils and fats used for edible purposes in the United States, exclusive of butter, for the period from 1923 to 1932, as shown by the Oil, Paint, and Drug Reporter, principal trade journal of the oils and fats industry, was 11.04 percent per pound, whereas during this same period the price of the oils and fats used for soap and miscellaneous industrial purposes averaged 6.95 cents per pound, a price difference in favor of the edible oils and fats of 4.09 cents per pound.

THE DAIRYMAN AND THE COCONUT-OIL EXCISE TAX

Seventy percent of the coconut-oil imports are used in 3 industrial products: Soap, rubber automobile tires, and the tanning of leather. The dairyman produces nothing which these three industries use.

The soapmaker, the rubber-tire maker, and the tanner cannot object to the tax's being levied upon edible coconut oil which is used in the manufacture of butter substitutes. We believe that the opinion of dairy economists will bear

more weight than ours in respect to the amount of benefit which a tax upon edible coconut oil would confer upon the dairyman.

The dairy economists state that the price differential between butter substitutes and butter itself is so great that if it were granted that the proposed tax would increase, even materially, the cost of butter substitute, it could not increase the price of butter or increase its sale.

That coconut-oil competition, whether in the form of nut margarine or otherwise, does not affect the price of butter, is evidenced by the fact that in Canada, where the competition of substitutes has not existed because of legislative edict the price of butter has commonly averaged below the price of butter in the United States.

As further evidence that even a prohibitive tax on imported raw materials would not reduce the price differential between butter substitutes and butter, we cite the opinion of four eminent agricultural economists, whose views are expressed in the inclosure attached hereto.

(Senator Tydings presented also for the record a pamphlet entitled "Will an Excise Tax on Foreign Vegetable Oils Benefit Producers of American Lard, Butter, and Cottonseed Oil?" Refer to testimony of J. B. Gordon before House Ways and Means Committee on Revenue Revision, 1934.)

(Senator Tydings also presented a printed copy of testimony of John B. Gordon before the Ways and Means Committee on the House of Representatives, Jan. 11, 1934. Refer to Hearings on Revenue Revision, 1934, before House Ways and Means Committee.)

(Senator Tydings also presented for the record a reproduction of an article entitled "The Tariff on Dairy Products" by Roland R. Renne. This pamphlet was presented previously, in the testimony of Mr. J. D. Craig.)

The CHAIRMAN. Congressman Whittington.

STATEMENT OF HON. WILLIAM M. WHITTINGTON, REPRESENTATIVE IN CONGRESS FROM MISSISSIPPI

Mr. WHITTINGTON. Mr. Chairman, as an advocate of the excise tax on foreign oils, I realize that that tax, like all other taxes, is difficult. I feel most friendly toward the people of the Philippines. The remarks of the gentlemen representing the islands had a definite ring. I recall that in all the discussions with respect to Philippine sugar, the interest of the small Philippine land and home owner was emphasized. I have heard, this morning, that it was the largest landowner in the Philippines that was interested in sugar.

While interested in the people of the Philippines, I believe that the producers of the United States are entitled to first consideration. It is my thought that all, whether in the United States or in the Philippines, should share in the burden of taxation essential to the functioning of the Government. I believe that the proposed tax will result in a distribution of the burden of taxation, so that all who enjoy the American markets will participate in our burdens of taxation.

Senator KING. You favor a tax upon the production of cottonseed oil, of 5 cents a pound, under the guise of an excise tax?

Mr. WHITTINGTON. No. I do not think it is necessary. My thought is that the cotton producer pays other taxes, that the Philippine producer of coconut oil does not pay, that go to the maintenance of our Government. I know of no better way of providing for participation in the burden of taxation than this excise tax.

Senator CLARK. Mr. Whittington, may I ask a question?

Mr. WHITTINGTON. Yes, Senator.

Senator CLARK. You do not contend that this provision in this bill is revenue producing?

Mr. WHITTINGTON. I think it will produce revenue, and substantial revenue. If I may be permitted to proceed——

Senator CLARK. The evidence of all the experts we have had before the committee has been to the contrary.

Mr. WHITTINGTON. I will give you my reason, and you can draw your own conclusion, Senator.

Senator CLARK. This is not a tariff provision.

Mr. WHITTINGTON. I say, I will give you my reason, and you can draw your own conclusion, but, to answer directly, it is said that coconut and other foreign oils are indispensible, and are not inedible. If that premise be admitted, some must come in. If the contention of the opponent is true, large quantities will come in, and if they come in, we will derive revenue, and this will be a revenue-producing measure.

Senator CLARK. Well, the real purpose of this tax is to keep out coconut oil in competition with certain animal oils and cottonseed oils in the United States?

Mr. WHITTINGTON. I would say the purpose of this tax is like the purpose of many excise taxes, including the tax on lumber, petroleum, and other excise taxes, that I might mention. They are in the same category, according to my judgment, Senator.

Senator CLARK. And which I consider are absolutely unjustifiable in a revenue bill.

Mr. WHITTINGTON. Yes. Then let us treat them all alike, but the cotton growers in the South are in an emergency. The cotton growers are interested in this tax, because one tenth of the value of the cotton crop is the value of cottonseed, approximately. I was reminded of the plight of the peons of the Philippines, but I am thinking of the plight of the 5 or 6 million cotton tenants in the South. Cottonseed is the cash crop of the tenants in the South. Over a period of 25 years the value of their cottonseed was determined by the value of the oil, which represented approximately 55 percent of the value of the cottonseed. Now, there have been increases in the importation of foreign oils, and there have been reductions in the price of cottonseed and cottonseed oil, and in the prices of coconut oil, but the relative decrease in the value of the two oils has been much greater in the case of cottonseed oil than in the case of coconut oil, and I think the opposition of Procter & Gamble is typical of the opposition to this tax. That institution uses both coconut and cottonseed and other oils. The prices of all are declining. They are profiting by the declining prices of Philippine oils and by the declining prices of cottonseed oil. It is small wonder, therefore, that such opponents oppose this or any other tax, either on domestic or foreign production, and it is no answer to say that Procter & Gamble, certainly the largest owners of one of the most concentrated industries in the United States own a few cottonseed oil mills in the South, my recollection is, some 11 in all. They are purely conveniences. Those oil mills are operated in any case. They are operated at a loss and that loss is absorbed by the stockholders of Procter & Gamble. They are operated as conveniences, because Procter & Gamble are the largest consumers

of cottonseed oil, and they get that oil, and they are getting it cheaply now, whether they produce it or not.

Senator BARKLEY. Are not most cotton mills operating at a loss, in cottonseed oil?

Mr. WHITTINGTON. Well, I think that they have been, as is the case of all industries in the South.

Senator BARKLEY. The situation with reference to the Procter & Gamble Co's cottonseed oil mills just goes up and down with the rest of them. They have profited at times by the operation of these mills, haven't they?

Mr. WHITTINGTON. The probabilities are that they have.

Senator BARKLEY. At the same time that other people were profiting?

Mr. WHITTINGTON. Yes. I am sure that is true, and my experience and observation is that they close down their mills and get the cheap product—and I know whereof I speak because one of the largest of their mills is located in my home city. I feel most kindly toward them. They get the product, whether they manufacture it or not.

Senator CLARK. Mr. Whittington, I do not care anything at all about Procter & Gamble. This a revenue bill and I would like to know how much you estimate would be added to the Federal revenue by the inclusion of this item in this bill.

Mr. WHITTINGTON. I would say that I am quite content for you to form your own conclusion from the testimony in this case. You are just as capable—more capable than I, but I will say, and, to repeat, that if there is no interchangeability, if there can be no substitution, that there will undoubtedly be importations, and, if importations, and if they continue in the same amounts as in the increase of importations in the last 10 years, there undoubtedly will be substantial revenue.

Senator CLARK. Well, you are an authority on the subject. Please——

Mr. WHITTINGTON. No, I am not.

Senator CLARK. How much revenue do you estimate, or do you have any estimate as to the amounts of revenue that will be added to the Federal revenue by this?

Mr. WHITTINGTON. No, sir. I have made no estimate, sir, and therefore am unable to answer the question, but I would say this, in answer to your question——

Senator GORE. Has anyone to your knowledge made such estimates?

Mr. WHITTINGTON. I beg your pardon?

Senator GORE. Has anyone to your knowledge made such an estimate about how much revenue will be produced?

Mr. WHITTINGTON. No, and I would say this, that I do not favor excluding the foreign oils. I am more interested in the tax than in the amount of the tax, and more interested in a tax from all foreign oils than I am in a 5-cent tax on coconut oil and sesame oil, as carried by the House bill, because there can be substitutions of other foreign oils, I believe, and I advocate a tax on all foreign oils.

Senator CLARK. In other words, you are not talking from a revenue standpoint at all—you are talking about the prohibitory standpoint?

Mr. WHITTINGTON. I like to be broad and somewhat liberal, and so I will say that I adovcate it for both reasons.

The CHAIRMAN. Mr. Parker tells me the estimate is between eighteen and twenty-five millions of dollars.

Senator BARKLEY. Assuming that it comes in.

The CHAIRMAN. Yes.

Senator BARKLEY. Now, isn't it the purpose of those who advocate this tax, that there will be no revenue at all?

Mr. WHITTINGTON. Well, I would not think so. It certainly would not be my position, Senator. If statements of the opponents of this tax are to be given the credence that many of them are, undoubtedly some foreign oils are essential, but I maintain that because a foreign product is used by some manufacturers and sold to some classes of people is no reason why there should not be a reasonable excise tax on that article.

Senator GORE. Do you think 200 percent tax is reasonable, Mr. Whittington?

Mr. WHITTINGTON. I said a few minutes ago, Senator, that I was much more interested in the principle and in a tax on all. For instance, it is my view, to answer your question, that I would prefer personally a tax of 3 cents on all oil to a tax of 5 cents on the two oils that is carried in the House bill.

Senator GORE. This is a tax of 200 percent. Would you be willing to see the tariff rates generally raised to the point of 200 percent?

Mr. WHITTINGTON. No. I would answer your question——

Senator GORE. On what principle would you base your discrimination?

Mr. WHITTINGTON. Well, there is no tax at all in this case.

Senator GORE. You are from Mississippi.

Mr. WHITTINGTON. Yes—and I am glad of it.

Senator GORE. Products from Mississippi—suppose they make it 200 on those, and less on others?

Mr. WHITTINGTON. I said, Senator, I was advocating a reasonable tax, and I am willing to compromise with you. If you think 5 is too high, I think we would come along with you, around 3.

Senator GORE. One other question. The President has recommended that Congress give him the power to negotiate reciprocal treaties. Would it answer your purpose, to give him the power in this bill to negotiate reciporcal treaties with the Philippines, in relation to agricultural products of the two countries?

Mr. WHITTINGTON. I favor that practice, and I think it will help the President in that policy, if we will put a reasonable tax on these foreign oils in this bill. That is my view.

Senator BARKLEY. In other words, you want to fix it up, before he begins to negotiate?

Mr. WHITTINGTON. No, sir; and I want to put the cotton producer—and I speak for his benefit as well as others in allied industries—on the same footing as those who are now being protected by excise taxes and tariffs.

Senator GORE. In other words, take 10 millions of our cotton products. Don't you think that this tax, if we permit them to restrict, ultimately would close their market against $10,000,000 worth of cotton fabrics, in order to close our market against $8,000,000?

Mr. WHITTINGTON. Senator, I do not take as much stock in the closing of markets, or in the removal of factories from the United States to other countries, as a good many other people do. Now,

I do not want to do the Philippine people any injustice. But I do submit it is my thought that with the importations mounting here, as you yourself have suggested, I think that we should give consideration to the cotton producers of the South, and I do not want to interfere with that trade, either on cotton goods or in other goods, in the United States, because I feel that a reasonable tax will not interfere with it, and will distribute the burden of taxes.

Senator CLARK. I may say, Congressman, I am concerned with the Philippines, but I do not care to have the American people plundered year after year. I understand it is your theory that if the American people are going to be plundered by tariff duties and tax exactions of various sorts, that you want to claim your part for the cotton growers of Mississippi.

Mr. WHITTINGTON. No; I am not in favor of a plundering, and you know I advocate an honest and a reasonable tariff, and I offered to compromise with the Senator, a few minutes ago, in answer to his question.

Senator CLARK. Frankly, you would not favor putting a tariff on bananas, in order to make the American people eat peaches?

Mr. WHITTINGTON. Well now, Senator, I had not thought of that question recently, but I recall an argument——

Senator BARKLEY. But it has been brought forward by the same people who are opposing this tax.

Mr. WHITTINGTON. Yes.

Senator CONNALLY. How is that?

Senator BARKLEY. We had the proposition, when we had the tariff bill before us, to put a tariff on bananas, in order to keep them out so as to make the American people eat peaches.

Senator CLARK. Eat apples.

Senator BYRD. Eat apples.

Senator COUZENS. That is what this is for, to keep the coconut oil out, and favor cottonseed.

Mr. WHITTINGTON. I think that is a fair question, and the Senator and I——

Senator BARKLEY. Virginia speaks up on behalf of the apples.

The CHAIRMAN. That is what they do in the whole tariff.

Senator GEORGE. We do not need to mince words about that. We have done that throughout the tariff.

Senator CLARK. I think it is time to stop, now.

Mr. WHITTINGTON. I would rather you would not stop right now. Put it off a little bit later if you could, Senator, because I am interested in the cotton growers, and I may say with respect to the question suggested by the Senator from Michigan and the Senator from Kentucky, I have heard the argument here and in the House, with respect to interchangeability. I think that they are unduly alarmed. I think that there can be substitutions, that will permit the use of the domestic fats. I recall that the price of fats has declined 70 percent in the last few years, the price of the manufactured product, soap, 30 percent. I recall that the manufacturers of soap, the largest users of this oil, have a 30 percent tax, as I recall, on their toilet soap, and 15 percent on their laundry soap. I am asking that some sort of similar relief be given to the cotton growers. Others can speak for the growers of the other allied industries, but let us see about this substitution business. I remember the testimony here

with respect to the recent, newly discovered chemical processes and inventions, and I can see that they have been encouraged. They said they had those uses, in the last 8 years. Certainly they have been getting cheaper and cheaper coconut oil, and you know "necessity is the mother of invention." I want to encourage these scientists and these chemists to seek new and better processes that will result in the use of domestic oils and fats, and it occurs to me that this ecxise tax will be of some benefit.

Now, what does the Tariff Commission say? In just a sentence, with respect to the interchangeability and substitution, and particularly in the manufacture of soap, that "Sometimes approximately 70 percent of the coconut oil" from the Philippines is used? "But by a material change"—and I am reading from report 41, second series, page 182:

> But by a material change in the type of soap produced, substitution may be carried much further.

Again:

> The most significant factor in making the use of both cottonseed oil and inedible animal oils and fats in soap making is therefore not the price relationship of each to coconut oil, but their price relationship to each other.

Now, Mr. Chairman, you have been very kind. I have no disposition to detain you. I just want to say, in conclusion, that the consumption of domestic fats in the manufacture of soaps sold to the American people, has declined from 1912 to 1930, from 19 to 43 percent.

Senator GORE. There is practically no cottonseed oil used in soap, is there?

Mr. WHITTINGTON. I do not know the amount, but they are using some, as I understand.

Senator GORE. Two tenths of 1 percent?

Mr. WHITTINGTON. They are using some, I know.

Senator GORE. Do you know how much cottonseed oil is exported, Congressman?

Mr. WHITTINGTON. No; I do not. I haven't those figures. I am trying as best I can to confine myself here to what I know.

Now, let me say this, in conclusion, that not only the carry-over, but the stocks on hand from cottonseed oil, are increased from year to year. There are about 2,000,000 barrels of carry-over with the decrease in the price. It occurs to me that even in the difficulties of trade relations, that the producers of American fats and oils are at least entitled to as much consideration as the producers of American sugar.

The CHAIRMAN. Thank you very much.

Mr. WHITTINGTON. Mr. Chairman, may I file as part of my statement, this memorandum in connection with it?

The CHAIRMAN. Yes.

Senator CLARK. Congressman, do you have any figures as to the comparison between the amount of revenue that would be added to the Federal income in a year, and the additional burden that would be put on the American users of soap? You have been talking about soap here a great deal. Do you have any comparison of those figures?

Mr. WHITTINGTON. No; I have not.

Senator CLARK. In other words, you do not know how much would be mulcted from the pockets of the American people, in order to grant a subsidy of about two tenths of 1 percent.

Mr. WHITTINGTON. I do not favor any mulcting of any kind. It is my thought that this tax can be ultimately absorbed, and if it is not absorbed, it will be rather small, and can be passed on to consumers, as practically all other excise taxes are.

SUPPLEMENTAL STATEMENT OF REPRESENTATIVE WILLIAM M. WHITTINGTON, THIRD DISTRICT OF MISSISSIPPI

Mr. WHITTINGTON. Mr. Chairman and gentlemen of the committee, I represent one of the largest cotton-producing districts in the United States, and I favor the excise tax not only on coconut oil and sesame oil, as provided in the pending bill as it passed in the House, but I advocate an amendment in the Senate so as to impose a tax on palm oil, on sunflower-seed oil, on palm-kernel oil, on imported whale oil, on imported fish oil, and on other imported marine-animal oils.

The 5 cents per pound carried in the bill as it passed the House represents the difference between the prices of fats at present and the price of the pre-war level. The aim of the Agricultural Adjustment Act is the pre-war or parity price.

Again, the prices of all oils, whether edible or inedible, whether crude or refined, advance or decline at the same time. Therefore there is a necessity for a tax on all competing oils.

Foreign oils are in competition with domestic oils and domestic labor is much higher than the labor of other countries producing coconut and other competing oils.

An excise tax on all oils is essential—a tax of 3 cents on coconut oil or sesame oil.

While 70 percent of the importations of coconut oil are used in soap and 22 percent in margarin, yet coconut oil is used for both edible and inedible products. It is in competition with domestic oils.

The importation of oils, as well as the uses of foreign oils is increasing year by year. In 1912, the soap industry used 19 percent of foreign importations, while in 1930 it consumed 43 percent of the oils imported into the United States.

Cottonseed oil and lard are the chief domestic fats. The carry-over of cottonseed oil on August 1, 1933, amounted to 1,800,000 barrels. The average stock of cottonseed oil for the 4-year period ending with 1930 was 800,000 barrels.

In 1926 the price of cottonseed oil was 6⅛ cents, while the price of coconut oil was 8 cents. On December 13, 1933, cottonseed oil was 3¼ cents and coconut oil was 2½ cents.

The importations of coconut oil and copra equivalent for 1909 to 1914 averaged 85,550,000 pounds. For the years 1919–21, these imports jumped to an average of 375,874,000 pounds and for the year 1933 an indicated total of imports of coconut oil and copra equivalent will be about 634,309,000 pounds.

Palm and palm-kernel oil imports have increased about 400 percent.

The price of cottonseed is determined by the price of cottonseed oil. Normally cottonseed oil constitutes about 55 percent of the gross value of cottonseed. Such was the case over a period of 25 years.

In 1931–32 and in 1932–33, the cottonseed oil represented but 40 percent of the gross value of cottonseed.

I said that the stocks of cottonseed oil have vastly increased. The carry-over has more than doubled since 1927. The price has declined. The reduction program will not suffice. Importations are increasing too rapidly. An excise tax is essential to restore the parity price of cottonseed. It is necessary in the National Industrial Recovery program.

The manufacturers of soap object to the excise tax. It is understood that there is a monopoly in the manufacture of soap. While the prices of fats have declined 70 percent, the price of soap has declined but 30 percent. There is a duty of 30 percent on toilet soap and a duty of 15 percent on laundry soap. If the American market is to be reserved to the domestic manufacturer, it should be reserved to the domestic producer.

The opposition of Procter & Gamble to the proposed excise tax is typical. While they operate a few oil mills in the South, they are probably the largest consumers of cottonseed oil. Their oil mills are really conveniences. They may or may not operate them during the season. Nevertheless, they get the cottonseed oil and are constantly decreasing the prices. At the same time they are large users of imported oils. Like other similar manufacturers, they profit by the competition between domestic and foreign oils. It is small wonder, therefore, that the large manufacturers oppose the excise tax. They are profiting by constantly declining prices and by the competition among the producers of oils.

Much has been said about the indispensable uses of coconut oil and about coconut oil not being interchangeable with cottonseed oil and other domestic oils—foreign oil is indispensable for certain products. This is no argument against an excise tax. Manufacturers would probably absorb the tax, but even if not absorbed the increased costs to the consumers have been overestimated. Consumers will ultimately absorb the tax as they absorb other excise taxes. All price-raising measures will fail unless competitive foreign prices are raised at the same time.

If coconut and other foreign oils are indispensable, much needed revenue will accrue to the Treasury.

The cottonseed crop is really the cash crop of the tenants of the South. It is equal in value to 10 percent of list cotton itself. The price of cottonseed during the past 2 years has been unprecedentedly low. There is an excise tax on lumber, coal, copper, and petroleum. The growers of cottonseed are entitled to the same consideration.

But, it is said that the tax should be denied because cottonseed is not interchangeable with foreign oils. The opponents have emphasized their opposition on this ground. Those interested may differ. The Tariff Commission in Report 41, second series, submitted data to Congress on vegetable oils. I quote from paragraph 2, page 182 of the report:

> From 1914 to 1929 the quantity of these oils (coconut and palm kernel) used in soap making arose from 109,000,000 pounds to 417,000,000 pounds—an increase of almost four fold, and from 13 to 25 percent of the total consumption of oils in the soap industry. By suitable changes in formulas, however, the proportion in which they are now used might be somewhat reduced without noticeably changing the kinds of soap produced. Thus to a limited extent inedible tallow and

grease, principally grease, may be substituted for coconut oil; to a somewhat greater but still limited extend cottonseed oil or another soft vegetable oil may be substituted. But by a material change in the type of soap produced substitution may be carried much further.

I quote again from page 200:

The most significant factor affecting the use of both cottonseed oil and inedible animal oils and fats in soap making is therefore not the price relationship of each to coconut oil, but their price relationship to each other.

The opponents have emphasized that new processes and chemical inventions have materially increased the use of foreign oils. It is natural that the cheaper oils should be used. Necessity is the mother of invention. If domestic manufacturers, to whom the domestic market is reserved, would devote more time and attention to new processes in the use of domestic fats, such uses could be multiplied.

I feel most kindly toward the Philippines, and the people of the islands. At the same time, the interests of the producers of the United States are entitled to first consideration. Those who benefit from American markets should contribute to the costs of the Government that makes possible such markets. All should share in the burdens of taxation.

The proposed tax will result in the distribution of the tax burden so that all who profit may share in the revenues that are essential for the welfare of the Government.

The CHAIRMAN. Congressman McDuffie.

STATEMENT OF HON. JOHN M'DUFFIE, REPRESENTATIVE IN CONGRESS FROM ALABAMA, RELATIVE TO SECTION 602, TAX ON OILS

Mr. McDUFFIE. Mr. Chairman, gentlemen of the committee: I shall not detail you but a few moments, and possibly anything I might say now would be repetition. I came principally to say what was said by Senator Tydings, the Senator now being at the head of the Committee on Insular Affairs, which deals with these 13½ or 14 million people who are under our guidance and control, not at their own request, but to whom I feel this Government owes some consideration, especially at this particular time, when we are all trying to discharge the responsibility which I think we have with reference to those people, in an effort to give them their independence, following the traditional policy announced many years ago in the treatment of the Philippine Islands, our dealings with them.

The Senator has very definitely stated that we are now moving forward, and I think we have ready, in the process of legislation, the purpose of bringing about a separation and complete independence, that is going to be successful. After several years of effort, their mission worked out with our representatives, a bill, the Hawes-Cutting bill, which was submitted to their legislature and was refused by that legislature. They refused to call a convention for its submission. I have assurances, and I have had the same cablegrams that the Senator has had, doubtless, from the speaker of the house, from the acting president of the senate—the president of the senate is here and testified this morning, all agreeing that they will submit this bill and pass it through the legislature, and give it their undivided, personal support, in an effort to bring about ultimately independence.

Many of us would like to see independence granted immediately, but whether or not that is the wisest thing to do, the best thing for us and for them is independence, ultimately.

Senator CLARK. Well, Mr. McDuffie, how many economic concessions do we have to grant, in order to give the Philippines what they claim they are after—their independence?

Mr. MCDUFFIE. Well, Senator, that is a question on which each man might have an opinion. I do not think we are granting any great economic concessions. Indeed, I think the bill which has been presented to both Houses of the Congress rather retains advantages for this Government, over the Philippine Government. I don't think we are granting much. At least, I think we are granting very little.

Senator GORE. Santa Claus is just sort of getting out of the picture?

Mr. MCDUFFIE. That is it, undoubtedly.

Senator CLARK. Well, so far as I am concerned, as one member of the Insular Affairs Committee of the Senate, I can say that I am in favor of granting the Philippines immediate independence.

Mr. MCDUFFIE. Well, Senator, that goes into another question.

Senator CLARK. But I do not propose to pay them any economic concessions, to give them what they say they want.

Mr. MCDUFFIE. Well, if you haven't read the bill——

Senator CLARK. I have read the bill.

Mr. MCDUFFIE. Well, I am sure you will agree with me that we are not conceding much in that bill, do you think?

Mr. CLARK. Well, I rather think we are.

Mr. MCDUFFIE. Well, that is just a difference of opinion.

The CHAIRMAN. All right, Congressman.

Mr. MCDUFFIE. Now, after all, this is a tariff. It is not a tax, and the question arises whether it is right to put an embargo on one product, to the benefit of another.

Senator CLARK. This is in effect an embargo, isn't it?

Mr. MCDUFFIE. It is in effect an embargo, because this oil is selling at 2¾ cents a pound, and you put a 5 cents a pound tax on it, and I do not believe that the benefits to be derived, even by those interests who feel that they are prejudicially affected by the importation of coconut oil, justifies us at this particular time, to say the least, while we are considering the question of independence, to take this bludgeon and bludgeon them over the head. If we are going to have independence of the islands, I think the quickest and the easiest way is the best way for all parties concerned. Now, I am not going to attempt to give you a lot of data or information. Doubtless you have much of that. I want to call your attention to the fact that so far as cottonseed oil is concerned, coconut oil does not compete in any appreciable way, and the destruction of the purchasing power of the 2½ or 3 million people who buy most of their goods, indeed 77 percent of the commerce of those islands, now, is with the United States, approximately 200 million dollars in value.

Senator KING. Congressman, let me ask you a question.

Mr. MCDUFFIE. Yes.

Senator KING. You are aware of the fact that the Department of Agriculture is practically cutting cotton production—let us say cottonseed production—by 40 percent? You are, of course, familiar,

with the bill that the House is considering today, which would put an absolute limitation upon production, to that effect, if it goes that far, assuming it passes. If there is an increased price by virtue of these restrictive measures, of cottonseed, isn't it reasonable to assume that coconut oils and Philippine products will come in and take a large part of the market that is now being taken by them?

Mr. McDUFFIE. I do not think so, Senator, for this reason——

Senator KING. In the edible field?

Mr. McDUFFIE. In the edible field?

Senator KING. Yes.

Mr. McDUFFIE. Only 25 percent of it now goes into the edible field.

Senator KING. I understand, but won't the larger percent go in?

Mr. McDUFFIE. And let me ask the Senator a question. If it be true I think the facts justify this statement that while more coconut oil was selling in this country than cottonseed oil it is consumption increase more than the consumption of cottonseed oil. Now doesn't that go to prove that it is not a competitor with cottonseed oil because if cottonseed oil were at a lower price certainly the consumers would have used cottonseed oil. Insofar as technical uses are concerned coconut oil does not compete with cottonseed oil and only 3 percent of all fats and oils brought into this country are coconut oil—75 percent of this goes into the manufacture of nonedible products.

Senator GEORGE. Yes I understand that You cut down on the production of our own domestic oils and is it fair to allow them to increase their importation?

Mr. McDUFFIE. Well that goes back to this question, Senator, is it fair for us to let them bring anything in here while they are under our flag? Don't we owe them something? I grant you they are not as much a part of us as the State of Missouri.

Senator CLARK. I insist on that.

Mr. McDUFFIE. How is that?

Senator CLARK. I insist on that proposition.

Senator GEORGE. I make the same insistence.

Mr. McDUFFIE. Certainly we owe these people something.

Senator GEORGE. Yes, sir.

Mr. McDUFFIE. And I do not think it is fair to them to destroy their purchasing power, their power to purchase from us.

Senator GEORGE. Is it fair to the cotton producer, to cut his production, here, 40 percent, would you say?

Mr. McDUFFIE. Well, you cannot do that.

Senator GEORGE. But is it fair to do that?

Mr. McDUFFIE. I think, Senator, you are getting into another question here.

Senator GEORGE. Why restrict their importations 40 percent?

Senator BARKLEY. As I understand it, the cotton farmer is here, asking the Congress to make him reduce.

Mr. McDUFFIE. Yes.

Senator GEORGE. Yes, he is asking to do that because he wants to get a living price for himself. That is all; he is tryingto live.

Mr. McDUFFIE. The same thing applies to this, to the cottonseed industry, that applies to the dairy industry. Those people buy, as the Senator told you, some of our dairy products, even though they

might be a minor matter, so far as the Senator from Michigan is concerned, and he thinks it is so small that it amounts to nothing, yet they stand out as our greatest producer of dairy products. When we destroy their capacity to purchase those dairy products, I do not think that we are aiding ourselves, assuming that this is a tariff, and it certainly can be nothing else.

Senator GEORGE. Well, I would be prepared to agree with you fundamentally, on that proposition, but it applies all over the world, not only to the Philippines, that when we put a prohibitive tariff on lots of things, that the Italians make, we are cutting pretty heavily into their power to purchase our raw cotton, and that argument is good, but it is applicable everywhere, and the only additional strength that it has on earth is that the Philippines are under our flag.

Senator KING. Yes. We do not forbid the Italians from trading with anyone.

Senator GEORGE. No, no. I say, they are under our flag.

Senator KING. Whereas we do, we do, the Philippines.

Senator GEORGE. But may I call my friend King's attention to this question? The Philippine sugar people are exceedingly solicitous about limiting importations of sugar, but they are not concerned with coconut oil, or anything that competes with their product.

Senator CLARK. Well, Senator, I have had a great many telegrams and letters from cattle producers and horse producers out in my country, in favor of this particular provision. Isn't it a complete answer to that, that there is no justification on the face of the earth, from a legislative standpoint, in putting an embargo in a revenue bills.

Senator GEORGE. Oh, I agree with you there, but I do think there ought to be a tax imposed that would restrict their importation substantially, as we are restricting production in this country. Otherwise, we are simply making a hole in our home market, for them to fill and it is not fair to do it.

Senator BARKLEY. Let me ask this: Assuming that the reduction in the cotton acreage is going to result in better prices, and to the very great advantage of the cotton growers, is there such comparative damage done to the price of cotton, by the limitation of coconut oil, as to materially offset that advantage in cotton, by this reduced program?

Mr. MCDUFFIE. Not at all, Senator. Just as I said a moment ago, we increased our use of coconut oil when it was at a higher price, than that of cotton oil. Therefore, there can be no competition there, and the slight advantage, even to the cattleman, the animal-fat man, I have seen figures. I do not know whether you have these figures. People representing every interest have been coming here, and the figures are to the effect that only 4 or 5 cents would be added to the value of a thousand-pound steer. Insofar as that is the effect of the production, that might be accorded by the imposition of this tax.

Senator GORE. There is one witness who said that the use of coconut oil in soap encourages the use of tallow in soap and creates that demand.

Mr. MCDUFFIE. Well, Senator, I am in no wise an expert on this question. I do not come to set myself up as one, and I haven't.

Senator GORE. I do not want to get you into the soapsuds controversy.

Mr. McDUFFIE. No, I do not want to get into the soapsuds. I have no soap industry in my section. I have no interest there that could be affected through cottonseed, and I do not believe cottonseed is affected to any appreciable degree. Now, we have had a great many people here charging that they are lobbyists who are fighting this tax. Indeed, Mr. Loomis, the dairy farmer referred to here by Senator Blaine, on one occasion, in the Congressional Record; other gentlemen who are assuming to speak for farmers and on someone else's pay roll have urged this and have charged that there are thousands of dollars being spent by lobbyists to prevent this tax.

Senator CLARK. I received a thousand dollars' worth of telegrams in favor of the tax.

Mr. McDUFFIE. In favor of the tax?

Senator CLARK. I say I have had at least a thousand dollars' worth of telegrams.

Senator BARKLEY. I got 60 yesterday from one town, all written in the same language. I would like to know who paid for all of that.

Mr. McDUFFIE. I do not know.

Senator GEORGE. I have gotten an equal number against the tax, so it is about event.

Mr. McDUFFIE. I think we are getting into a question with which we are not concerned. In short, all I came to say, gentlemen, was to express this hope, and I think I can say I speak for the Committee on Insular Affairs in the House of Representatives, where we have no opportunity to offer an amendment to this bill in the House, under our rules, and we were in hopes that this committee would strike out this provision, in your consideration of this bill. I haven't a resolution passed by the committee, but I have talked to practically every man on the committee, and while I could not say it is unanimous, the vast majority of the committee is in favor striking out the tax, and I hope the Senate committee will see fit to do so.

The CHAIRMAN. Thank you very much, Mr. Congressman.

Senator CLARK. Your theory, Mr. McDuffie, is that, having taken the Philippines by force of arms, and against their will, that we owe some obligation to the Philippines, as long as we did that.

Mr. McDUFFIE. Yes. I think so. I think that is fair. I think this Government has a moral responsibility.

The CHAIRMAN. I would like to say to the committee that the Assistant Secretary of Commerce was invited to come here to discuss the question; Mr. Manning, of the Bureau of Fisheries was invited to come, and Mr. J. W. T. Duvel, of the Grain Futures Administration, was invited to come; and we have those three gentlemen, and Congressman Peyser wanted to spreak briefly on the question of annuities. If we can get through with these gentlemen this morning, it is hoped that we can avoid a meeting this afternoon, and will adjourn over until Monday, so we can kind of get our thoughts together after this week of barrage. So, Congressman Peyser, we will hear you now.

STATEMENT OF HON. THEODORE A. PEYSER, REPRESENTATIVE IN CONGRESS FROM NEW YORK

Mr. PEYSER. I will be very brief.

The CHAIRMAN. I will say to you, Congressman, that this question of annuities has been discussed by a great many witnesses before the committee, during this hearing.

Mr. PEYSER. Yes; I know that there were some gentlemen appeared before the committee on Monday, on the question of annuities. As I say, I will be very brief. I have no statement written, but I want to bring to the attention of the committee the fact that I have not as yet heard stated the amount of revenue that they hope to receive through wiping out the present tax on life-insurance annuities, and it is my belief, and I have so expressed that belief, that in the final analysis the Government will not get any revenue, at the time that they expect to get more by deferring it as they do, under the 1932 revenue act. I base that on this, that if they are going to discourage the sale of life-insurance annuities, that the loss of income tax which would be received by the Government on commission earned as a result of those sales, would be practically enough to wipe out what revenue the Governmet might collect in their intermediate years, by putting on the immediate tax, as proposed under the new bill. If you follow me—I presume you do—I am not proposing a tax on the life-insurance annuities, but I do think it is a mistake in trying to change the date or the time at which those taxes are to be collected.

I am speaking as a salesman of life insurance, of 30 years. I am not an actuary. I am not connected with the companies, but in my judgment you are putting a tax here on thrift. You are putting a tax on people who, under the present set up, according to statistics, there are 6 out of 100 persons today who are independent at the age of 65 and a lot of those people are endeavoring to overcome that situation by purchasing annuities at the present time. I think, in setting this bill up, that there is a misconception, that the amount of annuities are purchased by the rich people, for the purpose of avoiding income and other taxes. If there is a way of analyzing, and I think that was presented to your committee on Monday, I was not here, but there are many of these annuities that are purchased by the smaller man, by payment of annual payments each year, to set up a thought which will provide an income for him beginning at a definite date, when he has reached the age of 60 or 65, or whatever the contract may call for.

In my judgment, I believe that under the present tax, whether a full return of the amount received from an annuity, after the purchase price has been returned, that the Government will get more money through that system than by attempting to collect now what is purely an arbitrary tax of 3 percent on the purchase price, beginning immediately.

To illustrate the unfairness of it, let us assume that 2 men, 1 at the age of 40, and 1 at the age of 62 or 63, were to deposit with the Government $100,000, to purchase an immediate annuity.

Senator GEORGE. With the Government?

Mr. PEYSER. With the company, I mean, although I understand there is a Government income-tax bill now pending, the man in the

earlier 60's, would receive for his $100,000 deposit, $10,000 a year, as long as he lives. If he has collected that for 10 years, and is still living, he immediately goes into the income bracket, with $10,000 a year, for the rest of his life.

Under the proposed plan, it is to collect 3 percent of the purchase price, or to assume that $3,000 of the $10,000 is interest earned. Now, let us take the man that makes a similar purchase, who is aged 40. That man will receive, instead of $10,000 a year, approximately $6,000 a year, or $6,200. He is going to be taxed $3,000, the same as the other man. If you are putting it on a percentage basis in one case, you are taxing a man 30 percent, the older man. The younger man, you are taxing 50 percent of his income, throwing it into the taxable items.

The CHAIRMAN. Well, thank you very much, Congressman, and if you want to elaborate your views upon that by sending a brief to the clerk, we will be very glad to have it.

Senator GEORGE. Congressman Peyser, do you think that many wealthy men have purchased annuities?

Mr. PEYSER. In percentage, I would say, without having any figures, but from what I could learn around in my particular section where I am—that is, in New York City—there are more annuity purchases made by the accumulation of the little fellow than there are by the big people. In other words, for 1 man that lays down $100,000, there are probably 1,000 people that are laying down $100 a year.

Senator GORE. How would it do to create two categories, and let the little fellow get by? I think this ought to be encouraged.

Mr. PEYSER. How is that?

Senator GORE. I think this should be encouraged, as you say. Why shouldn't we make it light on the fellow that has more?

Mr. PEYSER. Well, you are taxing them now, under your present system, after there has been a certain amount of money returned to them. In other words, under your present set-up, in my belief, you are putting a tax on capital invested, because the man that lays down the amount, whether it is in one payment, or through an accumulation of payments, and lives only to collect 30 percent of it, he has had a capital loss of 60 percent of his original investment, plus the loss of any interest earning during the time that fund was being built up.

Senator CLARK. Well, Congressman, couldn't you take care, as Senator Gore just suggested, of the little fellows who buy annuities, and which certainly should be encouraged, by making two different brackets, one for the big fellow and one for the little fellow.

Mr. PEYSER. You could, if you wanted to discriminate there.

Senator CLARK. Well, we do that in the income tax and every other kind of a tax.

Mr. PEYSER. Yes; I mean, if you want to set up that the man who buys the immediate annuity, not one of the annual purchases, which is really a savings fund for the little fellow, but a man who can deposit a certain amount, you can establish your amount, and then set it up. But the question arises again in my mind, I am not a lawyer, as to whether or not it would stand the test of courts. You are using, here, 3 percent, which is simply a factor that the insurance companies use, to ascertain what should be paid by that man in here, connected with his expectation. Now, that applies to a group.

Senator CLARK. I do not see how any difficulty should arise, in establishing the brackets. That is the same thing we do with the income tax, the estate tax, and so forth.

Mr. PEYSER. I say, you could establish it, but could you establish the fact that that is interest earned, or income that should be taxable?

The CHAIRMAN. Well, thank you very much, Congressman.

Mr. Dickinson is here, from the Department of Commerce. All right, Doctor, we will be glad to hear you.

STATEMENT OF HON. JOHN DICKINSON, ASSISTANT SECRETARY DEPARTMENT OF COMMERCE, RELATIVE TO FOREIGN-TAX CREDITS

Mr. DICKINSON. Mr. Chairman, I shall also be very brief, but I would just like to say a word about a proposed 50-percent repeal of the foreign-tax credit, as provided in section 131 of the bill before us. I would like to put forward three thoughts in connection with that proposed 50-percent repeal: First, that the provision in the present law is fair, and has eliminated the objections which were justly urged against some of the earlier forms of the foreign-tax credit; second, that the proposed repeal will probably not strike at the evil at which it is apparently intended to strike; and third, that it will have some unfortunate consequences that we probably would not like to bring about.

Now, if you go back to the provisions of the 1918 act, there was a foreign tax credit there in such broad terms that if an American concern doing business abroad had to pay a very high rate of tax in the foreign country, so that its total tax on a comparatively small amount of business over there was very large, still it could offset that entire tax against its American tax, and the result might sometimes come out that it would not have to pay any American tax at all. Now, that provision was modified by the act of 1921. In general, the theory has been the same ever since the act of 1921 and down to the present statute, and the modification consisted in providing that the credit should not be any larger percentage of a man's total tax than his foreign income bore to his total income. In other words, if he only had 20 percent of his income coming from foreign countries, the amount of the exception that he got could not be more than 20 percent of his American tax, which, in effect, worked out the same result as if we were to segregate his foreign income, and say that the foreign countries tax him on his foreign income, and this country taxes him on this income.

Now, that is the principle that we have been working on.

Senator GORE. But that insured some income for this Government?

Mr. DICKINSON. Yes, sir; it insured as large a proportion of the tax for this Government as the proportion of the man's income that was earned in this company. As I say, it sort of worked out a segregation between the man's income, into his foreign income, and left that for the foreign government to tax, and his American income, it meant that for us to tax. Now, I have felt that there was some feeling that in getting rid of this foreign tax credit altogether, this rather fair provision, as it seems to me, this provision which did eliminate double taxation, that we have been thinking that perhaps

we were going to hit at the foreigner. Now, I have heard the argument advanced.

Senator KING. You mean the foreigner who might be investing here?

Mr. DICKINSON. Well, that is the difficulty, of course. It does not hit the foreigner who is investing here. It hits the American who is doing business abroad, and it does not merely hit the American who is investing abroad. It hits the American who is going business abroad.

That brings up a second point. I am glad you reminded me of it, Senator King. That is the problem of the branch factory, which is a very real problem, but this foreign tax credit applies, of course, not merely to the American that has invested money in plants. It applies to all Americans who do business abroad. It applies to the American selling agency, where a concern makes all his products in the United States, sets up a selling agency abroad, and undertakes to sell them in certain foreign countries. Well, that concern is doing business abroad, and a great part of the people who will be hit by this provision are people of that kind. We have, of course, considerable numbers of branch factories abroad, but the volume of business that those people do is obviously nothing like the volume of business that is doing in the way of direct exports of American goods from this country to the foreign country, so whatever may be said for or against the branch factory—and I am not here to talk about that subject this morning—it does seem to me that we ought not to take action which would hit a great many other people than the people who have branch factories.

The question has been asked, "Well, do other foreign countries give this kind of a credit to their own people who are doing business abroad?" And the answer is "Yes, to a very considerable extent", but even suppose that they did not, that should not affect our policy. Because of the fact that they do not want to help their export trade is hardly a good reason why we should not want to help ours along.

Senator CLARK. In other words, Doctor, unless we have some such provision as this, we penalize or own citizens who are engaged in foreign trade to the extent of the foreign tax?

Mr. DICKINSON. Exactly. We make them pay double taxes on all business that they do in foreign countries.

Senator GORE. Doesn't that make them have a tendency to expatriate, say, in their business, and take out the charters in other countries?

Mr. DICKINSON. Yes, sir; I should think it would have precisely that effect. I should think it would have the effect of making them, as far as possible, separate themselves entirely from this country.

Senator LONERGAN. Can you tell us how many manufacturers in the United States have branch factories in foreign countries?

Mr. DICKINSON. Well, sir, the Department of Commerce has made a report on branch factories abroad just recently. I have a copy of it here. It is transmitted by a letter from the Secretary of Commerce, dated June 13, 1933, and contains a good many statistics. I do not know that the number of companies means very much. The figures seem to indicate that there are 664 American companies which have branch factories abroad, that are engaged in manufacturing lines, but the point that I want to make, Senator, is that I think that this pro-

vision that we are considering here ought to be dissociated from the branch-factory problem because it goes so much farther. It hits everybody in order to hit this one class of people who do not constitute the principal class of people that would be hit by the provisions.

Senator KING. Doctor, may I interrupt you right there?

Mr. DICKINSON. Yes, sir.

Senator KING. You mentioned six hundred and some branch factories?

Mr. DICKINSON. Six hundred and sixty-four American companies that have branch factories. Some of them have 2 or 3 factories, apparently, abroad.

Senator KING. Yes. Well, is it not a fact that some of those so-called "branch factories" are mere assembly plants?

Mr. DICKINSON. I understand that a very considerable part of them are assembling plants.

Senator KING. Exactly.

Mr. DICKINSON. Or plants that put the product into packages that are adapted to the case of the country, or something of the kind.

Senator KING. May I make an observation to present to the chairman? When I was in France, 2 or 3 years ago, and when I was in Canada, 2 years ago, I talked with a great many Canadians and some Americans there, and both told me that if the product seemed to have been assembled or organized or manufactured in that manner in their country they found it much easier to sell it than if it was shipped right over from the United States to the consignee and sold.

Mr. DICKINSON. Yes.

Senator KING. So that it advanced the sales, widened the market, by having an assembly plant there, or having a selling agency under a Parisian or Canadian or German name.

Mr. DICKINSON. I have been informed just as you have, sir, that that is the experience of men—of most of our concerns that are engaged in foreign trade.

Senator CLARK. Well, Doctor, it is a fact, is it not, that that is differentiated from branch factories, and a great many American manufacturers have been forced by this system of competitive tariffs that is now in effect throughout the world to establish subsidiary companies, organized under the laws of their own country, which are actually in competition with American companies.

Mr. DICKINSON. Yes. Yes, that has been largely the result of the tariff policy that has been practiced by these other companies since the war, and I might say, Senator Clark, right in that connection, that we are now on the eve of an attempt which we hope will be successful to do something toward helping American exporters to meet that situation, by appropriate tariff negotiations with some of these foreign countries.

Senator CLARK. I may say to you that I am very much in hopes that policy will be successful.

Mr. DICKINSON. I hope it is successful. And, just by way of conclusion, then, I might say that at this very time, when we are attempting to take up some of our own slack and get rid of some of our own surplus by restoring our export trade to more normal levels, I would like to raise the question as to whether it would be advisable to take any action in the form of a tax measure which would bear very heavily

upon everybody engaged in the export trade. A tax is supposed to bring in, I believe, if the entire foreign tax creditwere repealed, about $10,000,000 a year.

The CHAIRMAN. They estimate this change at 5 million.

Mr. DICKINSON. $5,000,000? Now, with regard to the change itself, that is what we called at the beginning the 50 percent repeal of the exemption. That seems to be most illogical. I see no advantage in stopping halfway on the thing. The 50 percent is a burden, and if the principle of double taxation of Americans who are doing business abroad is a bad thing and a discouragement of our expert trade, why should we say that, just because we are only putting a 50 percent burden on them, that that is all right? It is a little bit like the old story of the girl who excused the baby, you remember, because it was only "such a little one."

The CHAIRMAN. Well, your view is that this law ought to remain as it is today?

Mr. DICKINSON. Yes, sir.

The CHAIRMAN. And that the 50 percent should be stricken out?

Mr. DICKINSON. And in that connection, I would like to call attention to a letter from the Secretary of State to you, Mr. Chairman.

The CHAIRMAN. Yes. That will be placed in the record. Thank you very much.

Mr. DICKINSON. Thank you very much.

Senator CLARK. You do not think there ought to be any change in the present law?

Mr. DICKINSON. No, sir. It seems to me the present law represents a sound principle.

(The letter to Senator Harrison is as follows:)

MARCH 15, 1934.

MY DEAR SENATOR HARRISON: I desire to ask that very careful consideration be given to certain parts of the revenue bill of 1934 where the present text could probably do our export trade more harm than the revenue to be collected justified.

In many instances it would be unprofitable for American companies to maintain marketing branches and sales agencies abroad if it were not for section 131 of the Revenue Act of 1932 which permits the taxpayer to offset the foreign income tax against the American tax. The bill before your committee proposes to increase the United States tax on exporters by cutting in half the credit for foreign taxes. While this has been estimated to produce an increase in revenues of 5 million dollars, it is very doubtful that this would result. If American export agencies abroad are taxed by both countries, many of them will go out of business. This form of double taxation may go far to defeat efforts of our Government and people to foster foreign trade.

Section 403 of the revenue bill of 1934 imposes Federal estate taxes on all citizens, whether or not residents of the United States and on all residents, whether or not citizens, as to all their estate, real or personal, and wherever situated. The almost universally established principle of estate taxation has been that only the country of residence, regardless of citizenship, may tax the full estate and furthermore that real estate should be subject to succession taxes only in the country where situated. Section 403 would make it difficult for American citizens to live in foreign countries in the interest of American foreign trade. They will be subject to a tax burden much greater than that imposed on foreigners in a similar situation.

Section 104 of the bill establishes an additional income tax equal to 50 percent of the income tax otherwise imposed on citizens or corporations of a foreign country which subjects American citizens or corporations to discriminatory taxes. There is no quarrel with the purpose of this paragraph but it should be amended to apply not only to discriminatory but to extraterritorial taxes and should authorize the President to conclude an agreement eliminating such taxes or to

subject citizens of the foreign country to an additional income tax equal in burden to the objectionable discriminatory or extraterritorial tax.

I appreciate the importance of stopping all gaps in our income-tax legislation, but I do not think we should do this by subjecting the representatives of our trade abroad to double taxation contrary to the long-established and well-considered practice of the other great trading nations. Sections 131 and 403 do this. Section 104 is mandatory legislation against discriminatory taxation by foreign countries which should be modified to put power in the hands of the President to negotiate the removal of discriminatory foreign taxes. A great deal of study has been given to international double taxation and our efforts should be to promote agreements regarding the allocation of business income between countries for the purpose of taxation in order to secure fair and definite principles governing the taxation of American enterprises in foreign countries.

Sincerely yours,

CORDELL HULL.

The Honorable PAT HARRISON,
Chairman Senate Finance Committee, United States Senate.

The CHAIRMAN. Mr. J. W. T. Duvel. Mr. Duvel has been requested to come here in connection with commodity futures.

STATEMENT OF J. W. T. DUVEL, GRAIN FUTURES ADMINISTRATION, DEPARTMENT OF AGRICULTURE, REGARDING COMMODITY FUTURES

Mr. DUVEL. Mr. Chairman and members of the committee.

The CHAIRMAN. We will be glad to get your views, Mr. Duvel.

Mr. DUVEL. My statement has to do with a sales tax of 5 cents per $100 value, on sales on futures exchanges.

The CHAIRMAN. That was formerly 1 cent, as I understand.

Mr. DUVEL. Yes, that was formerly 1 cent. In 1914, that act was first passed with 1 cent a bushel, then in 1917 increased to 2 cents, and in 1924 dropped back to 1 cent, and in 1932 increased to 5 cents. Now, in watching the operations of the exchange——

The CHAIRMAN. You represent——

Mr. DUVEL. The Department of Agriculture.

The CHAIRMAN. The Grain Futures Administration?

Mr. DUVEL. The Grain Futures Administration; yes, sir. We feel that that 5-cent tax is too high to permit the easy and efficient working of the exchanges. It is a tax the burden of which comes primarily on the people who stand in the market and take orders, there buy and sell, as the merchant or the speculator is in the market. The tax itself is not necessarily such a burden on the man who makes one trade, but it is the man who is in the market all the time, and who is taking the orders. I think that can be illustrated very well in this way: A man comes into the market, a dealer, and he wants to sell, as a hedge or a speculation, 5,000 bushels of wheat. There is somebody in the pit who stands and takes it. Now, if a man can buy that wheat at $1 a bushel, and if he then can later turn around and sell it to someone else who wants to buy it, a real dealer, at $1.00⅛, he makes a profit of $6.25. From that, he must deduct his tax of $2.50.

Senator GORE. That is on the 5,000?

Mr. DUVEL. That is on 5,000 bushels.

Senator GORE. Yes.

Mr. DUVEL. On the other hand, if he sells that, not at $1.00⅛, but at 99⅛, he has lost the $6.25 plus $2.50 tax, or $8.75. Therefore, he has to make profits on about three times as many transactions as he does to offset his losses.

The CHAIRMAN. Is it your idea that it would really be helpful to the price of grain, if this was reduced to 1 cent?

Mr. DUVEL. We feel that it would help in that way, and it gives these people flexibility to the market, and to make that market at all times. It is the people who are trading a small list, say one sixteenth or one eighth of a cent in grain, perhaps in cotton, that would make that market.

Senator KING. But, pardon me, are you not encouraging that which we have been denouncing for a number of years, the dealing in futures, and to that extent encouraging gambling?

Mr. DUVEL. Well, of course, that gets into the futures question, but so far as we have the futures market—for instance, if you are a dealer, and you want to hedge your transaction, 5,000 bushels, you want to put that into the market, and you want somebody to take it. Now, there might be another dealer, but he is not in the market at the particular time. He might be in, a half hour later, or an hour later, but in order to wait—and you are anxious to get rid of your own, therefore you offer it, for instance, at $1 or 99¾. You offer it down before somebody will take it, but if you have these scalpers in the market, who are ready to take it, the instant you offer it, they are ready to take it, to take the chance and they don't always—we see records, sometimes, of those people who trade, and yet at the end of it, after they have paid the tax they have lost.

Senator CLARK. Isn't this true—suppose, for instance, that a cotton producer takes his cotton to a cotton dealer in Caruthersville, Mo., we will say, and offers his cotton for sale. Now, that dealer may not have a chance at the moment, he may not have a present buyer for cotton. He is familiar with the cotton market, but before he can buy the cotton from the cotton producer, he wants some reasonable assurance he is going to have some chance to get out, at something approximating the market price. He will buy that cotton and sell a cotton future, at the same time, which stabilizes markets, and the same thing is true of grains, of course.

Mr. DUVEL. And sometimes is true of grains, and he wants it merely where he can sell that instantly.

Senator CLARK. And if you did not give him an opportunity to do that, you do not have a stabilized grain market, or a stabilized cotton market, either?

Mr. DUVEL. He has to wait, before he can sell it. Then he would have to wait until there is another buyer comes in, which, as I say, might be a half hour further from then, and in his anxiety to get rid of it, he will offer it at a lower price, or offer the producers a lower price.

Senator CLARK. The local dealer in cotton or grain might hesitate to buy the commodities coming in at the moment.

Mr. DUVEL. Yes; I think that is true.

Senator CLARK. Unless he has some reasonable chance to get out at something approximating the market level.

Senator KING. Well, aren't you presenting the entire question or problem of futures? Now, I recall a few years ago, if you will pardon me, Senator Caraway was very much interested in this, and offered a bill. We took a vote on it in the Senate. It got a large number of votes which denounced these futures.

The CHAIRMAN. That was to abolish them altogether?

Senator KING. Well, to abolish them altogether. Now, I am told that down in the Agricultural Department you have a ticker there, and you buy and sell the futures on grain, and cotton, and so on, and the Farm Bureau bought, and went into the market there, bought and sold, lost enormous quantities, millions and tens of millions of dollars, which the taxpayers had to pay. We have denounced these dealings in futures and have tried to stop it on the stock exchange. It seems to me you are trying to encourage dealing in futures and reviving this gambling spirit which we have been denouncing.

Mr. DUVEL. Of course, we have, in the Grain Futures Act, jurisdiction over that, and regulation, and we are for regulating it. In fact, we are in perfect sympathy with the President's recommendation recently for more rigid regulation, but as long as you have the system, we feel that the burden should be so that that system will work, and will work freely.

Senator GORE. Your idea is that these grain and cotton exchanges provide facilities for carrying on hedging operations against actual purchase and sale of spot cotton and the cash wheat, and so on?

Mr. DUVAL. Yes, that is it. It is the hedging operations?

Senator GORE. Now, are not those hedging operations practically incidents to the conduct of that business?

Mr. DUVEL. Well, as our system has been working, we have been working under the hedging operations—I should say, under a futures market, where they limit for hedging, if it was new grain, and we feel they would have picked that grain or cotton out, and made wider margin, in order to protect themselves.

Senator GORE. There, the burden would be shifted back on to somebody else, probably the farmers.

Mr. DUVEL. It would have to be shifted somewhere.

Senator CLARK. Well, go back to the example used a little while ago, the farmer bringing in cotton to sell it at Caruthersville, Mo. Unless the dealer had some way to keep himself reasonably in touch with the market, which is all that hedging means, as I understand it, he would have to have a wider market. In other words, he would have to buy below the market, which would mean that the producer would have to sell below, isn't that true?

Mr. DUVEL. I think that is true.

The CHAIRMAN. Let me ask you, in regard to this provision—we had quite a fight on the floor of the Senate. It was recommended, I think, one or two steps. I have forgotten, but it was raised on the floor, and it was raised because they said this would help the farmers, to put it at 5 cents. Now, have you been in conference with any of the representatives of any of the farm organizations, to see whether it has undergone any change on that proposition?

Mr. DUVEL. No; I have not discussed it with farm organizations, at all, but we do find, I think, the greatest tax, the highest tax we have ever been brought in under was under the 1-cent tax. That was in 1924.

Senator GORE. You mean the largest revenue?

Mr. DUVEL. The largest revenue. Of course, at that time the prices were higher.

The CHAIRMAN. Yes.

Mr. DUVEL. And it is practically impossible to make any comparison of facts. There has been an increase under the present tax

The CHAIRMAN. It is your opinion we would get about as much revenue out of one as out of the other?

Mr. DUVEL. I think that would be true, under a normal market.

Senator GORE. Have you got any statistics, to find out how much this amounts to, as a percentage return from the profits of the operators?

Mr. DUVEL. No; I haven't; not as a percentage tax. Recently, from our market reports, they have not been very active. Most of the traders who supply this service have made a loss. They do not get enough out of it to pay the overhead.

Senator CLARK. Most of the traders in grain and cotton and other commodities operate on a very narrow margin.

Mr. DUVEL. That is, the scalpers in grain, that take about 60 percent of the volume, the buying is by the cappers in the pit.

Senator GORE. One eighth of a cent paid?

Mr. DUVEL. Well, his average is less than one eighth of a cent. It averages less than that. They have to pay the tax on the transactions they make. Where they make a profit, they have to pay the tax; and if they make a loss, they have to pay the tax; but if they buy and sell at the same price, there is no tax. There is a tax on the profits and a tax on losses.

Senator CLARK. Well, now, Doctor, it is a very narrow margin of profit or loss, either one?

Mr. DUVEL. Yes; in either one.

The CHAIRMAN. Well, now, the committee would thank you, if you desire to elavorate your views, so that when this record is read, the other members can see it, and so on.

Senator GORE. Doctor, I want to ask one question, to get this in the record.

Mr. DUVEL. Yes.

Senator GORE. I have been told, and I want to verify it, if it is true, if a dealer should buy 10,000 bushels of what at a dollar, and sell it at one eighth of a cent spread, which I believe is a customary gain, that would be $1.08. He would make 12½ cents a bushel. He would make $12.50 on that transaction, involving 10,000 bushels. Out of that, under the present law, he would pay $5 taxes. He would pay $2.50 clearance charges. That would leave him a profit of $5 on that transaction. On the other hand, if he bought the wheat at $1 but sold it at a loss of one eighth cent a bushel, he would take a loss of $12.50, plus the tax of $5, plus a clearance charge of $2.50, which would be $20 that he would lose on a transaction involving the same amount, the same number of bushels of wheat, so that a dealer has got to win four times out of five in order to break even.

Mr. DUVEL. It runs about that, in ordinary trading. That is what makes it an extreme burden on him, with this high tax. Now, on the tax, when they had the tax at 1 cent, they seemed to get along real well. Now, that 1-cent tax, the first one ran for about 3 years, and the second one for about 8 years, and during the war period we had the 2-cent tax.

Senator KING. This higher tax tends to discourage the dealing in futures, doesn't it?

Mr. DUVEL. So far as the scalpers go, you do not have quite such a ready market. Now, if I were to go out into the market and buy a million bushels of wheat, purely as a speculative proposition, the tax

is no great burden on me, from that standpoint. For that pure speculation, the man that wants to buy it may carry it for 2 or 3 weeks, or 2 or 3 months. It is not a very great burden on him, but it is the man that is there, that furnishes services, the fellow that furnishes the—well, he is the oiler, he keeps the thing going, he keeps the machinery working, so that it is always available for a merchant, in merchandising his grain.

Senator GORE. You think it would be in the interest of the merchant and the farmer and everybody concerned, to have this tax reduced?

Mr. DUVEL. That is the way we see it, on the basis of our experience on the exchange.

Senator CLARK. Doctor, unless you absolutely forbid dealing in futures, the producer pays the tax, in the long run, doesn't he?

Mr. DUVEL. Well, it has to come out some place in the long run; yes.

Senator CLARK. Yes. Well, it is usually the farmer that pays, isn't it?

Mr. DUVEL. It usually is taken care of in the pit.

Senator KING. You represent the Department of Commerce, as I understand.

Mr. DUVEL. Yes.

Senator KING. Because it is dealing in futures, now?

Mr. DUVEL. No, sir.

Senator KING. It is buying and selling on the stock exchange, has a ticker down in the Department of Agriculture?

Mr. DUVEL. We have a ticker, but that is only in connection with our supervision work, to keep in touch with the movement of the market.

Senator KING. But you buy and sell?

Mr. DUVEL. No; we do not buy and sell. It is because we have the responsibility of supervising the market, and in order to supervise it, we have to watch the prive movements.

Senator GORE. It is not so much the volume of the tax, as it is the interference with the market, generally, the liquidity of the market?

Mr. DUVEL. The interference with the market. It slows up the market machinery, so that the whole thing does not function.

The CHAIRMAN. The Secretary of Agriculture feels as you do about this?

Mr. DUVEL. Yes, sir. They feel that the takes——

The CHAIRMAN. Is there something else you desire?

Senator GORE. What other countries, Doctor, have this sort of a tax?

Mr. DUVEL. So far as we know, there is no other country that has a tax on sales. Canada had a tax for a short time, but removed it, and that is a factor, of course, in cotton, while it is not a great factor, the cotton merchant who is selling cotton abroad, he has to——

Senator GORE. Germany closed her future markets 8 or 10 years, and then reopened them; isn't that true?

Mr. DUVEL. But that cotton merchant has to take into consideration that tax in some way, and meet that competition. On 10,000 bales, it is about $300.

The CHAIRMAN. Now, is there something else you desire to put into the record?

Mr. DUVEL. There is nothing. I would be glad to leave this for the record. That shows, in both cotton, the rate of tax, and grain, from 25 cents a bushel up to $2.50; and on cotton, from 5 cents a pound up to 25. It is a little table. I will be glad to leave that.

MEMORANDUM SUBMITTED BY J. W. T. DUVEL

Tax on sales of commodities for future delivery on the basis of 5 cents per $100 of value as fixed in the Revenue Act of June 21, 1932. The following table is based on each 25 cents up to $2.50 per bushel of grain and shows the rate per bushel, the tax per 5,000 bushels, the profit on 5,000 bushels, at an average profit of one eighth cent per bushel, and the profit after payment of tax exclusive of clearing charges and all other expenses.

The lower table applies to cotton at prices ranging from 5 to 25 cents per pound and an average profit of 1 point per pound.

Wheat

Price per bushel	Tax rate per bushel	Tax on 5,000 bushels	Profit on 5,000 bushels, at one eighth cent per bushel	Gross profit on 5,000 bushels, after deducting tax
$0.25	1/80	$0.65	$6.25	$5.60
.50	2/80	1.25	6.25	5.00
.75	3/80	1.90	6.25	4.35
1.00	4/80	2.50	6.25	3.75
1.25	5/80	3.15	6.25	3.10
1.50	6/80	3.75	6.25	2.50
1.75	7/80	4.40	6.25	1.85
2.00	8/80	5.00	6.25	1.25
2.25	9/80	5.65	6.25	.60
2.50	10/80	6.25	6.25	None

Cotton

Price per pound	Price per bale	Tax per contract of 100 bales	Profit on 100 bales at 1 point per pound	Gross profit on 100 bales after deducting tax
$0.05	$25.00	$1.25	$5.00	$3.75
.07½	37.50	1.90	5.00	3.10
.10	50.00	2.50	5.00	2.50
.12½	62.50	3.15	5.00	1.85
.15	75.00	3.75	5.00	1.25
.17½	87.50	4.40	5.00	.60
.20	100.00	5.00	5.00	----------
.22½	112.50	5.65	5.00	.65
.25	125.00	6.25	5.00	1.25

[1] Loss.

The CHAIRMAN. Mr. Manning is the last witness, representing the Bureau of Fisheries. Several Senators requested that Mr. Manning appear before the committee, as they wanted to ask him certain questions relative to the tax on certain oil.

STATEMENT OF JOHN RUEL MANNING, CHIEF TECHNOLOGIST, BUREAU OF FISHERIES, DEPARTMENT OF COMMERCE

Mr. MANNING. Mr. Chairman and gentlemen of the committee, my name is J. R. Manning, and I occupy the position of chief technologist of the Bureau of Fisheries, Department of Commerce. I have a summary here of the technical and economic situation with respect to oils and fats, and I think I can save time by reading it [reading]:

MEMORANDUM ON THE INTERCHANGEABILITY OF THE USES OF OILS AND FATS, WITH SPECIAL REFERENCE TO MARINE ANIMAL OILS

At the outset, permit me to make plain that the chemical, economic, and general technical principles which I have outlined in this statement apply only to saponifiable oils and fats and do not pertain to the mineral-oil industry or petroleum industry.

The interchangeability of the uses of oils and fats in commerce and in the various industries involves both technical and economic considerations. From a technical standpoint, there can be and is free interchangeability of the uses of various oils and fats. Modern methods of hydrogenation, refining, treatment, etc., make it possible to prepare practically all oils and fats for almost any industrial use. This means that is is possible, chemically, to use practically any animal or vegetable oil or fat in soap manufacture or in some of the other possible consuming industries of these commodities. Therefore, the actual practice of the interchangeability of the uses of oils and fats is a matter of prices or other economic considerations. Formerly, certain technical and economic obstacles prevented any great interchangeability. At the present time, certainly no technical obstacles exist and it is doubtful that there are many economic obstacles which would hinder complete potential interchangeability. It is quite true that the specifications of the finished product may to a certain extent govern interchangeability. However, in many instances, favorable economic influences will overcome even these requirements or specifications.

The statement is quite often made that this or that particular oil or fat is not suitable for the manufacture of soap or other finished products, because of the relatively high or low content of the particular oil or fat in some specific fatty acid. This statement is not true for the following reasons: Animal and vegetable fats and fatty oils are of similar general composition, since they are mixtures of compounds of glycerin and certain organic acids, which, due to their presence in fats, are called fatty acids. Obviously, the variable in the composition of these materials is the fatty acid portion. For this reason, the properties of the various fats and oils, and consequently their desirability for a particular use, depend primarily upon their constituent fatty acids and the proportion of these various acids present. This situation applies to all oils and fats, both marine animal, terrestrial animal, and vegetable. Without making the discussion too involved, it is a known fact among chemists and technologists that developments in hydrogenation processes have made it possible to convert unsaturated liquid oils to any desired degree of hardness. Consequently, the apparent difference in the natural qualities of various fats and oils has resolved itself into little actual difference insofar as the possibilities for the interchangeability of these materials is concerned, or where hard fats are required for the particular use in question. It is, therefore, readily seen that, whenever economic considerations enter into the industrial picture, or in other words, when the price of a particular oil or fat is relatively low, it is quite often advantageous and economically attractive to substitute as an ingredient of the finished product a cheaper oil or fat than the one formerly used. It is commonly known among those familiar with the uses of oils and fats that such substitution or interchangeability is actually practiced in the consuming industries whenever market conditions are sufficiently favorable.

Statistics show that there is a world surplus of oils and fats. There is a domestic surplus of oils and fats for nearly all domestic uses. With the great possibilities for the interchangeability of the uses of these oils and fats as discussed above, it is readily apparent that a highly complicated and competitive market for these raw materials exists. Even though a particular oil or fat, because of some special natural property, is favored for certain specific uses, this specific oil or fat will be affected either directly or indirectly by changes in the

market for these commodities as a whole. In other words, if the supply of oils or fats intended for shortenings, for other edible use, for a source of vitamins for use in either human or animal nutrition, is more than the market can absorb, this oil or these oils and fats will affect and be affected by the supply and demand for other oils for other uses. Since the soap kettle is the principal consumer of oils and fats, it is probably one of the important, if not the most important, factors affecting the general market situation for these commodities. If an oil or fat is especially desired for some particular use and is commanding a higher price for that use than it would command for soap manufacture, and cannot find a market for this higher priced use, it will gravitate to the market for soap manufacture.

This is just one example of how the possible and actual interchangeability of the uses of various oils and fats can and does affect markets and prices for each and every type of oils and fats, generally speaking under conditions of a world surplus and a domestic surplus of oils and fats.

The CHAIRMAN. What do you mean by "saponifiable oils"?

Mr. MANNING. An oil, Senator, which will combine with an alkali to form soap.

Senator CONNALLY. "Saponify" means to convert into soap.

Mr. MANNING. Yes, sir; that is it, from the French word "sapon."

Senator GORE. What do you mean by "hydrogenation"?

Mr. MANNING. Hydrogenation, Senator, has to do with these oils and fats. They are unsaturated oils and fats. That means that they may be combined with an atom of hydrogen, in the commercial process known as hydrogenation. That determines the ultimate hardness of the fats, and in turn, its stability for various industrial uses.

Now, gentlemen, just one word, one point I want to make here. Of course, I am in the Department of Commerce, and I do not claim to be an expert in agriculture, although I have had considerable training in agricultural chemistry, but this situation with respect to oils and fats is one economic problem, regardless of the oils and fats, and I believe that the situation with respect to the surplus can and will vitally affect the success of the curtailment of the cotton acreage in the Agricultural Adjustment program.

Senator CLARK. Well, Doctor, what your statement means is this, then, that if the United States chooses to put an embargo on the importation of coconut oil into the United States, there can be an interchange of other oils and fats, which will take the place of coconut oil?

Mr. MANNING. That is correct, Senator. There would probably be a shift in consumption. Now, many years ago—I cannot give you the exact figures, but coconut oil was relatively an unimportant factor in soap manufacture. It is only in recent years that it has become increasingly important.

Senator CONNALLY. The price, too, had a great deal to do with that development?

Mr. MANNING. Yes, sir. I think the reason is economic and not technical. Now, cottonseed oil was formerly very popular in soap manufacture. In fact, there is absolutely no technical obstacle as to the interchangeability of these oils and fats.

Senator CLARK. In other words, if Congress passed a law absolutely shutting coconut oil out of the United States, we would be able to supply our needs?

Mr. MANNING. Yes, sir.

Senator CLARK. But at a higher price?

Mr. MANNING. Yes, sir.

Senator CLARK. By other kinds of oils and fats?

Mr. MANNING. That is correct, Senator. Now, of course, my bureau has no policy on tariffs, and I am not here to express an opinion on tariffs.

Senator CLARK. I understand that.

Mr. MANNING. But I will say this, that this situation with respect to oils and fats cannot be cured by any regulation of one oil or fat. It must be a consideration of the situation as a whole, in other words, with respect to domestic and foreign production of oils and fats. Now, I have considerable statistics here, and I won't burden the committee with them, but I will be glad to introduce them into the record, and they have been collected from various bureaus in the various Government departments.

Senator CLARK. In other words, Doctor, if I understand you correctly, in order to help the domestic producer of oils and fats, whether vegetable oils or animal oils and fats, it would not be sufficient to put an embargo on coconut oil, or a tax on coconut oil; we would have to extend it to all oils and fats, of every kind?

Mr. MANNING. Yes.

Senator CLARK. Because they are interchangeable?

Mr. MANNING. Yes, Senator, and I believe that it would be necessary to consider the whole picture—that is, all foreign oils and fats.

Senator CONNALLY. If we included palm kernel and marine oil——

Senator KING. Sesame.

Senator CONANLLY. And sesame, that would do the work?

Mr. MANNING. Yes, sir. Well, the principal oils. Of course, there are statistics on that, I can introduce in the record, but the principal oils and fats coming from foreign countries, are coconut, sesame, and palm.

Senator CONNALLY. Palm kernel?

Mr. MANNING. Palm kernel, perilla, tung oil, marine animal oils, of course. That includes whale oil and various fish oils.

Senator GORE. This is a tax of 200 percent on coconut oil? If that goes on, and keeps it out, soap made in Canada of coconut oil, which comes in there free, I understand, comes across the border at about 15 percent instead of 200 percent, couldn't the Canadian soap manufacturer ship his soap across the line?

Mr. MANNING. Senator, I could not answer that question directly, but I will answer your question this way. As long as there is a domestic surplus of oils and fats, I do not believe that this tax or any other tax on any foreign oils or fats will have much effect on the cost of soap manufacture. Now, I understand that the committee has received a number of letters from hospitals regarding the cost of soap in hospitals. As a matter of fact, all hospitals, the sort of soap they use there is a soft soap, and I understand the principal ingredient is free linseed oil or cottonseed oil.

Senator CONNALLY. That is, the statistics cover that?

Mr. MANNING. Yes, sir. I may not be absolutely exact. I do not claim to be an expert in soap manufacture.

Senator CONNALLY. Nearly all of the hospitals use a linseed-oil soap?

Mr. MANNING. That is right.

Senator CONNALLY. Let me ask you—some of them have testified that no other oil or fat contained lauric acid, except coconut oil. What about that?

Mr. MANNING. That is not true, Senator. It is true that lauric acid occurs in greater proportion in coconut oil than it does in other oils and fats.

Senator CLARK. Is that the acid that is used for finishing rubber goods, tires, and that sort of thing?

Senator KING. Leather, a fine grade of leather; making it white.

Mr. MANNING. Yes, sir. All fatty acids have other uses besides soap manufacture, and that one, of course, is included. No; lauric acid is not necessarily essential in soap manufactre. As a matter of fact, it is a disadvantage, in the sense that too much lauric acid and excess alkali will produce an astringent or papery feeling on the skin.

Senator CLARK. Well, I wans't speaking of the manufacture of soap. There is some testimony before the committee, or was the other day, that lauric acid was a very necessary process in the modern finishing of tires and other rubber goods, and that the lauric acid could not be obtained readily from any other product than coconut oil. Now, is that true?

Mr. MANNING. I am not an expert on rubber manufacture, Senator, but my opinion is——

Senator CLARK. There was some further testimony that lauric acis was a very necessary ingredient in the tanning process of leather.

Mr. MANNING. My opinion is that if it is, it can be obtained from other oils and fats. Now, of course, my field is largely marine animal oils. I do know that large quantities of fish oil are used in leather sizing and the tempering of steel, and I do not think that lauric acid alone is absolutely essential, and if it is, it can be obtained from domestic oils and fats, because it is a natural, fatty acid constituent of oils and fats, to a verying degree.

Senator CLARK. That is what I wanted to find out.

Senator CONNALLY. In other words, lauric acid is present in all oils and fats?

Mr. MANNING. Yes, sir.

Senator CONNALLY. In differing percentages?

Mr. MANNING. Yes, sir.

Senator CONNALLY. Therefore, you can get it out of any of these other oils?

Mr. MANNING. Yes, sir. There is just one other point I want to leave with the committee. Perhaps I am not the proper man to qualify on this. Perhaps testimony that will be given by the War Department may not even agree with this, so I do not know whether I should tell this committee this or not, and I certainly would not mention it except in executive session.

Senator KING. Well, if you state something that I regard as important here, and in contravention of something else, we will bring back some other witnesses.

Mr. MANNING. It has a military aspect, Senator, and that is this——

Senator KING. Well, do you come here as representing the War Department?

Mr. MANNING. No, sir; I do not.

Senator CONNALLY. He just said he did not.

Mr. MANNING. I happen to hold a commission as a reserve officer. I am a World War veteran, and I am a major in the United States Army Reserve, and so I am not here to testify as a military expert. I am here to testify as to my knowledge of chemistry and having read the opinions of certain experts, of this particular industrial situation, which did affect our military power during the World War, and that is this, that I understand that at that time we manufactured glycerin from our domestic oils-and-fats industries, as the raw material. Glycerin as you know, is an absolutely essential ingredient in the manufacture of explosives, that is, nitroglycerin. Of course, it is needless to mention that we not only supplied our own demands, but I understand that we had to supply England largely, and that in return for that England sold us coconut oil, which in turn was used in the manufacture of glycerin.

Now, it so happens, under present conditions, that coconut oil yields more glycerin than any other oil or fat, and therefore, under present prices, it pays the glycerin manufacturer to use coconut oil, and American industry is so administered today, under the present depressed conditions of our domestic oils and fats industry, if we should suddenly be cut off from our supply of coconut oil, which comes only from the Philippines, American industry would be in a tough spot, at first, to adjust itself to supply important wartime demands for glycerin.

Senator CONNALLY. If we have Philippine independence, of course, that would always be possible.

The CHAIRMAN. I thank you very much.

The hearing upon the bill will be closed. The committee will stand recessed until Monday morning at 10 o'clock at which time it will go into executive session.

CONFIDENTIAL

REVENUE ACT OF 1934

HEARINGS

BEFORE

THE COMMITTEE ON FINANCE
UNITED STATES SENATE

SEVENTY-THIRD CONGRESS

SECOND SESSION

ON

H.R. 7835

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

PART 6

MARCH 19, 1934

UNREVISED

Printed for the use of the Committee on Finance

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REVENUE ACT OF 1934

MONDAY, MARCH 19, 1934

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

The committee met, in executive session at 10 a.m., Senator Pat Harrison presiding.

Present: Senators Harrison (chairman), King, George, Barkley, Connally, Gore, Costigan, Clark, McAdoo, Byrd, Lonergan, Reed, Couzens, Keyes, La Follette, Metcalf, Hastings, and Walcott.

Also present: Messrs. Magill, Parker, Bartholow, Beaman, Stam, and other representatives of the Treasury Department, Joint Committee on Internal Revenue Taxation, and the staffs of the Senate and House legislative counsel.

The committee had under consideration H.R. 7835.

PROCEEDINGS.

The CHAIRMAN. The committee will be in order. What shall we take up first?

Dr. MAGILL. When you recessed for the public hearings we had gotten over to page 151 of the comparative print. The next 30 or 40 pages are more or less minor amendments, and until more members are present, you may prefer to do that rather than to take up the major items at this time.

Senator REED. On page 151, I have a suggestion, under "Employees' trusts." You will remember that as the stock market goes up, we change that section to take care of employees who would otherwise have to pay a tax. Then, when the stock market goes down, we change it again to protect them; and we have done that three or four times. Out in western Pennsylvania, there is a little individual steel company called the Blaw-Knox Corporation, which sold stock to its employees under an arrangement by which the company would contribute a certain amount per month to aid them in buying their stock, and the certain amount per month was deducted from their wages. When the time came to take over the stock, the slump had occurred and the value of the stock in the market was less than the aggregate of what the individuals had put in and it was less than what the company had put in; and yet, under the law as it stands, the total amount contributed by the company is considered to be a capital gain to them, when they actually get stock. I think that is the effect of the present law; and yet what they actually get is worth less than what they themselves actually put in, so they are

paying a tax on a contribution by the corporation which they never actually get in hand, and which is not represented by any value in this Blaw-Knox Co., which they bought.

The CHAIRMAN. Are there many cases of that nature, Senator?

Senator REED. Several.

Mr. PARKER. It would be possible for the tax to be more than the total value.

Senator REED. In fact, it is. While there are not many corporations like that, yet there are a great many individuals in that company and they are just poor workingmen, most of them.

The CHAIRMAN. What suggestion have you?

Senator REED. I have a suggested amendment, but I do not believe I have it with me.

Mr. PARKER. Is that to go back to what we had before?

Senator REED. I think we had better just put it in the way we had it before.

Senator HASTINGS. What page is that?

The CHAIRMAN. 151, Senator.

Doctor MAGILL. Have you any suggestion, or has the Treasury any suggestion with respect to the matter just mentioned by Senator Reed?

Doctor MAGILL. So far as section 165 of the bill is concerned it appears to take care of the case that you have in mind, so far as the present years are concerned. I think that you are probably talking about the situation under the prior law.

Senator REED. That is right, Doctor; yes.

Doctor MAGILL. Under this scheme, if he got today stock that was worth 50, and he had put in 75, he is not taxed at all, so I think what you probably want is a retroactive amendment to the prior law.

The CHAIRMAN. Well, should that be done?

Doctor MAGILL. I think not, myself.

The CHAIRMAN. If we begin retroactive legislation to meet hard cases, I do not know where the end would be, appealing though they might be.

Doctor MAGILL. At least it would be a separate provision.

The CHAIRMAN. Yes.

Doctor MAGILL. It would not go in this special bill.

Senator REED. I find I have offered this amendment. We would add to this:

> The provisions of this section shall be retroactively applied in computing income under the provisions of the Revenue Act of 1928, for any taxable year beginning on or after January 1, 1930. Any tax that has been paid under such act prior to the effective date of this act, which is in excess of the tax imposed by such act subject to the statutory period of limitations properly applicable thereto, will be credited and refunded as provided in section 322.

Dr. MAGILL. Would you like the Treasury to report on that amendment?

Senator REED. I think that is the wise way to handle it.

The CHAIRMAN. I think so.

Senator REED. If Dr. Magill will take this amendment and study it, and let us have the Treasury's opinion on it, I think that will be a good way to handle it.

Dr. MAGILL. The present section takes care of your case, so far as the future is concerned.

Senator REED. It does, but the actual distribution was made at the bottom of the slump, sometime around 1932.

The CHAIRMAN. Now, what action is being taken on page 5, with reference to the change in the date?

Senator KING. We are going back to 151.

Senator GEORGE. Are we going back to where we left off?

Senator KING. Page 151, Senator.

Dr. MAGILL. I think that finishes page 151. On page 152 there are no changes except the small clerical one at the top. On some occasion I would like to ask the committee to discuss a possible amendment to "Revocable trusts", section 166, but with your approval, I would rather take that up a little later on, when you take up the other more important amendments.

The CHAIRMAN. All right, Doctor.

Dr. MAGILL. Shall we pass that over? On page 153, section 168 is surplusage, in view of section 117, the general provision with respect to capital gains and losses.

The CHAIRMAN. We will strike that out.

Dr. MAGILL. On page 154, at the foot of the page, there is the provision dealing with a partnership on a fiscal-year basis, and a partner on a calendar-year basis, which is now taken care of in a subsequent section, 188.

The CHAIRMAN. Is that related to the first amendment at the beginning of the bill as to the change in the treatment of fiscal-year taxpayers?

Mr. BEAMAN. Yes.

Dr. MAGILL. Yes; it is.

Senator GEORGE. That is covered by what amendment, Doctor?

Dr. MAGILL. On page 158, you observe there is a new section 188, designed to take care of the situation, where the partner and the partnership have different taxable years, one fiscal and the other calendar; and the first change in section 182 is to eliminate the material which is covered by section 188. That I will speak of when we reach that section.

The CHAIRMAN. It would be well first for us to pass finally on this first change in the bill, would it not?

Dr. MAGILL. The fiscal year and calendar year?

The CHAIRMAN. Yes.

Dr. MAGILL. This is all tied up with that.

The CHAIRMAN. What is this? Why not get that straightened out now, on the first page? Then these other amendments can be handled more conveniently.

Mr. PARKER. Senator Couzens, I think, was the only one who objected to that. He is not here.

The CHAIRMAN. Well, we had better wait until he comes.

Senator REED. That clause (b), at the bottom of page 158, is certainly obscure as it stands.

Dr. MAGILL. I will speak of that in a minute, or do you want to take up section 188 now?

Senator REED. Hadn't you better tell us what you propose to do? Then we will understand the striking out that has preceded it.

Dr. MAGILL. Under the general arrangement of this bill, as you recall, it is applicable only to taxable years starting after December 31, 1933; consequently it was necessary to make some special provision for the case of a partnership on a fiscal-year basis, and the partner on a calendar-year basis. As you know, the partner normally takes up, in his own personal income-tax returns, his pro rata part of the partnership income, shown on the return of the partnership ending within his taxable year, so that if the partnership had a fiscal year, starting June 30, 1933, for example, and ending June 30, 1934, a partner on a calendar-year basis for 1934 would include that income in his report for 1934. Due to the various changes made in this bill, the question then arises as to the basis on which the partnership should be required to report its income for this year.

Senator REED. The committee understands, of course, that the partnership merely makes a report. It does not pay any tax.

Dr. MAGILL. It is simply an information return. It pays no tax.

Senator REED. No.

Dr. MAGILL. The tax is paid on the pro rata part by the partner. We finally concluded that the equitable method to follow is that which we tried to state on page 158. That is, (1) paragraph (a) states the same rule which we have in the present law, namely, that the partner in the case I have given, must report his pro rata part of the income of the partnership for the partnership year ending within his own year, and (2) that the partnership is required to put its income on the same basis as under the existing law, the Revenue Act of 1932, except so far as capital gains and losses are concerned, it should follow the plan set forth in this bill.

The CHAIRMAN. All right, Doctor, we will just pass that for the present until we get the other things straightened out.

Mr. PARKER. That could be approved tentatively. It is a technical matter. We spent a lot of time on it, and I think it is a perfectly fair rule.

The CHAIRMAN. Then section 188 will be approved tentatively.

Senator REED. I see how a partnership year beginning December 1933, would give an advantage to the partners having capital gains and losses, over all other taxpayers.

Dr. MAGILL. How so?

Senator REED. Suppose I were a member of a firm that had a fiscal year beginning December 1 last. Then until next December, that partnership might register off capital losses of which the individual partners would get the benefit, whereas no other taxpayer would have that same advantage.

Dr. MAGILL. Well, that is really the situation that we sought to cover, in fact.

Senator REED. But do you do that?

Dr. MAGILL. What we have said is that in that kind of a partnership, it should compute its capital gains and losses under the new provisions of this bill.

Senator REED. Excepting subsection (d) of 117? There is the tricky part of it.

Dr. MAGILL. Well, that is true, but of course that follows.

Mr. PARKER. Of course, we have got a 1-year limitation, Senator, even under the——

Senator REED. We will grant that, but you take a partnership that has got a lot of capital assets held over 2 years. They could register off big losses right up to next December.

Senator HASTINGS. Can't they, under this?

Dr. MAGILL. You have two limitations there, Senator Reed. In the first place, the partnership cannot carry over the loss to a subsequent year; and in the second place, under the provisions here, if the partnership had a loss on the sale of capital assets, a net loss, the partners are not to get the benefit of it against their own capital gains.

Senator REED. Are you quite sure of that, when we take out subsection (d)?

Senator HASTINGS. What is subsection (d)?

Senator REED. That is the one which says you cannot deduct losses in excess of gains.

Dr. MAGILL. What we have sought to provide so far as partnerships are concerned is essentially this; that the partnership shall be used as a tax-computing entity, but that if there is an excess of losses over gains in the case of the partnerships, that the partners shall not be permitted to deduct that excess of losses from their own capital gain.

Senator REED. Well, it is a very unusual case anyway. I think it is hardly worth taking up our time on it.

Senator HASTINGS. The question is whether you have done what you tried to do.

Dr. MAGILL. That is it. We think we have.

The CHAIRMAN. Without objection, it will be approved tentatively.

Senator MCADOO. What is that, Mr. Chairman?

The CHAIRMAN. Page 158, section 188.

Senator MCADOO. You are approving tentatively the entire section?

The CHAIRMAN. Yes.

Mr. PARKER. If we do not approve of the matter in section 1, about fiscal years, then we will have to come back to this section.

Dr. MAGILL. The remaining matter on page 155, deals again with the fiscal-year situation which we have spoken of. On page 158, you will observe a change in section 183. The purpose of that change is to give the partnership a deduction for charitable contributions made by the partnership. The same deduction would then not be allowed to the partners, and this carries out the general scheme we were just speaking of. That is, that the partnership should be regarded as a tax-computing unit and compute its own income and its own deductions by itself, and then carry over the net to the partner.

Senator REED. What did we do about allowing the corporation deductions?

The CHAIRMAN. We have not taken any final action on that.

Senator REED. That has not been acted on?

Dr. MAGILL. No; we have taken that up.

The CHAIRMAN. You do not recommend that?

Dr. MAGILL. Well, we have, as a matter of fact, a conference in the Treasury on it this very noon, as to whether a corporation should have deductions for contributions.

Senator REED. It all comes out of human beings anyhow; why shouldn't it be allowed in one case as well as another.

Senator HASTINGS. I think it might be helpful to contributions.

Dr. MAGILL. The community chests, as you know from your public hearings, are advocating it very strongly.

Mr. PARKER. There is some administrative trouble, too. We had a case where a bank had a 6-million-dollar deposit with the Red Cross, and they gave $100,000 to the Red Cross. They said, "we had to do this as a business matter; we would have lost the account if we hadn't"; although the regulations disallowed deductions to the Red Cross, the Bureau allowed the deduction as a business expense.

Senator REED. Very often it really is. Now, you take the Steel Corporation. It has a vital interest in the maintenance of water in Pittsburgh. Every time we have a community-chest drive out there, we press them into giving a good big subscription. It is probably ultra vires under a strict construction of the law.

Senator HASTINGS. I was going to say I never knew how a corporation could do it, anyway.

Senator REED. No; the stockholder pays, but that is a business expense to them.

The CHAIRMAN. Well, we will get back to that matter of corporation contributions.

Dr. MAGILL. Then, in section 184, on page 156, the italicized parenthetical clause provides that in the event that the partnership has no net income, the partners shall not be given the benefit of credits which would otherwise go to the partnership.

The CHAIRMAN. Well, without objection that will be approved.

Dr. MAGILL. I think all of the material on page 157 is stricken out as surplusage in view of other provisions of the law.

The CHAIRMAN. Without objection, it will be approved.

Dr. MAGILL. On page 158 we have spoken of that.

The CHAIRMAN. Approved tentatively.

Dr. MAGILL. On page 159 one of the lines is out of order. The language in line 5 should be transposed between lines 8 and 9.

The CHAIRMAN. Where is that now?

Mr. PARKER. Page 159, line 5, is a misprint. The language there should follow line 8. The printers got the lines transposed.

The CHAIRMAN. All right.

Dr. MAGILL. The italicized phrase in lines 19 and 20 is simply a cross-reference.

The CHAIRMAN. We approve that.

Senator LONERGAN. What changes have been made in the matter of taxes on life insurance?

Dr. MAGILL. There are none, except those corresponding with the changes we have made in the case of corporations generally.

Senator REED. They are still exempt from tax on their capital gains, I suppose?

Mr. PARKER. Yes.

Dr. MAGILL. Yes.

Senator KING. Don't you think that we should deal differently with this controversial subject? We have always dealt with it to the advantage of the corporation, and to the disadvantage of the Government. I think we have been too liberal in our allowance of deductions and what not to life-insurance companies.

The CHAIRMAN. Well, in 1932 there was no question that caused more controversy or that took up more time of the committee than this, and after we had finished it, none of us was satisfied. I think that whatever we do will not be satisfactory. We changed it four or five times, didn't we?

Senator REED. I think we consumed a lot of the time of the Senate discussing that. It is truly unfair to tax the taxpayers on their capital gains, excepting a particular class. There isn't any earthly excuse for exempting these people from the common burden to be borne by all taxpayers.

Senator KING. Dr. Magill, hasn't the Treasury any recommendation with respect to this matter?

Dr. MAGILL. I do not think we have made any on this particular point; no. I think there is much in what has been said, that they are given too much special consideration now.

Senator KING. Well, I vote against this conferring of special privileges. I think we ought to deal with it.

Mr. PARKER. As a matter of fact, during the last three or four years, it would have been a substantial benefit to the life-insurance companies if they had been subject to the capital gain and loss provision, because of heavy losses.

Senator GEORGE. Well, to open it up now would certainly give them a right to be heard.

The CHAIRMAN. Yes.

Senator GEORGE. They do not anticipate that we are going to disturb that, basically.

The CHAIRMAN. Yes; that would start a controversy right away.

Senator GEORGE. I do not know whether they have been treated like they should be treated, or not.

Dr. MAGILL. I think that page should be passed over.

Senator GEORGE. What page?

Dr. MAGILL. Page 160, line 16.

The CHAIRMAN. All right.

Dr. MAGILL. The amendment there is really clarifying, but we are going to suggest a change.

The CHAIRMAN. Page 161, dividends?

Dr. MAGILL. On 161, the change there corresponds to the change that was made in section 23 (p) with respect to ordinary corporations, the effect of which is to take out of the deduction for dividends the case of dividends from foreign corporations, 50 percent of whose income comes from sources within the United States. I think 23 (p) was passed over, was it not?

The CHAIRMAN. Well, this is so related that this should be passed until we determine on the other.

Dr. MAGILL. Yes. It ought to stand or fall with the other.

The CHAIRMAN. Passed.

Dr. MAGILL. Now on page 163, the change there is similar to the change which we spoke of in section 23 (b).

Senator KING. Are you speaking now of the phrase in line 2?

Dr. MAGILL. No; that is simply clerical.

The CHAIRMAN. That is clerical?

Senator KING. Yes.

Dr. MAGILL. In line 8.

Mr. BEAMAN. In view of the previous action of the committee, the words in italic should be stricken out.

Senator KING. Which do you mean?

Mr. BEAMAN. "Or the proceeds of which were used to purchase or carry."

The CHAIRMAN. Well, it is stricken out then.

Senator MCADOO. The italic is stricken out?

The CHAIRMAN. The italic is stricken out.

Senator KING. What about the words "or accrued"?

Dr. MAGILL. Purely clerical.

The CHAIRMAN. That is approved. How about securities?

Mr. BEAMAN. That is clerical.

The CHAIRMAN. All right.

Dr. MAGILL. There is nothing on page 164 and 165.

The CHAIRMAN. We will pass them over.

Mr. MAGILL. Then on page 167 we subject capital losses to the same limitation which is imposed in section 117d, that is, that the losses shall not exceed the gains.

The CHAIRMAN. Without objection, that will be approved.

Senator MCADOO. I have been wondering if we ought to do that, because in the discussion we had the other day, we only offset losses against capital gains to the same extent. As I recall it, there were some very manifest inequities possible under that plan. You might have nothing but losses, and you might have no capital gains.

Senator REED. But we get that in section 117. I think the committee will have to decide whether we are going to allow losses to insurance companies, and banks, on such matters as the premiums paid for bonds, and things of that sort. That question is still open.

Senator MCADOO. I see.

The CHAIRMAN. Shall we pass this on page 167?

Senator CONNALLY. You mean you are not approving it. You are just passing it?

The CHAIRMAN. Passing it. Page 168.

Dr. MAGILL. That is clerical.

The CHAIRMAN. Approved.

Dr. MAGILL. Then we go over next to page 171. Since we have only one rate of normal tax, that page becomes unnecessary. It was accorded special treatment in the case of an alien resident of a contiguous country. I think we still have under consideration the question of imposing an estate tax in the case of property of a nonresident citizen located outside the United States.

The CHAIRMAN. We will postpone action on this until we take up the other.

Dr. MAGILL. Page 173 contains simply clerical changes. Likewise, page 174.

The CHAIRMAN. Approved.

Dr. MAGILL. On page 180, in line 7, that is clerical.

The CHAIRMAN. Approved.

Dr. MAGILL. Page 181, line 22 is clerical. Section 20 at present is not in the bill.

The CHAIRMAN. Approved.

Dr. MAGILL. Nothing on page 182 or 183.

The CHAIRMAN. How about 185?

Dr. MAGILL. That is a real change. It was suggested, I believe, by the subcommittee, that the period of time allowed for the filing of a petition to the Board of Tax Appeals should be increased from 60 to 90 days. The theory was that if an additional month were given, the taxpayer would have an opportunity to negotiate with the Bureau and possibly settle the case, thereby preventing the filing of the petition.

The CHAIRMAN. Does the Treasury recommend this change?

Dr. MAGILL. We opposed it at the start, but after considering it, we believe it will be an improvement.

Senator REED. Ought we not on page 185, line 4, after the word "Sunday" include "not counting Sunday or a holiday in the District of Columbia as the nineteenth day. You take a taxpayer in Mississippi where Lincoln's birthday is not a holiday, he might send his papers up here all in proper form for filing on February 12, and find the whole place closed. Would it not be fair to exclude District holidays?

Mr. BEAMAN. The American Bar Association wants to go a little further and include not only holidays, but half holidays also.

The CHAIRMAN. Is there any objection to making it holidays in the District of Columbia.

Dr. MAGILL. I see no objection.

Senator BARKLEY. There is a half holiday once a week.

Dr. MAGILL. They ought to know that Saturday afternoon is likely to be a half holiday.

Senator MCADOO. I think holidays are enough.

The CHAIRMAN. That means, then, legal holidays.

Dr. MAGILL. Yes. Then in line 11 is the same change. There is no change on pages 186, 187, 188, 189, 190, and 191.

The CHAIRMAN. The next is page 194.

Dr. MAGILL. The purpose of this page, which the Bureau recommended, is to require the trustee or referee in bankruptcy to give the Bureau notice of the bankruptcy in order to enable the Bureau to file its claims for taxes before the period for assessment of such taxes has expired.

Senator REED. I would like to ask Dr. Magill a question on that. As I understand the law, a claim for income tax is not extinguished by bankruptcy proceedings. It survives as a liability of the bankrupt even after his discharge. Is that fair?

Dr. MAGILL. Well, it simply depends on how much priority you wish to give to the United States.

Senator REED. You have a prior lien on all of the assets of the bankrupt. You come in ahead of all other creditors against the fund in the hands of the receiver or the trustee. Why should that not end the matter? If the bankruptcy legislation is sound in theory at all, it ought to apply to these claims as well as others.

Dr. MAGILL. You have other claims of the same sort where the taxpayer has not formally gone through bankruptcy. Of course what is done in the great run of these cases is to settle them by compromise. I do not know to what extent you would be justified in giving special treatment to one who happens to go through bankruptcy, and not give it to other men who do not.

Senator KING. They surrender all of their assets to the creditors, you mean? They do not take advantage of the Bankruptcy Act, and

expect later on to meet any deficit as a moral and not a legal claim.

Dr. MAGILL. Those claims are the greatest single source of compromises which we do have, and they present enormous difficulties in trying to find out whether the taxpayer should be given relief from the taxes which are legitimately due. I would hesitate to say it should be done simply for people who have gone through bankruptcy, and I do not quite see how you can cover the other cases.

Senator REED. Particularly it seems to me unjust in view of the changes made in this law, where they assess a tax against a man who had actually made such losses in a year as to entirely bankrupt him, yet you go on and tax him on an imaginary income which is only wiped out by his capital losses. He goes through bankruptcy and he is confronted with the revival of the tax claims. Bankruptcy has not protected him against it.

Senator HASTINGS. I do not see any excuse in the world to let it survive because it happens to be the Government that he owes it to. The Government gets first claim upon what he has. If he surrenders all of it, I do not see what use the bankruptcy law is to him. I did not know that it survived.

Dr. MAGILL. Yes, it does.

The CHAIRMAN. Without objection, this will be approved.

Senator REED. Wait a minute. I would like to know what you think about this, Mr. Parker?

Mr. PARKER. I suppose the general policy in bankruptcy is to let a man's debts be wiped out. If he happens to have an unpaid tax for a million dollars, he never can get rid of it unless it is compromised. It is true we usually compromise such cases, but it looks bad to compromise a million dollars tax liability for $10. It makes administrative work.

Senator COUZENS. There is a great deal of fraud in these bankruptcy cases.

Dr. MAGILL. I presume it is for that reason that these provisions have been kept the way they are. If we do succeed in stirring up some assets at some time, we can collect the tax.

Senator KING. My information is that in a number of cases where bankruptcy cases have proceeded to complete distribution of the assets, and the ascertainment of the tax due the Government, which is unpaid, and yet after a final discharge the bankrupt, whether it was fraudulent, or otherwise, is able to unearth a considerable sum and compromise the claim, and the Government reaped a considerable amount in the aggregate from these so-called "bankruptcy" cases.

Dr. MAGILL. We have a good many cases of that sort. I know of claims that have come across my desk, where men have offered up to $50,000 to compromise cases in situations where they say they have no assets. The fact of the matter is, that some of them created large trusts in favor of their wives and that they are living in the style to which they have been accustomed, although they themselves have no assets.

Senator COUZENS. You can see cases that I know of personally, where they have gone through bankruptcy, yet they are spending the winter in luxury at Palm Beach, or in Florida, or California——

Senator McAdoo (interposing). Not California, Senator.

Senator Couzens (continuing). Notwithstanding the fact that the creditors have been wiped out.

Senator Hastings. That is a condemnation of the operation of the bankruptcy law itself, and not this particular provision. I do not see why the Government should have a preference over someone who has loaned that man a few thousand dollars in good faith, and the Government comes along and takes it all, and leaves the individual debtor out entirely.

Senator Barkley. His situation is not any worse than if the Government were in the same position, because the debtor would be discharged from the private debt in any case.

Senator Couzens. In spite of the fact that he is discharged in bankruptcy, we still have to protect him, and furnish an army and a navy for him, whether he is a bankrupt or not.

Senator Barkley. And he has been discharged from all of his other debts by the law of the Government which he is not supporting.

Dr. Magill. If any change of that sort is made, it ought to be made in the bankruptcy law and not here.

Senator King. I move we approve it and proceed.

The Chairman. Without objection, this provision will be approved.

Senator McAdoo. Have we approved that?

The Chairman. Yes.

Senator McAdoo. At the foot of page 195 is a provision changing the period of limitation upon an assessment or collection from 2 to 3 years.

Senator King. What is that?

Dr. Magill. That again is a matter of some importance. The Bureau has found, as they advised me, that in many cases the 2-year period is actually too short. The best argument they give is that it would simplify their work materially if they could examine the returns for 2 years at once instead of examining them one at a time.

If the period of assessment is only 2 years, they say that it is impossible to do that as a matter of fact. If it is 3, they would be able to take 2 years at a time.

Senator Hastings. That would be a saving to the Government, too, wouldn't it?

Dr. Magill. Yes; they estimated a saving of some 40 percent, which I imagine is too high, but they would have a material savings.

Senator Hastings. I never could see any sense in their coming around and asking about one and not asking for the next year, when they are 3 years years behind, but they say, "No, we will come along some other time."

Senator Couzens. I move it be approved.

The Chairman. Without objection, it will be approved.

Senator Couzens. Page 196, line 8.

Dr. Magill. Page 196, line 8, is another change of the same general sort. At the present time, in the case of a decedent's estate, or a corporation which is in liquidation, the corporation or executor may request prompt assessment, that is, that the tax be assessed within one year. The Bureau says again that that is too short a period and

they would like to have it extended to 18 months. I think their original request was for 2 years, which the Ways and Means Committee cut down to 18 months.

Senator COUZENS. That is a good deal of a hardship in many instances, where people would like to close up the estate and make a distribution of it.

Dr. MAGILL. So far as they are concerned, 1 year is better. If is just a question of how much time the Bureau should be allowed for the purpose.

Senator REED. In practice, it does not mean that the tax is settled in 1 year. I have just been through that painful process, and it took me 5 years to get a final adjudication, although we did everythings we could to speed it up. It seems to me the Bureau ought to be able to act within 1 year. The reasons which apply for extending the general statute do not apply to this.

Senator MCADOO. Isn't it a question merely of organization of the Bureau? Under the economy acts, we cut down in every way we can the staffs in the Government service, and then we put the burden on the taxpayer in another direction. I am just wondering if this does not relate merely to the organization of the Bureau. Give them an adequate force to do it in a year instead of 18 months.

Mr. PARKER. What they brought up was that these requests are filed with the collector, and for some reason the Commissioner's office does not get them until sometime later. Of course that is an administrative proposition.

Senator MCADOO. That is administrative, and shows inefficiency.

Senator HASTINGS. Is it 1 year at present?

Dr. MAGILL. That is the present law.

Senator MCADOO. I think we ought to give the opportunity to close up these estates promptly. I know we had that trouble when I was in the Treasury, and it really got down to a question of organization.

Senator COSTIGAN. Has the Government lost anything by this?

Dr. MAGILL. I do not say that. Their point is simply that in the case of a large estate or a large corporation in liquidation, it is difficult to conclude their investigation in the course of a year.

The CHAIRMAN. You recommend 18 months?

Dr. MAGILL. We recommend 18 months.

The CHAIRMAN. All in favor of 18 months will raise their hands.

(The vote is so taken.)

The CHAIRMAN. Eight. Those opposed.

(The vote is so taken.)

The CHAIRMAN. Eighteen months is approved.

The CHAIRMAN. Line 12.

Dr. MAGILL. That is the one I spoke of first, changing the period of assessment to 3 years. Lines 17 and 20, we have just spoken of.

The CHAIRMAN. Approved.

Mr. PARKER. The new subsection at the foot of page 196 is designed to clarify the period during which the statute of limitations will run.

If a taxpayer files his return ahead of time, the statute of limitations at present runs from the time the return was filed. The Bureau would like to have the period start upon the day upon which

the return was due to be filed to avoid the necessity of checking each filing date.

Senator GORE. If filed then or prior to then?

Dr. MAGILL. Suppose that a return is filed on March 10 and it is due on March 15. At present the period runs from March 10. They would like to have it run uniformly from March 15.

Senator GORE. I can see the point in that. Suppose it was filed March 29?

Dr. MAGILL. It then starts running March 15.

Mr. BEAMAN. No. March 29.

Mr. PARKER. In the case of a delinquent return, the Government feels they should have additional time.

Senator GORE. You still have your zigzag business.

Senator KING. The Government frequently grants, upon application, additional time to file. It would seem that a person who gets the benefit from the Government ought to give the Government a corresponding benefit in enlarging the time for the Government to act.

Senator REED. As a practical matter, the Bureau can rest confident that an assessment made before March 15 is in time?

Dr. MAGILL. That is right.

The CHAIRMAN. Without objection, it will be approved.

Dr. MAGILL. On the following page, the subsection has been rewritten with one change. The Subcommittee of Ways and Means recommended that if an individual omits from his gross income an amount in excess of 25 percent thereof, that then there should be no statute of limitations with respect to the assessment of the tax as to such an amount.

Senator REED. Don't you think that is unfair? Suppose that you, next December 30, have a loss. You had a big capital gain this month, and you sell something at a very great loss which would wipe out that capital gain on December 30. You do not actually get your check from the broker until January 2. You might in all innocence report that sale as of the wrong year, and you are treated as if you were a criminal. You might report it too early, or you might report it too late, according to what they finally decide was the proper year to report that in. You have not concealed anything—you have merely made an honest mistake of law.

Mr. PARKER. The Treasury's first reaction was in opposition to this, for the reasons you give. But the taxpayer can always protect himself by reporting the transaction on his return, and showing what it was, and saying, "I am not reporting it."

Senator REED. He nevertheless still omits from the gross income an amount properly includible in excess of 25 percent of the amount.

That is a change, Doctor, we ought to consider. If he did not include it in the figures of gross income, although he explained why he did not, he is nevertheless guilty of fraud, and can be sued 15 years later.

Dr. MAGILL. I think you are right, and my statement was wrong. If he did not include it but spoke about it.

Senator REED. That is too savage.

Dr. MAGILL. I think what the subcommittee had in mind was if the amount was not included and the Bureau had no notice of it,

that the 3-year period for assessment would be likely to run before the omission would be discovered.

Senator REED. He ought to be able to protect himself by making a frank disclosure.

Senator COUZENS. Why not put in "unless notice is given"?

Senator REED. Will you take that section and rewrite it to cover that?

Dr. MAGILL. Are you agreeable to the proposition that if he does not disclose the situation the statute does not run?

Senator REED. Even that change puts a heavy responsibility on the average man who has not a skilled knowledge of the law. If he has a tax expert, he is all right, but the ordinary citizen does not know it.

Senator GORE. Can't you put in something in regard to intent?

Senator REED. The present law covers that.

Mr. PARKER. I would like to take Senator Reed's case and show how abuses might arise. A taxpayer did not report a certain transaction in 1931 but did report it in 1932, and paid the tax on it. If, after the statute has run on his 1931 return, he finds that this transaction ought to have been reported in 1931 instead of 1932, and files a claim for the refund of his 1932 tax, there is nothing to do except give him the money back although he has never paid a tax on the profit at all.

Senator GORE. In your hypothetical case, had the statute run?

Mr. PARKER. The statute had run on assessment of the taxes for the prior year, and the subsequent year was open for refund.

Senator GORE. He had a right to refund?

Mr. PARKER. And therefore he can get the refund for this subsequent year, and the result is he never pays tax on that item of income.

Senator GORE. Couldn't you insert a provision covering that?

Mr. PARKER. I think we ought to give some study to such a provision.

The CHAIRMAN. Suppose we pass that for the present, and you experts study it.

Senator REED. Your point is right, and my point is right.

Mr. MAGILL. I believe the next change is at the foot of page 209.

The CHAIRMAN. Limitation of allowances.

Dr. MAGILL. I believe what is done there simply corresponds to the changes we have already spoken of. This particular change is a limitation with respect to filing claims for refund. Since you have extended the period for assessments to 3 years, the period of filing a claim for refund is extended for 3 years, and the period is made to run from the date of filing the return to correspond to the period of assessment.

The CHAIRMAN. They are related?

Mr. PARKER. Yes, sir.

The CHAIRMAN. Approved without objection.

Senator REED. There is a little more change than that.

Mr. PARKER. I can explain that, I think. Under the present law the period for assessing is 2 years from the date of filing the return. The period for refund is 2 years from the time of payment of the tax. A great many taxpayers report on the installment basis. The

result is that taxpayers in many cases have 2 years and 9 months from the time of filing their returns to file claims for refund.

The CHAIRMAN. Two years after the final payment?

Mr. PARKER. This provision is intended to give the taxpayer practically the same period for filing refund claims as the Government has to assess—it gives him a period of 3 years from the date of filing the return or 2 years from payment of the tax, whichever is later.

Senator REED. You said "report on the installment basis." You mean "pay on the installment basis."

Mr. PARKER. Yes.

Senator BARKLEY. What do you mean by the last sentence there? Do they all make a return when they pay a tax?

Mr. PARKER. Of course we have cases where the Commissioner goes out and has to assess a tax where the taxpayer files no return.

Senator BARKLEY. That is where he deliberately refuses to file a return?

Mr. PARKER. Under the law, a collector is given the right to file a return for him if he does not file it.

The CHAIRMAN. Without objection, we will approve it. Page 211.

Dr. MAGILL. The provision there is to insert the requirement that the Board of Tax Appeals, among other things, shall determine whether the claim for refund was filed within 3 years from the date that the return was filed. The situation as I understand it has been this: If a taxpayer files a petition with the Board of Tax Appeals claiming that the deficiency which has been assessed against him is erroneous and the Board finds that a refund is due him, the Board is unable to determine whether the refund is barred by limitation. Consequently the case has to go back to the Bureau to determine whether a proper claim was filed within the limitation period.

The general purpose of this change is to require the Board to make a finding as to whether or not the claim for refund was filed within the period of limitations.

The CHAIRMAN. Without objection, it will be agreed to.

Mr. BEAMAN. Senator, the American Bar Association very urgently asks you to strike out this sentence that Mr. Magill has just been explaining. They state that since the Commissioner has the power to increase deficiencies before the Board, the taxpayer should be entitled to get back any refund which the Board finds is due him.

Senator HASTINGS. Regardless of whether the statute of limitations for filing the claim has run or not?

Mr. BEAMAN. They claim that that is necessary to put the Government and the taxpayer on an equality.

Senator REED. It is true, isn't it?

Senator HASTINGS. I do not see how that is true.

Senator CONNALLY. The taxpayer has keen lawyers, and if they cannot find it out, I do not see why we should put that in.

Dr. MAGILL. We opposed that strongly. The theory of the law has been for a number of years, and it has been established by the decisions that if the taxpayer is to obtain a refund, he must have filed with the Commissioner a claim and must give the reasons why the refund should be made to put the Bureau on notice of the par-

ticular reasons why he should get some money back. The theory is that he should not be allowed to maintain an action until he has complied with that reasonable requirement.

Senator CONNALLY. Isn't it the same theory as in any law suit, that he must plead it before he can get relief?

Senator REED. The Government can get relief without it?

Dr. MAGILL. That is to some extent true that the Government must send out a deficiency letter and say, "We claim a deficiency on this ground" and they may change their position.

Senator KING. But the taxpayer has the facts within his knowledge and the Government has not.

Dr. MAGILL. That is the important consideration. I think this is right the way it is.

The CHAIRMAN. Without objection, it will be approved.

Dr. MAGILL. The estate tax amendment, commencing on page 212, I would like to have Mr. Bartholow explain, because he is more familiar with them than I.

Mr. BARTHOLOW. The new matter here starts at line 14, page 212, and is believed to be necessary to insure a proper interpretation of the language which appears on lines 7 and 8. You will notice that it says, where one person creates a trust and retains the rights to revoke the trust, if that power existed on the date of death, then the full amount of the trust property should be included in the gross estate of the decedent. The theory is, of course, that if a taxpayer——

Senator CONNALLY (interposing). That is the present law?

Mr. BARTHOLOW. That is the present law. If the taxpayer creates a trust of property and has the right to pull it back at any time, to all intents and purposes that is his property at all times.

Senator BARKLEY. In other words, his death automatically operates to pull it back.

Mr. BARTHOLOW. Then it goes wherever he has left it. But we find of recent date many of those trusts are trusts which the creator can revoke only upon the giving of a notice, say of a month or of a year.

You have substantially the same situation there, and yet it is doubtful whether the present law covers the situation, because it speaks of where the enjoyment of the property was subject, at the date of his death, to the right to revoke, alter, or amend, and technically the trust is not subject to that right, because the creator has not given the required notice of a year or a month or whatever it may be. Therefore, in order to make sure that that type of case is covered by the statute, paragraph 2 on page 212 is added, which merely says that the property shall be deemed to be subject to the right to revoke on the date of the decedent's death even though that power is subject to a precedent giving of notice, or even though the alteration, amendment, or revocation can take effect only on the expiration of a stated period.

There is some question as to whether, without this amendment, such property would be held to be subject to the right of revocation at the date of death.

Senator REED. Has any court held it is not?

Mr. BARTHOLOW. We have not had any decisions, to my knowledge, on that, but the language seems to favor the taxpayer, if the

matter were litigated. I think the Government, however, would contend that the transfer would be subject to tax under another subsection. Section 302 of existing law includes in the gross estate all of the property of the decedent. In view of the Guggenheim case in the Supreme Court, the contention would probably be sustained that such a transfer, being subject to the right to revoke, does not really take the property out of the decedent at all, but the property remains as that of the decedent. As long as specific language relating to revocable trusts remains in section 202, it ought to be made definite in its inclusion of the type of transfer I have mentioned.

The CHAIRMAN. And this is for clarification?

Mr. BARTHOLOW. That is the construction of the Department.

Mr. PARKER. It is very important, of course, under our present system, to catch these trusts either with the one tax or the other. We were afraid that this constituted the loophole. That a man would be able to give away his property, and get away from the estate tax. I discussed the matter informally with the judge of one of the courts passing on this matter, and he was afraid of the existing law. He told me informally that he would have to hold it was not subject to the tax.

The CHAIRMAN. You think this should be approved?

Mr. PARKER. I think it is important not to leave a loophole.

Senator REED. I agree fully with the justice of this provision you have written in here, but I am surprised that any court would take the view of extinguishment of the power by death. If I were a judge, I would hold differently. But it cannot do any harm to put that in.

Senator CONNALLY. The fact that this man was dead makes it impossible to give the notice.

Senator REED. What is the present status of this 2-year transfer matter in contemplation of death? Is that presumption still respected by the courts?

Mr. BARTHOLOMEW. You are referring to the language of paragraph 3 on page 213? In the 1932 act Congress amended one section of the estate-tax law, which the court held to be unconstitutional, but the particular subdivision referred to here was overlooked. This amendment merely conforms the statute to the Supreme Court decision and changes an irrebuttable presumption into a prima facie presumption.

Senator CONNALLY. Do you think this language in section 2 there as drafted will do what you are trying to do?

Mr. PARKER. Yes, sir; I think that language will.

Senator CONNALLY. I notice the last part of it—"such notice shall be considered to have been given, or exercised, on the date of his death."

Do you mean the notice to revoke?

Mr. PARKER. Yes, sir. So it would bring it within the estate tax. If he did not have any power over it at the date of death, we could not reach it by the estate tax.

Senator MCADOO. In other words, if he has established an irrevocable trust, this would not apply?

Mr. PARKER. If it was a straight revocable trust, revocable at any time, it is plain that at the date of death he held the power, but

when the exercise of the power is subject to the prior giving of notice, at the date of death—that particular moment—he has no power.

Senator CONNALLY. If he has no power, he cannot revoke it, of course. I do not think it is necessary, but I want to be sure that that language will do it.

Mr. PARKER. I think it does.

The CHAIRMAN. Section 402 on page 214.

Mr. BARTHOLOW. Under the present law, the policy is that if a decedent dies, and the property passes to a legatee, and he in turn dies within 5 years of that decedent's death, if the property in question was included in the gross estate of the first decedent, it shall be included in the estate of the second decedent, but taken out by way of a deduction—the principle being that it would be too severe to impose two estate taxes where the two decedents died so closely together.

Senator KING. Within 5 years?

Mr. BARTHOLOW. Within 5 years. But the proper interpretation of that statute also results as follows: If the second decedent died within the 5 years and left the property to a third decedent who died within 5 years of the second decedent, the property would in turn be exempt from estate tax to the third decedent.

Senator KING (interposing). That would mean the fourth decedent?

Mr. PARKER. Theoretically, under the present law, you could go on forever, for 200 years, if the decedents died within 5 years of each other.

Senator REED. That actually does not occur in practice.

Mr. PARKER. We had a refund on it.

Senator KING. I know of a number of cases of three decedents in 5 years.

Mr. BARTHOLOW. The effect of this amendment will merely mean that where one decedent dies within 5 years of a prior decedent, there is an exemption from the estate tax, but the third decedent's estate will pay the tax, so that there will only be one exemption.

Senator GEORGE. Not another period of 5 years?

Mr. BARTHOLOW. Not another period of 5 years. If the first decedent dies, and the second decedent dies within 5 years, the transfer is exempt, but the person who gets the property from the second decedent will have to pay an estate tax on that property.

The CHAIRMAN. Without objection, it will be approved.

Senator GORE. Let me ask you a question at that point. Is any provision made in this which is contemplated as covering this estate in Chicago, where the estate was worth $11,000,000 at the time of death, and at the time of the assessment of the tax it was worth about $1,500,000, and the taxes were more than the property was worth?

Senator GEORGE. We struggled with that in the last bill.

Senator REED. That is the Donnelly case.

Senator GORE. I know. But Germany has a provision that the tax shall not exceed 80 percent of the value of the property at the date of collection. It looks to me that that is a fair provision.

Mr. BARTHOLOW. That proposition has not been gone into at this time.

Mr. PARKER. The situation was somewhat relieved by the recent last year's rise in the stock market, and we have 8 years for the payment of the estate tax, so the situation is not merely as bad as it was, when it came up in the 1932 act.

The CHAIRMAN. Some of these stocks are worth twice as much now as they were then.

Senator GORE. You do not make any changes in the estate or gift rates?

Mr. BARTHOLOW. None at all.

The CHAIRMAN. All right; approved without objection.

Mr. BARTHOLOW. The next series of amendments is made by section 403, starting at page 215, and extending over to the top of page 218. At the present time the estate tax is levied in the case of residents of the United States upon all the property of those residents. On the other hand, if the decedent is a nonresident of the United States, it is only imposed upon the property situated in the United States. The distinction is as between a resident and a nonresident. That does not conform to the distinction made for income-tax purposes. All residents and citizens are subject to that tax on all of their incomes, while nonresident aliens are subject to the tax only on income from sources within the United States—in other words, the theory of the income tax is that a citizen of the United States, no matter where he may reside, should be subject to tax on all of his income, because he has the benefit of protection by this country.

The purpose of the amendments made by section 403 is to put the estate tax upon a similar basis, that is, in the case of citizens of the United States, even though they may be nonresidents—to subject them to a full estate tax on all of their property, wherever situated.

Senator GEORGE. You give them credit for the estate tax paid in the country of actual residence?

Mr. BARTHOLOW. There is no provision for that.

Senator GEORGE. You give no credit for the citizen actually residing abroad, and who actually pays on the portion of his estate in the country of his domicile.

Mr. BARTHOLOW. There is no such provision.

The CHAIRMAN. Would they charge it?

Senator GEORGE. Certainly. They have the right to charge on any property within that jurisdiction.

The CHAIRMAN. I have a letter here from the Secretary of State about this.

Mr. PARKER. The Secretary of State wrote a letter that covers three or four subjects. If there is no objection, I will just read the paragraph that relates to this particular thing.

Section 403 of the revenue bill for 1934 imposes Federal estate taxes on all citizens whether or not residents of the United States, on all residents, whether or not citizens, as to all of their estate, real or personal, and wherever situated. The almost universally established principle of estate taxation has been that only the country of residence regardless of citizenship, may tax the full estate, and furthermore that real estate should be subject to succession taxes only in the country where situated. Section 403 would make it difficult for many American citizens to live in foreign countries, in the interest of American foreign trade. They will be subject to a tax burden much greater than that imposed on foreigners in a similar situation.

Senator GEORGE. A foreign country might consider a very limited stay in that country as establishing residence, and they might attach an estate tax on any property there. There might not have been any intention of establishing a domicile there, within our meaning of the word "domicile." Therefore I think he should be credited for any tax given to the country of actual residence.

The CHAIRMAN. Why not give him a credit on the foreign payments?

Senator CONNALLY. Why not limit it to real estate?

Senator HASTINGS. That is exactly what I had in mind—to limit it to real estate, because all of his personal property ought to be considered as part of the property here, anyway.

Senator CONNALLY. The personal property, the situs of it, is his citizenship.

Senator GEORGE. Suppose a foreign jurisdiction says that a very limited residence, say 3 months, will constitute a domicile in that country for taxable purposes, and he has personal property there, and actually has to pay on it.

Senator HASTINGS. They might require his estate to make a report on what he had in this country, for instance.

Senator GEORGE. I do not think they could do that.

Senator REED. That is just what we do on a foreign citizen resident here. We require him to pay on all of his personal property abroad and here. We do that now.

Senator GORE. A foreign country, in case of death, they do not try to collect an estate tax on real estate situated in this country?

Senator CONNALLY. No.

The CHAIRMAN. Why can we not pass this for the present, and you gentlemen get together with amendments on this proposition?

Mr. BARTHOLOW. We already have a credit for gift taxes, and also a credit for State death duties. If we are going to adopt the policy of also allowing credit for foreign estate and inheritance taxes, we will have to apply appropriate limitations, resulting in such a complicated structure that it is just going to fall of its own weight.

Senator COUZENS. Could we exclude real estate?

Mr. BARTHOLOW. I might say on that point that the Attorney General, a number of years ago, ruled that foreign real estate was never includible in the gross estate, even though our statute says in the case of a resident that the gross estate includes property wherever situated, real and personal. The Attorney General pointed out that to include foreign realty was contrary to the uniform treatment followed on the subject, and gave the statute a construction under which foreign-owned real estate was excluded from the gross estate for Federal estate-tax purposes.

Senator REED. That is still your practice?

Mr. BARTHOLOW. That is still the practice, but the intent of these amendments was to overrule that opinion and put into the gross estate of our citizens and residents, all of the foreign real property.

Senator COUZENS. Is that the only purpose of this amendment?

Mr. BARTHOLOW. No. There are two things. First, to put the foreign real estate into the gross estate of our residents; and secondly, to put the nonresident citizen of the United States in the same category as that of a resident.

The CHAIRMAN. Was this submitted to the House Ways and Means Committee?

Dr. MAGILL. It was a recommendation of the subcommittee in the first place. In my judgment, you ought to split it up in your consideration with the two matters that Mr. Bartholow has spoken of, and as to one of them, at least—the one proposition, as to foreign real estate, as he says, under the Attorney General's ruling, which is quite old—back in 1917 or 1918, or thereabouts—we cannot subject to the American estate tax real property owned abroad.

On the other hand, if this American resident, for example, has personal property located in a house in London, we can and do tax that personal property as part of his estate. I believe that that division follows the general lines of international law or conflict of laws, as we have thought of them in the past.

Now, the one question that I think the committee could decide at this time is whether or not you wish to change the estate tax to as to subject foreign real estate to the American estate tax.

Senator REED. Where do you find any provision dealing with foreign real estate?

Dr. MAGILL. There is nothing said about it. The thought is that these amendments which have been made here will have that effect.

Senator BARKLEY. You mean the tax on foreign real estate?

Dr. MAGILL. That is right. That is one purpose of these amendments. For example, I know of a case of my own in which an individual died in New York, who had a shooting lodge in Scotland. Well, the British Government, of course, subjected him to an estate tax with respect to the lodge and with respect to all the contents of it. Now, under the Attorney General's ruling the United States may not impose an estate tax with respect to the transmission of a shooting lodge, yet it can tax all the personal property that is in it.

Senator BARKLEY. Upon what theory ought we to tax his foreign real estate as a part of his estate?

Dr. MAGILL. I am personally very doubtful about it.

Senator BARKLEY. The only theory I could think of would be, he must have made the money in this country, and if he had not put it into real estate in England, he might have put it into real estate here, and therefore would have been taxed; but I doubt if that is a sound theory.

Senator GORE. What do foreign governments do in that regard, respecting real estate in this country, held by their citizens?

Senator GEORGE. Doctor, what is our ruling regarding resident aliens, so far as estate taxes are concerned?

Dr. MAGILL. The estate tax is, I believe, affirmed on the basis of residence. In other words, if an individual is a resident, then the transmission of all his property, except this foreign real estate, is included in the gross estate.

Senator CONNALLY. All of his property in this country?

Dr. MAGILL. Yes; and his property abroad, if it is personal property.

Senator CONNALLY. Yes; it follows the situs of his residence.

Dr. MAGILL. Of course, as you know, the legal theory is that if he has personal property abroad, that personal property is supposed to adhere to him as a person; and wherever he is, it may be taxed.

Senator GORE. Suppose an Englishman had a hunting lodge in this country; does the English Government tax it in case of his death?

Dr. MAGILL. I think not. I am not positive, but I think not.

Senator COUZENS. I move we draw it to except real estate.

Senator REED. I am sure that would be the effect. I do not think these amendments would change that rule of taxation on foreign real estate.

Dr. MAGILL. I am not sure that they do. The theory of it was to change it.

The CHAIRMAN. Is it the idea of the Treasury that real estate should be excluded?

Senator CONNALLY. No.

Dr. MAGILL. Well, the Treasury concurred generally in this recommendation.

The CHAIRMAN. It includes real estate?

Dr. MAGILL. It includes real estate.

The CHAIRMAN. Your motion is to exclude real estate, Senator Couzens?

Senator COUZENS. My motion is to exclude real estate.

Senator HASTINGS. I want to ask Senator George, were you interested in the point of the man paying taxes twice on the same property in foreign countries and in this country, too?

Senator GEORGE. Yes. My suggestion was that it should be excluded only in the event that a like tax had been paid there to the extent that he had paid a similar tax on the property.

The CHAIRMAN. Let me ask you, Doctor. You say that the subcommittee made this recommendation, and you presented it to them, but the full committee knocked it out; is that right?

Dr. MAGILL. No; no; the subcommittee recommended it in one of the very short paragraphs of their report, that foreign real estate, owned by an American citizen, should be subjected to the American estate tax, and as I say, the Treasury concurred in that recommendation, among a great many others.

Now, at the time the subcommittee passed on these matters, the bill was not drawn, but this particular provision was designed to carry out the purpose of the subcommittee, yet, I say, we are very doubtful as to whether it will carry it out.

Mr. BARTHOLOW. I might say this word of enlightenment. The same question came up with respect to the gift tax. Gift taxes are levied on the principle that we should fully tax, as we do for income-tax purposes, all of our citizens, as well as all of our residents. Then the question came up as to whether foreign real property which was, as we have said, excluded for estate-tax purposes should also be excluded for gift-tax purposes. The language imposing these two taxes is quite similar, and it looked as if a similar result should be reached; whereupon it was realized that it would be very easy for a wealthy person in this country, instead of giving cash to his son and being subjected to a gift tax, to buy real estate up in Canada and make a gift to his son of the realty instead. If a gift of foreign real estate was exempt from gift tax, the son could get the real property and convert it into cash. The gift tax could thus be very easily avoided. With that situation in mind, the position has been taken

that a resident or citizen of the United States is required to pay a gift tax on gifts of property inter vivos, no matter where the property is located, no matter whether the property is personal property or real property. It was with that background in mind that this estate-tax provision was drawn up.

Senator CONNALLY. Mr. Bartholow, the estate tax, however, after all, is a succession tax, isn't it?

Mr. BARTHOLOW. That is right.

Senator CONNALLY. It is a tax upon the privilege of transmitting property?

Mr. BARTHOLOW. The privilege of giving property away at death, as it is usually stated.

Senator CONNALLY. For example, take the case of a man who has got a home in France. Of course, that title must be granted and respected by the Fernch Government. Now, exclude that from the estate tax, and then we make him pay on all his personal property, which under the law follows his person. I remember the old distinction to the effect that real estate has its own situs, but personal property has the situs of the man who owns it, wherever he is. Now, why won't this provision do substantial justice?

Mr. BARTHOLOW. I believe it will, and I think Dr. Magill agrees with me.

Mr. PARKER. Wouldn't you want to tax it at all? A man might have real property in a country where there is no estate tax.

Senator BARKLEY. Is that our business? Have we got to follow all countries and see whether they impose an estate tax on a person's real estate to determine whether we will do it or not? I do not think that is a sound taxation method.

Senator CONNALLY. The only argument against it, as I see, is that it would be a temptation to a man to invest a lot of his money in foreign real estate.

Senator GORE. Let me ask this question: Do not a great many more foreigners own real estate in this country than do Americans own real estate in foreign countries?

Senator REED. I doubt it.

Senator GEORGE. I do not know, but you might have a flight of capitalists.

Senator GORE. It would be better not to start a war upon this line, if you are bound to lose it.

Senator WALCOTT. I should just like to ask Dr. Magill if leases are included. For instance, if you take a house in London, you would call the house yours, and yet you would have the unexpired portion of a 99-year lease in those cases, as you probably know. Would that come under this provision?

Senator COUZENS. That would come under the exception, according to the motion that I made.

Senator WALCOTT. I should think so.

Senator BARKLEY. Let us pass on it one way or another.

Senator REED. I am not so sure that a lease is real estate.

Dr. MAGILL. We have had that same matter up before.

Senator BARKLEY. Is there a motion?

The CHAIRMAN. There is. I am going to submit the proposition as soon as Senator Walcott and Dr. Magill get through with this conversation.

Dr. MAGILL. It ought to be regarded as real property, but as a technical matter, I do not know whether it would be or not.

Senator WALCOTT. I would like to amend Senator Couzens' motion to include leases, because a lease is virtually real estate.

Senator CONNALLY. That is real estate.

Senator GORE. We tax the whole estate.

The CHAIRMAN. Suppose we submit this question in two ways. First, excluding real estate, and then take another vote on the question of giving them a credit on that proposition, and let us see what the sentiment of the committee is.

Senator WALCOTT. Why not include real estate and leases on real estate?

Senator GEORGE. There should be a limitation on a lease. It should not be a lease merely for 1 year.

Senator WALCOTT. No.

Mr. BARTHOLOW. The gift tax is not universally imposed, and therefore there is an incentive to buy property in countries which do not have such a tax, and make the gift in those countries, and have the donee convert the property and come back into the United States. Now, in the case of an estate tax, it is well known that those taxes are quite universal, and therefore there isn't the incentive to take property out of the United States into a foreign country because, after all, you are not saving any taxes by doing that.

Senator COUZENS. My motion would not include the exemption of real estate from a gift tax there. I do not want to disturb the gift tax.

Mr. BARTHOLOW. I just wanted to make sure that attention was called to the distinction between the two taxes.

The CHAIRMAN. We will put this question in two ways, to get the sentiment of the committee—to exclude the real estate, together with certain leases, if we can get together on the proposition, from the provisions. Another is, to permit a credit.

Senator BARKLEY. If the first motion carries, then the second would be unnecessary.

The CHAIRMAN. That is true.

Senator COSTIGAN. Mr. Chairman, before the motion is put, may I ask how much is expected out of the foreign real-estate tax?

Dr. MAGILL. It could not amount to very much, because the proceeds of the estate tax generally are down to a small amount now, and for that reason I personally would hate to see you pass this credit proposition, because it would involve a lot of complications and when you got all done you would not have accomplished much.

Senator REED. How much do you figure would be derived from the estate-tax law?

Dr. MAGILL. I think it is 30 million.

Mr. PARKER. That was last year, of course, before we got the higher rates. It is estimated, however, that in 1935, as I recall it, we will get about $85,000,000. I have the exact figure here, however. I can look it up.

The CHAIRMAN. All in favor of excluding real estate and leases of real estate, if we can get together on that, will signify by raising their hands.

Senator BYRD. This is on the real estate, is it?

Senator WALCOTT. Yes.

The CHAIRMAN. The motion apparently is carried. The amendment will be drafted by you gentlemen, then, accordingly.

Senator REED. Now, another question, Senator, whether we want to exclude the whole estate, except real estate of citizens domiciled abroad. That is the real effect of this series of amendments here.

Senator CONNALLY. Whether we want to exclude them?

Senator REED. Whether we want to include them or exclude them.

Senator CONNALLY. Yes; include them.

Senator REED. The present law does not include them. The effect of this amendment would be to include them.

Senator CONNALLY. I think the effect of the amendment would be to include them.

The CHAIRMAN. Excluding real estate.

Senator REED. Well, if that is understood, all right.

Dr. MAGILL. Yes.

The CHAIRMAN. All right. That takes us down to page 218.

Dr. MAGILL. Two hundred and eighteen puts into the prior act a provision which you have agreed to, extending the time for petition to the board from 60 days to 90.

The CHAIRMAN. Without objection it will be approved.

Dr. MAGILL. The section at the top of page 220, is designed to give the Commissioner 5 years in which to recover any refund which was obtained by fraud or misrepresentation of a material fact.

The CHAIRMAN. What is the existing law?

Dr. MAGILL. Under the existing law, he would have 2 years.

Senator CONNALLY. Well, if he must establish fraud, I am in favor of giving him 5 years.

The CHAIRMAN. Without objection it will be approved.

Dr. MAGILL. Section 503 is merely a clarifying amendment.

The CHAIRMAN. Approved.

Dr. MAGILL. Section 504 is the same type of amendment which I explained earlier for the Board of Tax Appeals to find whether or not a proper claim for refund has been filed in this case, and in the case of estate taxes and gift taxes. In other words, this carries out the action which the committee has agreed on, but it needs a clarifying amendment, the amendment as drawn here.

The CHAIRMAN. Approved with an amendment.

Dr. MAGILL. Correct.

The CHAIRMAN. All right.

Dr. MAGILL. Page 222 is the same thing which you have already agreed on.

The CHAIRMAN. Approved.

Dr. MAGILL. All of page 223, I believe, to carry out the same purposes as to prior laws.

The CHAIRMAN. All right. Approved.

Dr. MAGILL. On page 225——

The CHAIRMAN. How about section 505, bankruptcy and receiverships?

Dr. MAGILL. That carries out as to the prior laws, something that you have already agreed upon.

The CHAIRMAN. All right. Approved.

Dr. MAGILL. Now, section 506. At the present time it is provided, as is shown below in the small print, that the Secretary of the Treasury may apply a regulation or a Treasury decision, with-

out retroactive effect. The purpose of section 506 is to give the Secretary the same power with respect to rulings. He may apply a ruling without retroactive effect as well as a regulation or Treasury decision.

The CHAIRMAN. It will without objection be approved.

Senator BARKLEY. Suppose the ruling bears upon a question that has been in the Bureau, where the facts are similar to the case in which he makes the ruling?

Dr. MAGILL. Well, the situation that we have in mind is this—that in various cases there is a good deal of doubt as to what the proper interpretation of the law is. Now, taxpayers honestly make their returns under what they deem to be a proper interpretation of the law, and oftentimes an interpretation of law which the Treasury itself has announced. Well, then, later, the Treasury changes its mind, or gets out a new ruling on the subject. The design of this provision is to give the Treasury the privilege of leaving those past returns alone.

Senator BARKLEY. That is, where you have made a ruling heretofore?

Dr. MAGILL. Yes.

Senator BARKLEY. It would not apply to a previous set of facts, in a case that is pending, where you have made no ruling in that case. It would be the ruling that you might make in another case. It should not affect the situation as to prior facts, in another case.

Dr. MAGILL. Well, I think it would apply to your case in this way, that here you have, let us say, a series of trusts—this is one case which we had—which have reported income, as trusts. Now, later on, guided by some decisions of the Supreme Court, the Bureau decides in a ruling in a particular case, that one of these trusts ought to be taxed as an association. The purpose of this provision is to give the Secretary of the Treasury the power to say, "This ruling shall apply prospectively with respect to all this group of trusts, but we won't reopen these cases as to past years."

Mr. PARKER. In other words, it might make a difference what year was involved. You might have a lot of open cases in the Bureau, some for 1927, 1928, or 1929. This provision says the Secretary of the Treasury, "may prescribe the extent, if any, to which" the rulings "shall be applied without retroactive effect." He could make a ruling that, beginning with 1929 returns, he would put this thing into effect. Of course, we have great trouble to get consistency in the Bureau because under the court decisions they have to change their rulings. Then we have got millions of cases on hand. They cannot, every time a court decision comes down, go through every one of those cases. The taxpayers get a little bit the advantage of us on that.

Senator GORE. Let the old remain res adjudicata.

Mr. PARKER. In the Bureau the cases are in the closed file, and they are unable to pull out of those files, cases which might be affected in every particular case, but this is in the interest of consistency of taxation, I think.

Senator COUZENS. Do I understand from that that in some cases the Commissioner of Internal Revenue may go back retroactively and pick one case out and not another case?

Mr. PARKER. Under the present procedure if a case is active and has not been closed and a new ruling comes out the Commissioner will apply that ruling to the old case if it is in process. Another case, an exactly similar one, might have gone to the closed file the year before. The statute may not have run, but it will not be disturbed.

Senator REED. In other words, this thing makes for uniformity, and for the benefit of the taxpayer?

Mr. PARKER. I think so.

Dr. MAGILL. I think so.

Senator REED. It allows him to legislate, which is what he really does retroactively.

Senator COUZENS. If, with this written into the law, the Commissioner of Internal Revenue has the right to pick out any case he chooses and to leave the others in the closed files, he has a power that should not be granted to any Government official. That is one of the cases where there is more graft and favoritism possible than anywhere else, where the Commissioner of Internal Revenue could exercise his power to relieve one taxpayer and tax another; and if we are going to do this sort of thing, let us write into the law what we want him to do.

Senator HASTINGS. That is, he might promulgate a new regulation, to pick some particular case that was under examination, away back?

Senator COUZENS. And catch you, and leave him out, and so on down the line.

Dr. MAGILL. Suppose Mr. Parker is prosecuting a case before the Bureau. Now, he convinces the Commissioner that under existing decisions the ruling should be thus and so in his case, and the Commissioner makes that ruling. Well now, there are a dozen other cases in the closed files, which have been dealt with. If you followed the Parker ruling, they might be entitled to some relief or might be subject to some additional tax, but they are closed in his files. Now, the Commissioner, giving him the benefit of being honest in this instance, has no way of knowing about those cases. They are closed and are out of the way.

Senator COUZENS. If you want to write into the law those cases that are closed, I won't have so much objection. It is the idea of authorizing him to pick out certain closed cases and to go after them, if he wants to, or not to go after them if he does not want to. That is the kind of discretion that I do not think should be granted to him.

Dr. MAGILL. He is pretty nearly bound to have it.

Senator BARKLEY. This language prevents his going back and picking out any of them?

Dr. MAGILL. No; it does not. It is permissive.

Senator COUZENS. You are wrong about that.

Senator BARKLEY. This ruling which he makes in Parker's case is not to be retroactive. In other words, it cannot go back and affect cases that have been closed where different rulings have been made, as I understand it.

Senator REED. It is left to his discretion.

Dr. MAGILL. It is permissive.

Senator COUZENS. But I want to take away from him the discretion of doing that sort of thing, penalizing one taxpayer and letting another taxpayer go.

Senator CONNALLY. What does it mean "without retroactive effect"? What does that mean if it does not mean that he cannot go back?

Senator BARKLEY. It provides that the Commissioner may prescribe to what extent it may be done.

Senator GEORGE. I think we should limit it to live cases.

The CHAIRMAN. How would it do to strike out the last paragraph, leaving it to the discretion of the Commissioner?

Senator GORE. Then that would make all the cases which had been decided res adjudicata and they could not be reopened, is that the point?

Dr. MAGILL. If you want us to work on an amendment of that kind, we will see what we can do.

Senator HASTINGS. Mr. Chairman, I would like to ask whether this is applicable to this sort of a case. I understand that the Bureau has a regulation which prevents wealthy people owning farms from deducting those farm losses. The Board of Tax Appeals has reserved the Bureau, but they continue with their present ruling and assess taxables. Do you know about that?

Dr. MAGILL. Well, I do not know about that particular case. I know that general situation. There is a little variation from what you have said, in this respect. You are allowed to deduct, as you know, under the law, business expenses, losses incurred in a trade or business. Now, in the case of a farm, which is partly used as a country place, and is partly used for racing, it becomes a question of fact as to whether this is really a business enterprise or whether it is a country place. Now, the Board, in some cases, has held that the racing stable, for example, is a business enterprise. In other cases, it has held that it is not a business enterprise.

Senator HASTINGS. It all depends on the facts in each particular case.

Dr. MAGILL. It depends on the facts in each particular case. The decisions themselves are some on one side and some on the other. The Widener stables, I believe, were held to be a business enterprise and the Vanderbilt stables, I believe, were held not to be.

Th CHAIRMAN. Well, Doctor, we will pass this by and you get up an amendment.

Dr. MAGILL. We will see what we can do.

Senator BARKLEY. I would like to ask you a question before you do that.

Dr. MAGILL. I am not sure that you can do anything but go back to the present law.

Senator BARKLEY. Well, does this language really make any effective change in the present law?

Mr. BARTHOLOW. Let me ask the Senator what he thinks should be the provision.

Senator MCADOO. May I interrupt to inquire how long you are going to sit today?

The CHAIRMAN. Well, what we are going to do is to quit this morning; I want to meet over in the District of Columbia Committee room this afternoon at 2 o'clock, so we can proceed with the con-

sideration of it, and I hope that all the members will be present so we can expedite this.

Mr. BARTHOLOW. May I indicate the type of situation that brought this amendment up? The Bureau for a long time has published a ruling which says, "This is our interpretation of the law." It has been published for years and the Bureau is following it. Now, all of a sudden, the court unexpectedly rules on the very situation that the Bureau has ruled on and reverses it against the taxpayer. Here has been a ruling that has been published for years. Taxpayers have relied on it. They have closed their books on the basis of it. They have made their plans on the basis of it, and now, all of a sudden, the court says, "That is wrong; the taxpayer should take this up as income; it should not be regarded as a capital item." Now the question is whether, under those circumstances the Bureau should go back and take all of the known cases, all of the open cases at least, and apply this ruling retroactively as far back as the statute of limitations will permit, or whether the Commissioner should have the right, as this provision says, in changing the ruling, to say that it only affects taxpayers in the current and subsequent taxable years. That is a clear question of policy.

Senator GORE. Well, I can see where it would operate against the taxpayer. That would be all right, to grant him oblivion and not go back.

Mr. BARTHOLOW. That is the situation that the Treasury has in mind.

Senator COUZENS. Why don't you state in the law that you will only go back 1 year or 2 years in case of a change in the rulings, or to some specific date? That is not in the amendment.

Senator GORE. We should put in a proviso that this should be applied only in case of fraud.

The CHAIRMAN. You think about it and see if you can get together on something.

The committee will recess until 2 o'clock to meet in the District of Columbia Committee room over in the Capitol.

(Whereupon, at 12 m., the committee recessed until 2 p.m.)

(The hearing was resumed at 2 p.m. at the District of Columbia Committee room at the Capitol.)

The CHAIRMAN. The committee will come to order.

Dr. MAGILL. We had finished page 225. Section 507, on page 226, is designed to give the Commissioner the authority to inspect books belonging to a transferror of property in order to determine the tax liability of the transferee—that is, a corporation may dissolve, distributing its assets—the Commissioner later determines that the stockholders who received the assets are liable to an additional tax which should have been paid by the corporation.

This is designed to give the Commissioner the power to get at the books of the corporation in order to determine that.

The CHAIRMAN. You have never had that power?

Dr. MAGILL. Not certainly in so many words. The books may be in the hands of someone who won't give the Commissioner access to them. The Commissioner does have access to the taxpayer's own books to determine his liabilities.

The CHAIRMAN. Have you ever had any trouble in getting any books and papers in an investigation?

Dr. MAGILL. That is the reason for this section. The case they talk about is getting hold of a corporation's stock books to find out who was a stockholder at the time the corporation was dissolved. They have difficulty sometimes because they say it was not the taxpayer's books.

Senator REED. They ought to have the power. I do not see any objection to it.

The CHAIRMAN. Without any objection to it, it will be approved.

Dr. MAGILL. In section 508, the general design of that is to give the collector the power with respect to personal property which is being sold under distraint proceedings, which he now has for realty under the revised statutes, that is, to fix a minimum point below which the property shall not be sold, and if necessary to buy it in, in order to resell it at a later occasion.

The CHAIRMAN. There should be no objection to that.

Senator REED. I should not think so.

The CHAIRMAN. Page 228. That is part of it, isn't it?

Dr. MAGILL. No; that is a little different thing. That is this case. Suppose that a lien has been filed against the taxpayer's property, and he finds that he can sell part of it. This is to give the Commissioner authority to accept the money with respect to a part of the property and release that from the lien, so that the taxpayer can sell it.

The CHAIRMAN. That ought to be done. Approved.

Mr. BEAMAN. We have an amendment. It is not to change the purpose, but merely to clarify.

The CHAIRMAN. Approved with amendment.

Dr. MAGILL. On page 229, the purpose there is to make the provisions for jeopardy assessments with respect to taxes other than income tax, correspond to present provisions in the law with the present jeopardy assessment for income taxes.

Senator REED. In other words, you can make a jeopardy assessment on a brewery, for instance?

Dr. MAGILL. That is right.

The CHAIRMAN. Without objection, it will be approved.

Dr. MAGILL. Section 511 is to repeal a part of the gift tax which is no longer necessary because of the decision of the Supreme Court in the Guggenheim case.

Senator REED. In effect, what was that decision? That it is not a gift if it is revocable?

Dr. MAGILL. Yes, sir.

The CHAIRMAN. Approved without objection.

Dr. MAGILL. This provision for the general counsel and for assistants in the Treasury—there are two different provisions there. The first, section 512, is intended to permit——

The CHAIRMAN (interposing). Give us a picture first of what happens and what you are trying to do.

Dr. MAGILL. At the present time there is a general counsel for the Bureau of Internal Revenue, there is a general counsel of Customs, there is a solicitor of the Treasury and various other legal assistants.

The situation has grown up with each of the various Bureaus in the Treasury Department having essentially its own legal staff.

The purpose of this provision is to provide for a consolidation of the legal activities under the head of a single General Counsel for the Department.

The CHAIRMAN. You have your General Counsel, and what else?

Dr. MAGILL. Then it is contemplated here that there shall be an Assistant General Counsel in charge of these various divisions of legal work.

The CHAIRMAN. How many Assistants General Counsel do you provide for?

Dr. MAGILL. They provide for not to exceed six. It is not contemplated that this provision would result in any increase of personnel. The idea is to take the present personnel and consolidate it into a single legal department, instead of several, as we have now.

The CHAIRMAN. What salaries are increased by this provision?

Dr. MAGILL. I do not know that any are. It is provided that the General Counsel shall receive $10,000, subject to the reduction. That is really the only one which is provided for. The Assistants General Counsel are provided for here, too, but there are men at present fulfilling those duties. I do not see where there would be any increase in expenditures by virtue of this provision.

The CHAIRMAN. Then you have asked for the appointment of a General Counsel and six assistants, six Assistants General Counsel?

Dr. MAGILL. Not to exceed six.

The CHAIRMAN. What else?

Dr. MAGILL. That is all there is to that.

The CHAIRMAN. I had an idea you had six.

Dr. MAGILL. The assistants is the next section. That is a separate one—Section 513.

Senator REED. At the present time, is the General Counsel for the Bureau of Internal Revenue subject to confirmation by the Senate?

Dr. MAGILL. Yes, sir; he is a Presidential appointee at present.

Senator REED. Then the effect of this is to take away all of these offices from Presidential appointment and the consent of the Senate, and put them within that of the Secretary of the Treasury; isn't that true?

Dr. MAGILL. Not quite. The General Counsel is subject to confirmation, but the General Counsel of the Bureau and the Solicitor of the Treasury—an office which is not now filled, I believe—are both Presidential appointees, and these two positions would be eliminated.

Senator REED. The General Counsel for the Bureau of Internal Revenue?

Dr. MAGILL. He would become an Assistant General Counsel.

Senator REED. At present he is subject to confirmation.

Dr. MAGILL. Yes, sir.

Senator REED. And the Solicitor of the Treasury, the same way?

Dr. MAGILL. I believe that is so. I think these are the only two Presidential appointees.

The CHAIRMAN. The Assistant Counsel in the Department of Justice—are they Presidential appointments?

Dr. MAGILL. I do not think so. I believe the Solicitor General is. I do not believe that the Assistant Attorneys General are.

Mr. BEAMAN. They are.

Senator REED. I think, Mr. Chairman, that these assistants ought to be appointed by the President, subject to the advice and consent of the Senate.

The CHAIRMAN. That is, the General Counsel and the six assistants?

Senator REED. Yes. I suggest we amend it so, and let it go to conference, anyway.

Senator LA FOLLETTE. I agree with you.

Senator REED. We have abdicated enough power for this session.

The CHAIRMAN. That will send it to conference. Without objection, then, we will amend this.

Senator REED. That the President may appoint—line 12, page 213—with the advice and consent of the Senate. You have the thought?

Mr. BEAMAN. Who do you want to fix the salary?

Senator REED. The President.

The CHAIRMAN. The way it reads here, the Secretary of the Treasury fixes it.

Senator LA FOLLETTE. I do not see why we should not fix the salary.

The CHAIRMAN. What salary does he expect to fix on these assistants?

Senator REED. I think we should fix it.

Dr. MAGILL. I should think $8,000; it says "not in excess of $10,000." At the present time that means $8,500.

The CHAIRMAN. Do you make that suggestion?

Senator REED. I move that we fix the pay at $8,000.

Dr. MAGILL. The difficulty is to get a man of the sort you want to run the bureau at that salary.

The CHAIRMAN. Why can't we leave that off? It comes to the Senate with that amendment.

Senator REED. If we fix the maximum at $10,000, it is practically the same as fixing the salary at $10,000.

The CHAIRMAN. With that change, then, subject to the confirmation by the Senate.

Dr. MAGILL. Six Assistant General Counsels appointed by the President, with the confirmation of the Senate.

The CHAIRMAN. Approved with that amendment.

Dr. MAGILL. The provision for the Assistants in the Treasury, in section 513, is that the Secretary may appoint not to exceed 10 assistants, who would be Assistants to the Secretary of the Treasury.

Senator REED. The same reasoning applies to that. The President ought to appoint them with the consent of the Senate. I move that that be done.

Senator LA FOLLETTE. Are these in addition to men now in the Treasury, or is this just a different designation?

Dr. MAGILL. Essentially men already there. What the Secretary had in mind particularly was this: That in connection with the operation of the equalization fund, and the various other emergency activities which the Secretary has to supervise, he wanted a few men to assist him, particularly in the case of the equalization fund. I have talked it over with him further, and he says he has surveyed the whole situation at length, since this bill went to the House, and that in his opinion, five will be enough to do the work.

The CHAIRMAN. Let us change it to five assistants.

Dr. MAGILL. As to the Presidential appointment, you have a somewhat different situation here than you have on the counsel. The appointments of these men are limited to the emergency. When the President declares the emergency is over, they are supposed to go out.

Senator REED. You are optimistic.

Dr. MAGILL. Of course, what the Secretary had in mind was to appoint men of experience and competence to do this work.

The CHAIRMAN. These are not permanent jobs.

Senator REED. No. But that leaves it with some assistant secretaries who are subject to confirmation on Presidential appointment, and some who are not.

Dr. MAGILL. These are assistants, too. The only effect this has is to enable him to pay $10,000 instead of $8,000 which he can do now. These men will not be assistant secretaries of the Treasury. They will be assistants in the Treasury Department. He has several of them now.

Senator REED. Bailey was one of them, wasn't he?

Dr. MAGILL. Yes.

Senator REED. And the Senate expressed its views very decisively about Mr. Bailey. It seems to me we should at least keep our present control over those positions.

The CHAIRMAN. If it were for any lenth of time, that would be quite true, but these things may not last for more than a few months.

Dr. MAGILL. I know as far as the present assistants are concerned, they are not going to be there long.

Senator CONNALLY. In other words, this is to let him pay $10,000 instead of $8,000?

Dr. MAGILL. That is about all it boils down to.

Senator BYRD. Even if they are temporary, what is the objection to having them confirmed by the Senate?

Senator REED. The Senate has not been slow to act on these confirmations.

The CHAIRMAN. I think we will save time to let them be confirmed by the Senate. It has got to go to conference.

Senator REED. In line 22 we change "10" to "5."

The CHAIRMAN. Approved with amendment making it "5" instead of "10."

Senator REED. Subject to confirmation, and the President appoints.

The CHAIRMAN. Section 514.

Dr. MAGILL. Section 514 is the section which was put in at the request of some members of the Ways and Means Committee to provide special penalties in case of failure to report income from illegally produced oil.

The CHAIRMAN. Was this one of the provisions that the Secretary of the Interior brought up?

Dr. MAGILL. No, sir; this is a separate thing.

Senator CONNALLY. Are you sure it is separate?

Dr. MAGILL. It is a separate provision. The Ickes amendments come later in the bill.

Senator CONNALLY. Yes. This is all right.

Dr. MAGILL. Various proposals were made to the Ways and Means Committee, with the general design of using the revenue bill to stop the flow of illegally produced oil.

Senator CONNALLY. Is this a new provision?

Dr. MAGILL. This is a new provision.

Senator CONNALLY. What does it do?

Dr. MAGILL. Provides a civil penalty of $500 and a $50-a-day fine for failure to report income from illegally produced oil.

Senator REED. Did you recommend this?

Dr. MAGILL. We did not.

Senator REED. Do you approve it?

Dr. MAGILL. Our view would be that it is not necessary. We have provisions now for informer fees, and we have also penalty provisions for failure to report income.

Senator CONNALLY. Who put this in?

Dr. MAGILL. It was put in by the Committee on Ways and Means.

Senator REED. I am told by Mr. Beaman that this is not any Federal limitation of production that is being enforced, but this is an attempt by the United States to give informer privileges in the enforcement of State laws.

Dr. MAGILL. That is right.

Senator REED. That is an unsound policy, in my judgment.

The CHAIRMAN. What is the history of this?

Dr. MAGILL. One of the members of the Ways and Means Committee, Mr. McClintic, was the author of it.

The CHAIRMAN. I think he spoke to me about it, and he said that it would help them to enforce the law against this illegal business.

Senator CONNALLY. Yes.

Senator REED. It is bad enough to do it with informers of violation of a Federal law, but to help to enforce a State law——

Senator CONNALLY. This is a Federal law, the income tax.

Dr. MAGILL. It depends on a violation of a State law.

The CHAIRMAN. What did the Secretary of the Interior say on that?

Senator CONNALLY. He did not discuss that.

Dr. MAGILL. The way it came up, as I recall it, is this, that Mr. McClintic had a provision that he wanted to put in with respect to an excise tax with respect to the illegally-produced oil. We told him it was unconstitutional, because he wanted to go back to oil produced some time ago. He had various conferences with Secretary Ickes, but I do not think Mr. Ickes is particularly responsible for this.

Senator CONNALLY. I think the Ickes section is all right, but not this.

The CHAIRMAN. Suppose we pass that. Senator Gore is not here, and Mr. McClintic is from his State, and no doubt they have conferred about it, so we won't take action on it in the absence of Senator Gore.

Senator CONNALLY. What are the Ickes proposals?

The CHAIRMAN. Section 514, and it goes down through section 515.

Dr. MAGILL. The Ickes matters start over on page 245.

The CHAIRMAN. What about 514 and 515?

Dr. MAGILL. Section 515 is simply designed to keep the 3-cent postage rate on first-class mail for an additional year, as recommended by the President.

The CHAIRMAN. That is a question of rates. Let us pass that for the present. We have to get into this rate structure after a while. The next is section 601.

Senator LONERGAN. Mr. Chairman, paragraph B, page 233—is this a new provision? Under section 514.

Senator LA FOLLETTE. We have passed that over temporarily.

The CHAIRMAN. We have passed that over until Senator Gore comes in.

Senator LONERGAN. Yes.

The CHAIRMAN. If there is no objection to the tax an certain oils which the Secretary of the Interior appeared before us on, we can approve those [laughter]——

We will pass that coconut oil section. Section 603.

Dr. MAGILL. Section 603 was designed to make some changes in the administrative positions with respect to collecting the excise taxes on lubricating oil and gasoline, and these changes were originally suggested by the Bureau of Internal Revenue. After they were suggested and put in the bill, the petroleum people came down to the Bureau, and urged that these administrative provisions were much too drastic. I can tell you, I think, the general tenor of that, because the Bureau is disposed to recede on this proposition.

If one producer sells to another producer or manufacturer, and he files a so-called "tax-free certificate" so that the first manufacturer or producer does not pay the tax, but it is left to the the subsequent manufacturer or producer; the Bureau said that it had found in many cases that the second manufacturer or producer was a fly-by-night and that actually they were not able to collect the tax from him, so their proposition was to impose the tax on the first man who made the sale, and then let him get a refund in the event that he sold to someone else who was going to resell. As I say, after discussing it, the Bureau has now come to the conclusion that these provisions would be too drastic in that it would be too difficult in the case of oil, in many cases, to trace the oil through and see whether or not the oil which the first man sold was actually resold or used in commerce. What bothers them, as I understand it, is this: That the oil may be sold and maybe itself refined or used in several ways, and that it is practically impossible to trace for the purposes of obtaining a refund, so their present recommendation, as I understand it, is that we go back to the present law, but with some amendments which define what is gasoline, and require a manufacturer or producer who buys tax free to put up a bond conditioned on his paying the taxes which are due.

Senator CONNALLY. This is section 603 you are talking about now?

Dr. MAGILL. Yes.

Senator CONNALLY. That has nothing to do with the hot oil?

Dr. MAGILL. That is not hot oil. It is a matter of administration of the present taxes on gasoline.

The CHAIRMAN. It is the recommendation of the Treasury and a substitute amendment for this, practically agreeing to the present law, with some modifications.

Dr. MAGILL. It is my understanding that the Commissioner of Internal Revenue and Mr. Turney of my office, and several others, have conferred with the American Petroleum Institute on this, and

I think they are in agreement on several new administrative provisions which would amend what is in here.

The CHAIRMAN. All right.

Senator BARKLEY. Before we go on to the next section, I want to go on to section 512, just for a question. That is about the General Counsel for the Treasury. I note by that section that you abolish the office of General Counsel of the Internal Revenue Bureau, and Assistant General Counsel, and that you create a General Counsel for the Treasury, with some 10 assistants, I believe. How many were there?

The CHAIRMAN. Six assistants.

Senator BARKLEY. It has always seemed to me that there was some advantage to the public that the Internal Revenue Bureau itself, by having a man known as the General Counsel of that Bureau, deal with these questions. What is the idea of abolishing it and simply losing its identity, so that some man may be assigned to that Bureau among these assistants? What is the advantage to be gained there?

Dr. MAGILL. The advantage that is sought to be gained is the administrative advantage of having one legal department for the Treasury as a whole. I explained a little earlier each of the various Bureaus of the Treasury now has its own legal staff, and the things are disconnected, and it results in a disproportionate review and waste of time.

Senator CLARK. Isn't the Solicitor of the Treasury Department still in existence?

Dr. MAGILL. That office is one of those that would be abolished by this section.

Senator REED. Why don't you abolish the office of Solicitor for the Bureau of Customs on the same principle?

Senator MCADOO. The Solicitor is an officer of the Department of Justice, assigned to the Treasury.

Dr. MAGILL. That has been the case. I am not sure whether it now is.

Senator MCADOO. He has certain functions to perform. But infinitely more legal questions arise out of these revenue laws than anything else. I do not know whether this change will be beneficial or not, but I am perfectly willing to accept the view of the Department.

Dr. MAGILL. The present General Counsel of the Bureau was just designated recently, and recently confirmed, and this has all been gone over with him and, as I understand it, he is in sympathy with this change.

Senator BARKLEY. I had not any person in mind at all.

Dr. MAGILL. He unquestionably would be one of the assistants general counsel.

Senator BARKLEY. It seems to me the Internal Revenue Bureau, coming in contact with taxpayers all over the country, is a little different from the ordinary bureau in the Treasury. For instance, you have your bank reorganizations now under the Comptroller, and they have their legal staff who are supposed to be trained in matters of bank reorganization, and all of those subjects under the National Banking Law. You have your General Counsel for the Internal Revenue Bureau, with a corps of attorneys who, if they are not ex-

pert when they come in, are supposed to be intelligent enough to become experts.

Now, with the General Counsel of the Treasury, with the power of the Secretary of the Treasury, or the General Counsel to appoint or assign to these different bureaus, assistants to look after it, it takes away from the bureau and its legal staff the identity of being particular attorneys for that bureau, unless some assistant general counsel would be assigned and kept there long enough so he would be identified with that bureau.

Dr. MAGILL. I think undoubtedly it would be administered that way. This provision doubtless would meet the possibility of transferring some individual attorney from the Internal Revenue Bureau to the Procurement Bureau, for instance.

Senator CONNALLY. At present, we confirm this General Counsel of the Internal Revenue Bureau, and under this provision——

The CHAIRMAN (interposing). We have taken action that the general counsel not only shall be confirmed by the Senate, but that the six assistants also should be confirmed, and the President shall name them.

Senator CONNALLY. I understand that, but we might think a man was particularly suited in the Internal Revenue Bureau and not so well equipped for any other Department of the Treasury. Under this section they can switch him around anywhere they want to. I think the Bureau of Internal Revenue should be independent.

Senator MCADOO. You mean this legal staff should be independent of the Secretary of the Treasury.

Senator BARKLEY. I do. Thus far it has been a Bureau with its own separate identity, and I believe it should remain so.

Senator COUZENS. I certainly agree with you. I do not see the use of confirming a man if we do not know that he is particularly qualified. We confirm him to do any kind of a job whether he is fitted for it or not. He does any kind of a job under the Secretary of the Treasury, and just makes the Secretary of the Treasury more autocratic than he ever was before.

Senator CONNALLY. We might think that he was a good man for taxes and confirm him for that, and they might not assign him to tax work at all, but might put him over to customs.

Senator MCADOO. The General Counsel will be named from time to time and confirmed by the Senate. He may be an entirely new man and does not know anything about Treasury practice at all, and then he can shift these assistants around as he sees fit. The experienced man at the head of the Internal Revenue Bureau knows the requirements of that Bureau and the particular ability of the man for the work of that Bureau.

Senator COUZENS. He can fire them all.

Senator MCADOO. If you say the assistants must be confirmed by the Senate, that will enable the Senate to say something about it. Take the Comptroller of the Currency. He has to have a legal staff well qualified to deal with the problems that arise in the Comptroller's office. That has no relation to internal revenue. If he has to proceed finally through the General Counsel of the Treasury, being an assistant, he cannot act independently, and it seems to me that it would involve delays and possibly inconveniences that are unnecessary. I am rather inclined to think it is better to have these

two Bureaus have their own counsel, as they have now. You can have the General Counsel for the Treasury with respect to other matters if you want to.

Dr. MAGILL. One of the reasons for imposing this was to eliminate some of the delays you are speaking of.

On Senator Couzens' point, there are many cases at the present time which the statute requires shall be signed by the Secretary of the Treasury before action is taken. Those come up, of course, through the General Counsel of the Bureau of Internal Revenue, but they necessarily have to be reviewed by somebody on behalf of the Secretary of the Treasury.

Senator MCADOO. The Solicitor of the Treasury does that now, doesn't he?

Dr. MAGILL. No; those do not fall under him.

Senator MCADOO. Whom do they fall under?

Dr. MAGILL. As a matter of fact, in the past few months, I have been reviewing them myself.

Senator MCADOO. As I understand it, he is now special counsel to the Secretary, Mr. Oliphant.

Dr. MAGILL. Yes.

Senator MCADOO. Does he review those matters?

Senator BARKLEY. That is not a statutory office, is it?

Senator MCADOO. No. A personal counsel.

The CHAIRMAN. Unless there is a motion to reconsider the action of the committee——

Senator MCADOO (interposing). I suggest it be passed to enable some of us to look into it a little further.

The CHAIRMAN. There will be another report on the proposition.

Dr. MAGILL. There is an amendment which would need to be made to it in any event, that is the appropriation bill for the Treasury, I believe, has already gone through. There would have to be an appropriation for the office of Solicitor of the Treasury, and there should be a provision here carrying the appropriation over.

The CHAIRMAN. We cannot appropriate.

Dr. MAGILL. This would not be an appropriation. The appropriation has already been made. Simply provide that that money should be available for the General Counsel.

Senator BARKLEY. That would have to be taken care of in the deficiency.

The CHAIRMAN. All right.

Senator MCADOO. You can provide that the office of the Solicitor of the Treasury be merged in the office of the General Counsel.

The CHAIRMAN. That brings us down to section 617, does it not?

Senator CLARK. What is section 513?

The CHAIRMAN. Those were approved with amendments. The number of assistants was cut to 5, instead of 10. The President was to appoint, with the consent of the Senate.

Senator MCADOO. Have you any provision in this bill to prevent the appointment of employees in the Treasury who are not authorized by statute? Or any other department, for that matter?

Senator REED. The President is given authority to appoint such other officers and employees as he may deem necessary to assist the General Counsel in the performance of his duties. No limits.

Senator McADOO. I am speaking of the Assistant Secretaries, for instance, or other officials in the Treasury, which are not statutory offices. We have had several Assistant Secretaries of the Treasury, as I recall, or assistants down there, under Mr. Morgenthau's regime that are not authorized by statute. I do not know how they are paid.

Dr. MAGILL. They are assistants to the Secretary, as distinguished from Assistant Secretaries.

Senator McADOO. They are, in effect, Assistant Secretaries.

Dr. MAGILL. Well, hardly. It depends on the person.

Senator BARKLEY. It all depends on the duties assigned to them.

Senator CLARK. We had one case with which we are all familiar, of a man who was appointed to some office that was not a statutory office at all, and was in effect performing the duties of the Secretary of the Treasury, which is a statutory office, and since he had not required appointment by the President, and confirmation by the Senate, it raised considerable embarrassment.

Senator McADOO. I think the officers should be appointed in the regular way and confirmed.

Senator CLARK. I think so, too.

The CHAIRMAN. If these provisions are carried through, you would not carry on the other practice, would you?

Dr. MAGILL. This bill, I take it, does not affect the power of the Secretary of the Treasury to appoint assistants of various kinds to help him, under the civil-service law, the banking law, or any other laws.

Senator McADOO. Where would he get the money to pay their compensation?

Dr. MAGILL. I do not know. Out of whatever appropriations are appropriated.

Senator REED. We have made our appropriations in lump sums, so widely that it is just a matter of executive apportionment.

Dr. MAGILL. Mr. Bemman and myself are both assistants of one kind or another to the Secretary of the Treasury.

Senator McADOO. I would vote for you with pleasure.

Dr. MAGILL. Thank you. I do not know how my appointment is made. I know it is under civil service in the sense that it goes to the Civil Service Commission. I did not take any examination.

Senator McADOO. You would not need one. Would you look into that practice and see how that is done, so that we can determine whether it is wise to incorporate it in the bill?

Dr. MAGILL. Yes. Some of them I know hold office under the emergency banking legislation.

Senator BARKLEY. There is a position of Under Secretary of the Treasury which is not filled now, and at the same time there may be one or two or more men who are up there in official positions, probably performing the duties of Assistant Secretary of the Treasury, but not so designated.

Dr. MAGILL. The main difference comes in this, that whatever would be done by myself, for instance, would be signed by the Secretary of the Treasury.

Senator REED. Now, let us get to page 242. All of that gasoline tax is to be changed?

Dr. MAGILL. You are agreeable to these amendments, I take it, to the lubricating oil?

The CHAIRMAN. The lubricating-oil proposition was to be a substitute, you say?

Dr. MAGILL. Yes. That gets you over to Secretary Ickes' provisions on page 245 and following.

The CHAIRMAN. Let me ask you about that section 617, the tax on gasoline. Is that part of it?

Dr. MAGILL. Yes; that is all part of it.

The CHAIRMAN. There seemed to be no objection to that. Without objection it will be approved. I understood there was some amendment.

Senator REED. The Treasury authorities and the American Petroleum Institute have gotten together now on a redraft of sections 616 and 617. It seems to me, for the satisfaction of both of them, it ought to be adopted.

Senator MCADOO. A new draft is to be submitted, isn't it?

Dr. MAGILL. Yes; we will have that.

Senator REED. From page 240 through page 244.

Senator MCADOO. That whole thing is going to be considered?

Senator REED. It will be rewritten, and when it is rewritten, it will be submitted.

The CHAIRMAN. Have you finished section 617? It carries out the same idea as the other, doesn't it?

Dr. MAGILL. That is changed in Mr. Ickes' provision.

Senator REED. We are not talking about that. We are talking about the present tax on petroleum. You have some provision here to stop leaks which the industry said was too drastic, so Mr. Turney sat down with the Petroleum Institute representatives, and produced something which you say is satisfactory to the Treasury, and satisfactory to the industry.

Dr. MAGILL. That is my understanding.

Senator REED. When those are ready for submission we can pass upon them.

Dr. MAGILL. You can have them now if you want.

The CHAIRMAN. Is there any need to read all of that?

Senator MCADOO. Tell me exactly what this applies to.

Senator REED. Tell us in substance what you have done.

Senator MCADOO. You begin on what page?

Dr. MAGILL. Starting at the foot of page 239.

Senator MCADOO. Section 603.

Dr. MAGILL. Mr. Turney will present that.

Mr. TURNEY. These provisions in the bill do two important things. They revise the definition of gasoline and, more important, they eliminate the system of taxes on sales between manufacturers of lubricating oil and gasoline now existing, substituting a provision under which each manufacturer in a chain, where it passes through the hands of several, has put the tax on in the sale, and then the duplication of taxation was to be wiped out by credits upon a proper showing that the tax had been paid more than once with respect to the same product.

It has been decided, after conferring with the industry, that we can get all the protection we need against the evasion that is taking place without doing anything as drastic as that, and the proposed

substitute tightens up slightly the changed definition of gasoline, which is in the bill, and that is agreeable to the American Petroleum Institute and the Treasury.

The principal purpose of that is to get at a certain amount of evasion which is now taking place by the manufacturers who sell a naphtha which is entirely suitable for motor fuel. They simply sell it under the name such as "painter's naphtha" or "cleaner's naphtha", and we have no effective way of checking up on that.

The principal change in the definition is to require that the sales of naptha for particular industrial uses shall be made under exemption certificates, as we now do in the case of benzol. The evasion that is taking place by the fly-by-nights buying tax free and then not paying taxes, either by going bankrupt or quitting the district, or something of that sort, is covered by a provision that they shall have to register and give a bond to account properly for all the taxes due from them, and a provision that if the Commissioner finds that any of these people are evading taxes he may take away from that individual the right to buy tax free and leave him to a system of credit to get rid of the additional tax.

In short, instead of taking away everybody's rights to buy tax free, it gives the Treasury the power to do that when they find some evasion going on.

Senator GORE. It relies principally upon this registration bond?

Mr. TURNEY. On the bond and the right to take away from the individual the power to buy tax free, which does not mean that there will be double tax, but means that they will have to get relief by way of a credit on the proper showing.

The CHAIRMAN. Without objection, the substitute will be accepted.

Senator GORE. There was some trouble at first about the cities buying, wasn't there? Have those things been ironed out?

Mr. TURNEY. As far as the municipal purchases are concerned, this restores the existing law without any change.

Senator REED. Now that Senator Gore is here, why don't you go back into that other proposition?

Senator COSTIGAN. What does it cover?

Mr. TURNEY. All of section 603 of the bill.

Senator LA FOLLETTE. Was any action taken on that, now that we have had it read?

The CHAIRMAN. Without objection, the substitute of the Treasury Department will take the place of what is here.

Senator CLARK. Why can we not take up section 514 now that Senator Gore is here.

The CHAIRMAN. Senator Gore, there is a section, 514, respecting penalties and rewards to informers of illegally produced petroleum. We passed that over because you were not here. That is known as the McClintic amendment that was put in in the House. It pays something to informers with reference to these illegal sales, and so forth, but the Treasury does not like it very much.

We thought that perhaps you might be interested in it.

Senator GORE. If you do not mind, I would like to pass it. I am not very strong for informers.

The CHAIRMAN. That is section 514.

Senator GORE. Thank you.

The CHAIRMAN. Section 604, page 245.

Senator MCADOO. We have passed section 603, which is to be rewritten, as I understand?

The CHAIRMAN. We have adopted the substitute for section 603. This has all been presented by Mr. Turney.

Senator MCADOO. I meant to say, section 617.

Dr. MAGILL. That is the old section which has been rewritten.

The CHAIRMAN. Section 604 is one of the Ickes amendments, a tax on production of crude petroleum. You heard his explanation. Aren't there some amendments they desire to put in there?

Dr. MAGILL. Yes. Mr. Turney can give you those.

Mr. TURNEY. The provision in the bill on the production of crude petroleum provides for this tax of one tenth of a cent a barrel to be paid by stamps attached to the run ticket or bill of lading under which the oil is removed from the place of production, and I understand that after the Interior Department got that in the bill, they heard from the producers to the effect that, from the producer's standpoint, that method of collecting the tax is entirely unworkable, and I think from the Treasury standpoint the proposed change is better.

Senator CLARK. This is not a revenue provision at all, is it?

Mr. TURNEY. As I understand it, the purposes given for it were to require the keeping of records which are to be made acceptable to Federal and State officers interested in the production of crude petroleum, and it is designed to produce enough revenue to pay for the administration of the oil code.

Senator CLARK. It has to do with regulation of the oil industry, and not with revenue, and therefore I give notice, Mr. Chairman, that I am going to move to strike it out on the floor. Putting something in a revenue bill which has nothing to do with revenue.

Senator GORE. I would like to say, Mr. Chairman, that my position being neutral in the premises, I never vote for a tax that is not designed to raise revenue. I do not think we should use or abuse the taxing power for collateral purposes. I am not going to make any particular protest. I simply let my opposition go on that.

Senator BARKLEY. This is really designed to raise revenue, but it is allocated to a special purpose.

Senator CLARK. Just enough revenue to administer the section.

Senator GORE. The main point in this is to have access to the books of these companies.

Senator BARKLEY. It is supposed to raise about one and a half million dollars.

Senator GORE. The object is to open the books of these companies, that are running hot oil. That is a good thing in itself, because they are in a bad business.

Senator MCADOO. The Commissioner of Internal Revenue has the right to examine their books.

Senator BARKLEY. Not for this purpose.

The CHAIRMAN. Senator Connally, do you desire to say anything on this?

Senator CONNALLY. Yes; I do. Mr. Chairman, this will hit my State probably harder than it will any other State, and I am frank to admit that part of its purpose is to aid in the enforcement of the law. It will raise revenue, however, and raise considerable revenue.

Senator KING. Which law?

Senator CONNALLY. We enacted a law last year on the N.R.A bill which I offered, called the "hot-oil amendment." In my State, and I think we are the only State that has a law that limits the production of petroleum—all the other States get the benefit of it, because if we just turned our wells loose, they would flood the market, and nobody would get any price for oil. We have a State law shutting these wells down and controlling them, but they evade that law, because these people shipped it in interstate commerce. They would say, you cannot control me, because I am shipping this oil in interstate commerce.

When the N.R.A. bill was up, I offered the hot-oil amendment, providing that the President should have power to prohibit, if need be, the interstate shipment of oil produced in violation of a State law. That is not taking over the States' rights at all. It is really aiding the States in maintaining their sovereignty, because we prohibit the evasion of such laws by shipping in interstate commerce. What happens? In my State, a Federal court in a case denied the Federal authorities the right to go in an oil properties, or the right to look at their books to determine whether the oil was being shipped in interstate commerce or not. They say: "You first have to show that it is interstate."

You cannot do that, because the very purpose of their going in and looking at their refineries, and looking at their oil, perhaps, is to determine whether it is being shipped in interstate commerce or not.

So they have just paralyzed the Federal part of the law. In all fairness to the committee, I want to say that recently the State legislature has passed three bills which will give great aid to the enforcing of this law. One of them is to give the railroad commission power to control the refineries and regulate them, and to enter their premises, and so forth and so on, supervise them, but there is some division in my State over this. Some of the oil companies do not want it. Those that are violating the law do not want it, but the great bulk of the oil people in my State want this law, even though it will tax them something, because it will supplement the State laws and will make it easier for the Secretary of the Interior to prohibit the evasion of the State law limiting production.

That is not for our benefit. That is for the benefit of all of the people. That will help California more than it will help us, because, by shutting down our wells and making that law effective, it helps the price of oil in Pennsylvania and everywhere else. It is not a local matter at all. They want this. The Secretary of the Interior wants this, and the Oil Conservation Petroleum Board wants it, and I am somewhat "on the spot" on it, because there are two groups——

Senator KING (interposing). Will you permit an inquiry? Does not the enforcement of the law, or the law itself, tend to give a monopoly?

Senator CONNALLY. The whole N.R.A. does that.

Senator KING. And to increase the price of gasoline and lubricating oils that we have to buy?

Senator CONNALLY. That might be true; but with oil there is another factor. This is a great natural resource, and we could just open those wells and squirt oil all over the United States in 24 hours

and the price would go to nothing. Talk about the consumer getting the benefit of that? He would not get the benefit of it, because it would never be reflected in the gasoline price, because the big companies would buy it all up and hold it in storage and when the people wanted gasoline they would jack the price up. But we are trying to conserve and feed this oil out over a long period. It is artificial in a way, but oil is something that squirts all out at once and is gone, whereas it ought to be prorated out over a long period.

Senator HASTINGS. What do you say about the objections made by Senator Clark that that is not a revenue measure?

Senator CONNALLY. I frankly admit it had two purposes. I won't deny that part of its purpose is to give the Secretary power to examine the books. On the other hand, it is costing the Government money to administer this oil law. It is coming out of the Treasury now. We are saving a great deal of money in enforcing this particular law, and why shouldn't this industry pay for that? To that extent, why should not the tax be levied? Our State levies a special tax on oil to make it pay its own way.

Senator MCADOO. You are levying a tax of half a cent a gallon on gasoline, a Federal tax, and the Government is getting ample money out of the oil industry to pay for this machinery which it sets up in opposition to the interests of the great numbers of independent producers in the State.

Senator CONNALLY. That is supposed to be for roads. We levy the gasoline tax on the theory that the Federal Government is putting large sums of money in roads.

Senator BUCKLEY. Part of this is to take care of an extraordinary appropriation which we voted for roads, some hundreds of millions.

Senator MCADOO. If we tax every industry that is protected under the tariff laws, for instance——

Senator CONNALLY (interposing). The industry is not going to object to it, so why should anybody else? If we open all of our wells down there, California with all of its sunshine would be washed into the Pacific Ocean.

Senator MCADOO. I would think it is not necessary to impose a tax to examine the books of the companies.

Senator CONNALLY. How can we do it otherwise? The Federal court has held that they cannot go on the premises and cannot investigate their books.

Senator MCADOO. That is a district court decision. That is not controlling it.

Senator CONNALLY. You cannot do anything with the district judge giving them injunctions. I hope you will adopt this. The administration wants it, and I think it is all right.

Senator MCADOO. I want to say a word about this, because I have a very large number of protests here from the small independent producers in my State. Our conditions are very different from Texas, because we have in California an immense amount of what we call town-lot drilling. Towns have been built up, and oil has been discovered under the surface in these little communities and there are more independent producers of crude oil in California than any other State in the Union. They are having a very difficult time, especially under this N.R.A., because under the allowables that are

made now by the oil administrator, the major companies are getting the chief benefit from this operation. I would just like to explain to the committee for one moment how that happens.

Take a settled field like Signal Hill or Santa Fe Springs, which are town-lot areas. That settled production, the wells are producing probably 50 to 200 barrels a day as a maximum. The major companies, for instance, can drill an oil well in Kettleman Hills which will produce 5,000 to 10,000 barrels a day, and the oil is prorated on the potential production of the new wells they bring in.

Every time they bring in the new wells, you get a new proration, and the little fellow is cut down until he can scarcely live as it stands today.

That has not anything to do with this particular bill, except to this extent, that the more tax you put on the oil industry, the more difficult it is for the little fellow to survive.

The moment you put a tax on crude petroleum under this bill, one tenth of 1 cent, it will stay there forever, and will be increased probably to 5 after a time. It is a new source of revenue, and the disposition always is to keep it and then to increase it. We are already paying all over this Nation a burdensome tax upon gasoline, which is really one of the necessaries of life, and if we now start putting a tax on the crude petroleum from which the gasoline is produced, it imposes a very heavy and serious burden upon the entire industry, which is already staggering under what it has now.

I think this tax should not be imposed. I am perfectly willing to have any provision put in this bill that is legal or proper, and perhaps our draftsman could suggest something that would give access to the books of all of these companies, but I do not think it is necessary to put a tax on crude petroleum.

Senator GORE. This tax will probably grow in amount, and be extended to other mining industries.

Senator REED. Why has not the Interstate Commerce Commission authority now to look into those books?

Senator GORE. I think the point is, it is a well. It is purely a State concern, and not concerned in interstate commerce.

Senator BARKLEY. I just want to say a word about this, Mr. Chairman: We do not have as much oil in Kentucky as they have in Texas, Oklahoma, and California, but we do have some oil, and if I had not tried to find some of it, I would have more money now than I have. But I can recall a year or so ago, the high-grade oil in eastern Kentucky which measures up very near to your Pennsylvania oil, was selling at 35 cents a barrel, and it was proportionately low all over the country. All of the oil people in the United States came to Washington, asking that something be done, some sort of proration or regulation be inaugurated in order that the price of oil go up. That has happened. The Federal Government has stepped in and taken advantage of it, and as the result of it, oil has gone up so that the oil that in my State was bringing 35 cents a barrel is now bringing $1.15 and $1.20.

Senator KING. Who has paid for it?

Senator BARKLEY. The people. But the oil people asked the Federal Government to take charge. They have taken charge. They have brought about doubling, and in some cases trebling the price of oil——

Senator McAdoo. It made no difference in California.

Senator Gore. It has not increased the price of gasoline proportionately.

Senator Barkley. No; it did not. Neither did the low price of crude oil decrease the price of gasoline in proportion. You never get the price of crude oil reflected in the prices of gasoline. It seems to me this is a very light tax to make the oil industry contribute a portion of the expense which the Government has gone to in making it possible for it to make money.

Senator Gore. Let me ask a question. Does this discriminate between wells? We ought to except the stripper wells out of this.

Senator Connally. They are producing every barrel they can produce, and the other fellow is shutting his down.

Senator Gore. If you shut it down, you never can open up a stripper well.

Senator Connally. It is only one tenth of a cent a barrel.

Senator Gore. I want to move that wells producing less than 3 barrels a day shall be exempt from this.

Senator McAdoo. I hate to establish the principle.

Senator Reed. It is going to put an intolerable burden on the small farmer producing a barrel a day to make an accounting under this act. It would be a great nuisance.

Senator McAdoo. In California there are thousands of farmers and small-lot owners who are living on these royalties.

Senator Barkley. They are not doing the producing. They are getting the royalties.

Senator McAdoo. Yes; but their royalty depends upon the income. The tax must be deducted from it first.

Senator Gore. Mr. Chairman, I move that wells producing less than 5 barrels a day be exempted.

The Chairman. It is moved to exclude from the operation of this provision wells producing less than 5 barrels a day.

Senator King. I will vote for that and then vote against the whole thing.

Senator McAdoo. I would like to offer an amendment to make it 50 barrels a day.

Senator Gore. That is too high. Ten would be right. I started to say 10.

Senator Reed. Leave it at 5, Senator.

Senator McAdoo. The whole provision ought to come out.

Senator Reed. Leave it at 5.

Senator Gore. All right, 5.

Senator Barkley. Of course, this tax is collected in bulk. It will be paid by the producing companies. There is no inconvenience that is going to come to the farmer who happens to have a well on his place producing 3 barrels. He may have one eighth of a cent reduced from the net result of his royalty, but it is not going to cause him any inconvenience, and he has no books that have to be examined.

Senator Reed. That is not the way it works in Pennsylvania. The farmer runs his own little 1-cylinder gas engine, and pumps his well, and produces from 1 to 3 barrels a day, and sells it to the pipe-line companies.

Senator GORE. Does this apply to the royalty interests as well as the producers?

Senator REED. It applies to the oil.

Senator MCADOO. I do not think it ought to apply to the royalties.

Senator BARKLEY. It applies to the oil.

Senator GORE. I guess we could not enforce it. Royalties might vary, and you could not enforce it at all.

Senator CONNALLY. The royalty man gets what is left.

Senator MCADOO. After the tax is taken off, he gets the royalty. He has to pay it because he sells his oil.

Senator GORE. He has to pay it. There would not be any way to administer that.

Senator REED. Question.

The CHAIRMAN. Do you make that motion, Senator?

Senator CONNALLY. Five barrels.

The CHAIRMAN. All in favor of Senator Gore's motion will show by raising their hands.

(The vote is so taken.)

The CHAIRMAN. Seven. Those opposed raise their hands.

(The vote is so taken.)

The CHAIRMAN. The amendment is adopted.

Senator MCADOO. I move now, Mr. Chairman, that we strike the entire provision out of the bill.

The CHAIRMAN. The Senator from California moves that the entire provision be stricken from the bill. Those in favor will raise their hands.

(The vote is so taken.)

The CHAIRMAN. Five. Those opposed will raise their hands.

(The vote is so taken.)

The CHAIRMAN. The amendment is lost.

Senator CONNALLY. I want to interrogate the expert on this for a moment.

The CHAIRMAN. The provision is adopted with the amendment.

Senator CONNALLY. This section that we have just voted on, the only effect of that is that one tenth of 1 cent per barrel—that is all, isn't it? All this is just a matter of administration?

Mr. TURNEY. That is the section that the Secretary of the Interior appeared on, and asked to have the method of the collection changed, and in cooperation with the Interior Department, I helped him prepare a redraft of that section, which provides for the same tax, but payable by returns instead of the stamps on the run ticket.

Senator CONNALLY. That is what I wanted to know. We have not adopted the amendment.

The CHAIRMAN. That meets with the approval of the Interior Department?

Mr. TURNEY. It has their approval.

The CHAIRMAN. Accordingly the amendment will be changed to carry out that idea.

Senator KING. Is it workable? Is it coincident with the Administration policy, or does it introduce new methods and technique that would make it difficult of enforcement?

Senator MCADOO. The little fellow has to keep books now, and has to be submitted to visitations, and it will cost you more money——

Senator CONNALLY (interposing). I move that the amendment be substituted.

Senator MCADOO. It will be one of the most annoying things you can put on the industry.

The CHAIRMAN. Without objection, then, the amendment as suggested, modifying this amendment that has been agreed to, will be accepted by the committee.

Senator MCADOO. Is that supposed to be final or tentative?

The CHAIRMAN. I had understood that this was pretty much agreed to. Of course, if anyone wants to reconsider, they have that right.

Senator MCADOO. I would like to have it adopted, tentatively.

The CHAIRMAN. If you want to reopen it, at any time, you can do it.

The CHAIRMAN. Now, how about section 605? That is carrying out the other suggestion of the Secretary of the Interior, I understand.

Senator REED. Here is another tax on petroleum.

Senator GORE. There is one tenth of 1 cent.

The CHAIRMAN. Let us let the expert explain this section 605.

Mr. TURNEY. Well, 605 simply imposes another tenth of a cent a barrel on crude petroleum, to be paid by the refiner when he refines it.

Senator GORE. For what purpose? That is the way it goes, now.

Senator MCADOO. Oh, revenue again.

Senator GORE. You have got an awful lot in here now.

Senator KING. You voted for that a moment ago, what are you kicking about?

Senator GORE. I did not vote for it.

Senator KING. Oh, I beg your pardon.

Mr. TURNEY. I might say this amendment to section 604 also includes a change in 605, striking out a paragraph which provides that the refiner can pass the burden of this tax on to anybody with whom he has a contract to sell the product. The Interior Department, after thinking that over, felt that the tax was so slight that it was not worth the trouble that would be involved in showing those facts.

The CHAIRMAN. So you have modified it some?

Mr. TURNEY. Yes.

Senator GORE. Well, what is the point in this tax? I understand what the other one was for.

Mr. TURNEY. Well, as I understand it, the purposes are the same as the first tax, to derive a small amount of revenue and to require the keeping of another set of books at another point as a check on the first set of books.

Senator GORE. Well, I see.

Senator CLARK. Just to raise enough revenue by this tax to administer the provisions of this section?

The CHAIRMAN. It is largely for the enforcement of the act?

Senator CONNALLY. Let me ask you this, Mr. Turney. You tax it one tenth when it comes out of the well?

Mr. TURNEY. That is right.

Senator CONNALLY. Then you tax it another tenth when it is refined?

Mr. TURNEY. Yes.

Senator CONNALLY. It is a double tax?

Mr. TURNEY. Yes.

Senator CONNALLY. But the purpose of it, of course, is to check at the refinery and at the well also?

Mr. TURNEY. That is right.

Senator CONNALLY. And see that they correspond? If you catch a fellow in the middle of the creek, between the two you have got him; is that the idea?

Mr. TURNEY. Their idea is, as I understand it, that if they require these two sets of records, between them, they will be able to find out who is producing this excess oil and cut it out.

Senator REED. May I say a word for the possible benefit of the Senators from the oil States? If you stop to see how this thing is going to work out, you will see there is a great injustice here. Assuming a 40-percent gasoline recovery, you are going to have to use 2½ barrels of crude to make 1 barrel of gasoline.

Senator GORE. And 40 cents is mighty high, Senator.

Senator REED. Yes; but assuming good cracking methods, you are using 2½ barrels. Now, each of those 2½ barrels is subjected to an excise tax of one tenth of a cent on the production, and another tenth of a cent excise tax on the refining.

Senator GORE. That is a half a cent.

Senator REED. So that 2½ barrels carry five tenths of a cent, or a half a cent tax on one barrel of gasoline. Now, if you produce that same gasoline from natural gas, you only pay one fifth of such tax. You have got five times as heavy a tax on gasoline produced in the ordinary way, as you have on gasoline produced from the natural gas, and that is not square. Either one ought to be lowered or the other ought to be increased.

Senator COUZENS. But the natural gas is not a competitor of the oil gas. It is used as a flux with the crude-oil gas.

Senator REED. It is, to a certain extent.

Senator COUZENS. There is hardly any competition at all between the two oils.

Senator REED. It is a competitor with the lighter run from the well. I admit they are both too high-test to use in a motor. I have got no interest in this question one way or the other. It just struck me as being unusual.

Senator CONNALLY. It costs a good deal more to make gasoline out of gas than from oil, doesn't it?

Senator COUZENS. It isn't on the market.

The CHAIRMAN. Without objection, the amendment as modified will be approved.

Senator CLARK. I move to strike out the section on the ground it is a provision in a revenue bill, the design and effect of which will not be to produce revenue. I think that is bad legislation.

The CHAIRMAN. All in favor of that motion will show their hands. Those opposed will show their hands. The motion is lost.

Senator CONNALLY. Mr. Chairman, may I ask the expert, Is there anything in this bill, anywhere, taxing natural gas as such?

Mr. TURNEY. No.

Senator GORE. That comes next.

Senator CLARK. That will be the next tax in the revenue bill.

Senator GORE. They are agitating for a tax of 5 cents a thousand cubic feet.

Senator REED. Mr. Chairman, I am told that the Interior Department is preparing something on this natural-gas gasoline tax.

Senator GORE. Five cents a thousand cubic feet, which is equivalent to $1.30 on coal per ton.

Senator REED. No; he isn't preparing that, but he is preparing something to meet this point I have just raised about that inequality.

Senator CONNALLY. We can consider that when he gets it ready. You mean this amendment to this section?

Senator REED. Yes.

The CHAIRMAN. Now, section 606. I would like for that to be passed for the present, "Termination of Bank Check Tax."

Dr. MAGILL. That is all.

The CHAIRMAN. Is that all?

Senator MCADOO. What page is that on?

The CHAIRMAN. Page 252.

Now, gentlemen, we will go back to the first page and begin again, but before we do that, I see no reason why we should keep the reporter any longer.

(Whereupon the reporter retired and the balance of the session was not reported.)