Would stopping the turbines and generators in all of the hydro-electric plants in the United States make business worse? Certainly it would. The 20 million horsepower dammed up in hundreds of miles of rivers and lakes—and the three billions of invested capital—would become useless if the wheels were not permitted to go round and round.

What happens to business when prohibitive taxes on funds locked up in personal holding and investment companies (15% tax paid by the corporation plus 70% or more, in many cases, paid by the stockholders) stop capital transactions and freeze present investments? Almost twice as much capital is tied up in personal holding and investment companies as is invested in all of the hydro-electric plants in the United States.

Why not remove the bars and padlocks of prohibitive taxes from all corporations and let the wheels of active capital go round and round?

REVENUE ACT OF 1938

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

SEVENTY-FIFTH CONGRESS

THIRD SESSION

ON

H. R. 9682

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

REVISED

MARCH 17, 18, 19, 21, and 22, 1938

Printed for the use of the Committee on Finance

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REVENUE ACT OF 1938

THURSDAY, MARCH 17, 1938

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

The committee met, pursuant to call, at 2 p. m. in the District of Columbia Committee room, Capitol, Senator Pat Harrison (chairman) presiding.

The CHAIRMAN. May I say to all of the witnesses who are in the room that the time limitation placed on their testimony may appear to be harsh, but the committee has available to it the hearings held before the House Ways and Means Committee. We want to expedite this bill just as much as we can, and we will ask all the witnesses to be just as brief as possible. We have requested that briefs be submitted, so that they may be placed in the record, and when these questions come up in the committee, in executive session, we can then take the various suggestions up for discussion.

All right, General Fletcher.

STATEMENT OF R. V. FLETCHER, WASHINGTON, D. C., REPRESENTING THE ASSOCIATION OF AMERICAN RAILROADS

Mr. FLETCHER. My name is R. V. Fletcher. I am a lawyer and live in Washington, and represent the Association of American Railroads. That association comprises practically all of the class 1 railroads of the United States.

I was given the privilege, Mr. Chairman, of appearing before the House committee, and my testimony is found in the published proceedings of the Ways and Means Committee of the House. I would like to show in the record just where that is, if I may. Page 219 of the House hearings, a statement by myself, and page 345 of the hearings, a statement by Mr. Trottman, who is a representative of the Chicago & North Western Railroad and who spoke particularly for railroads in bankruptcy, and Mr. Samuel O. Dunn, the editor of the Railway Age. His testimony appears on page 342.

I am mindful of the statement of the chairman as to filing briefs. There was put into those hearings a statement which we had prepared in the form of a memorandum, and with the permission of the chair I would like to file that here, without reading it, as containing the substantial arguments which the railroads are making in favor of being exempted from the provisions of the surtax on undistributed profits.

The CHAIRMAN. Very well.

(The memorandum referred to is as follows:)

MEMORANDUM IN SUPPORT OF THE PROPOSITION THAT RAILROADS SHOULD NOT BE SUBJECTED TO THE SURTAX ON UNDISTRIBUTED EARNINGS

INTRODUCTORY

The Under Secretary of the Treasury has kindly consented to receive and review a memorandum submitted by the Class One railroads of the United States in support of the proposition that railroads should not be subjected to those provisions of the Revenue Act of 1936 which impose a surtax upon undistributed income. The memorandum is the work of a special committee of railroad lawyers and accountants. It is understood that the officers of the Treasury are engaged in making a careful and critical survey of the tax laws, with a view to making a recommendation to the President and to Congress providing for their possible revision. In connection with this work of the Treasury experts, this memorandum is submitted, in the hope that, in any general revision of the revenue law, railroads will be exempted from the surtax on undistributed income, just as are now banks, insurance companies, corporations in bankruptcy, foreign corporations, and others mentioned in Section 14, subsection (d) of the present Revenue Act.

In this memorandum we are not submitting the draft of any particular bills which would accomplish the end advocated. We shall content ourselves with endeavoring to demonstrate the injustice of the law as it stands now. There are a number of bills pending in Congress, the purpose of which is, in the case of corporations, to allow credits for amounts expended in debt reduction and in additions to the property. The railroads appreciate the fact that ultimately the recommendations of the Treasury will be based upon their accurate and expert examination of the need of the Government for revenue and the effect of any tax levy upon business.

This memorandum deals only with the situation of the railroads. While certain of the arguments may have general application, yet they are submitted in the light of the work which the railroads are called upon to do and their characteristic peculiarities.

THE ESSENTIAL NATURE AND IMPORTANCE OF THE RAILROAD INDUSTRY

The railroad industry is essentially a business affected with the public interest. Railroads are quasi-public institutions. Almost all of their activities are subject to regulation. They are not permitted to expand their business by the construction of new lines, except after having been so authorized by the Interstate Commerce Commission and, in many cases, by State regulating commissions. They are not permitted to issue capital stock or sell bonds or other obligations except by public authority. It is especially important to remember that the rates of railroads are controlled. They are not free, in the case of increased expenses, to advance their charges to the public until they have applied for and secured authority from the Interstate Commerce Commission and from State regulating bodies. Their lines cannot be abandoned, except a certificate is obtained from the regulating authorities permitting this to be done. Their accounting methods are all regulated by the Interstate Commerce Commission and this fact becomes important in considering certain aspects of the problem. They are thus differentiated from ordinary corporations by reason of the intensity of the regulation which is applied to them.

It is admitted on every hand that the prosperity of the railroads is inextrically interwoven with the prosperity of the country. This industry contributes more than any other directly to the prosperity of all industry. In 1936, which still felt the effects of the depression, the Class One railroads of the United States spent $272,270,000 for fuel, $76,683,000 for forest products, $273,753,000 for iron and steel products, $180,715,000 for miscellaneous items, making a total of $803,421,000 spent for materials and supplies. In the same year, they spent $1,848,035,804 for labor and paid $319,752,721 for taxes. These amounts may seem large, but it should be remembered that in 1929 $2,896,-566,000 was expended for labor and $1,329,535,000 for fuel, materials, and supplies. It is easy to visualize the loss to the general business of the country by reason of the reduction in the employing and purchasing power of the railroads. In addition to the value of the railroads as purchasers of material and employers of labor, the economic aspects of the railroad industry from the viewpoint of the investor in railroad securities cannot be ignored.

RAILROADS ARE NOT WITHIN THE PURPOSE OF THE SURTAX

The surtax on undistributed profits was proposed by the President of the United States. The President's message, dated March 3, 1936, to Congress said:

"The accumulation of surplus in corporations controlled by taxpayers with large incomes is encouraged by the present freedom of undistributed corporate income from surtaxes. Since stockholders are the beneficial owners of both distributed and undistributed corporate income, the aim, as a matter of fundamental equity, should be to seek equality of tax burden on all corporate income whether distributed or withheld from the beneficial owners. As the law now stands our corporate taxes dip too deeply into the shares of corporate earnings going to stockholders who need the disbursement of dividends, while the shares of stockholders who can afford to leave earnings undistributed escape current surtaxes altogether.

* * * * * * *

"A proper tax on corporate income (including dividends from other corporations), which is not distributed as earned, would correct the serious twofold inequality in our taxes on business profits if accompanied by a repeal of the present corporate income tax, the capital-stock tax, the related excess-profits tax, and the present exemption of dividends from the normal tax on individual incomes. The rate on undistributed corporate income should be graduated and so fixed as to yield approximately the same revenue as would be yielded if corporate profits were distributed and taxed in the hands of stockholders."

Legislation in accordance with the President's recommendations was initiated by House Bill 12395 of the 74th Congress. Due to radical differences of opinion between the Senate and the House, a compromise bill was enacted, which did not adopt all of the President's recommendations. This compromise bill retained a flat tax, called the "normal tax," of 15 per cent on corporate net income in excess of $40,000 (with graduated rates on less amounts), retained the capital stock tax at a reduced rate, retained the excess profits tax, and added to these taxes the recommended graduated surtax on undistributed profits. The law, as enacted, followed the President's recommendation in subjecting all dividend income of individual taxpayers to full tax liability.

The report of the House Committee on Ways and Means (Report No. 2475 of the 74th Congress) at page 3 stated the purposes of the changes made by the House bill in the method of taxing corporate income as follows:

"The major purposes of the change in the method of taxing corporate incomes are (1) to prevent avoidance of surtax by individuals through the accumulation of incomes by corporations, (2) to remove serious inequities and inequalities between corporate, partnership, and individual forms of business organization, and (3) to remove the inequity as between large and small shareholders resulting from the present flat corporate rates."

The tax law, as enacted, abandoned the purposes numbered 2 and 3 in the above quotation from the House Committee report, so the only purpose of the President, or of the House bill for that matter, enacted into law was that of preventing the accumulation of surplus by corporations, by means of higher rates of taxation on their undistributed net income, and thus encouraging, if not forcing, the distribution of net income to the fullest practicable extent to the end that it might be subjected to the surtax liability of the individual stockholders.

The railroads were not, at the time of the President's message, and had not been within the whole history of the income tax law, "controlled by taxpayers with large incomes," who used the railroad corporations as a means of avoiding surtaxes by accumulating corporate profits. Whatever may be said of industrial corporations, it is not believed that our statement with respect to control can be challenged.

It may be said that the general statement does not apply to certain so-called short lines, some 1,042 in number. While certain short lines may be owned by a comparatively few stockholders, yet with rare exceptions, these companies are not sufficiently prosperous to have income beyond their barest necessities. In cases where these short lines are subsidiaries of industrial corporations, we assert that they have not been used as instrumentalities for accumulating undistributed income. Any income over and above the limit of bare necessity would be needed in the treasuries of the parent companies. It seems to us clear that these short lines are not within the scope of the purpose of the

President or of Congress in enacting the surtax. With reference to subsidiary companies owned and controlled by trunk lines, under the present law, their return is consolidated with that of the parent company and what we shall say on this subject, therefore, applies to them.

Generally speaking, each of the Class One railroads has many thousands of stockholders. In a comparatively few cases, there may be holding companies functioning as large stockholders but even in these exceptional cases, there is no history of the accumulation of net income beyond the needs of the railroads. Certainly there is no account of net income being withheld from distribution, either for the benefit of the controlling stockholder or for the benefit of the thousands of minority stockholders. There could be no such history, obviously, where the stock of one railroad company is owned by another, because, prior to the enactment of the Revenue Act of 1936, dividend income of corporations was not subject to income tax. The statement is true with respect to individual stockholders, because the largest individual stock holdings, in the case of Class One railroads, are an insignificant fraction of the very large amount of capital stock which each of these railroad corporations has outstanding.

We have examined, as illustrative, the common stock holdings of one of the most prosperous Class One railroads. The analysis was made as of April 20, 1935. Its largest stockholder was a Dutch syndicate, with headquarters at Amsterdam, serving as an agency for investment in American companies by residents of European countries. Our understanding is that these investments were in small lots. This Dutch syndicate owned only 2.33 per cent of the outstanding capital stock of this particular railroad. No other common stock holdings of this company approached in amount the holdings of this foreign syndicate. The larger holdings were generally in the names of stock exchange houses or the nominees of banks, indicating, presumably, holdings in behalf of a number of clients in each case.

The common stock holdings of this company, other than its so-called Brokers Ledgers, were distributed among 36,800 accounts holding 100 shares or less and 1,742 accounts holding from 101 to 499 shares, together aggregating 1,199,348 shares. Five hundred and seven accounts of less than 500 shares in the Brokers Ledgers aggregated 61,696 shares. The holdings of 500 shares or over were distributed among 167 accounts in its Brokers Ledgers and 380 other accounts, a total of 547 accounts with holdings aggregating 961,866 common shares. The last mentioned class of holdings in the highest bracket included 20 holdings of colleges, schools, hospitals, and similar institutions, 13 holdings by life insurance companies and savings banks, 119 holdings by banks, trust companies, security companies, investment trusts, fire insurance companies, casualty companies, etc., 50 holdings by trustees and 178 holdings of individuals.

We think the facts disclosed by this analysis are typical and it is interesting to note, in this connection that the Statistics of the Railways in the United States, published by the Interstate Commerce Commission, reports, as of December 31, 1935, that the average holding of railroad stock is $9,501.

For 1935, the year prior to the President's message, all Class One railroads together aggregated a net income, after fixed charges and other deductions, of only $7,539,000 and for each of the three preceding years, 1934, 1933, and 1932, the Class One railroads, in the aggregate, showed a deficit. In 1935, 47 per cent of the Class One railroads operated at a loss. Even at the close of the year 1936, 33 Class One railroads, having a mileage of 67,800 miles, were in receivership or in bankruptcy. The railroad industry is far from prosperous and it is struggling to meet the competition of new methods of transportation. At the time of the President's message and now, the problem of the country is how to save the railroad industry, not how to devise a new tax measure which will appropriate a larger share of railroad income.

We are confident that an analysis of the 1936 income tax returns will not disclose that individual taxpayers in the surtax bracket have realized any increased dividend income as a result of the surtax, or that the Treasury, in any other respect, has been benefited by the application of this tax to the railroads.

Because of the widespread distribution and the small holdings of the stock of railroad corporations, the operation and result of the revised tax legislation of 1936 was the very opposite of that which the President contemplated, so far as railroad stockholders are concerned. The President said:

"As the law now stands our corporate taxes dip too deeply into the shares of corporate earnings going to stockholders who need the disbursement of dividends * * *."

By retaining the normal tax on corporations, which the President recommended be repealed, and subjecting dividend income of individuals to normal taxes, the small individual taxpayers have had imposed upon them an increased exaction. Any additional tax, either on the corporation's income or on the stockholder's dividend income, resulting from the surtax law, imposes on them a still further burden. This, to be sure, is true as to small stockholders of all classes of corporations, but it falls with especial force on the small stockholders of railroad corporations, because of their general meager realization of any dividend income at all.

RAILROADS SHOULD BE EXEMPTED ON GROUNDS ANALOGOUS TO THOSE ON WHICH BANKS AND INSURANCE COMPANIES ARE EXEMPTED

In the report of the House Committee on Ways and Means, Report No. 2475—74 Congress, 2d Session, page 9, it is said:

"Banks and trust companies are not brought within the new plan, but pay a flat rate of tax of 15 per cent on their net income and domestic corporations in receivership are treated in the same manner. This seems to be a wise public policy, since the surplus of banks must be built up for the protection of the depositors and because receiverships in the vast majority of cases cannot, of course, pay dividends. For similar reasons there is a flat tax of 15 per cent on the net income of all insurance companies whether domestic or foreign."

Honorable Fred M. Vinson of Kentucky, a member of the Committee on Ways and Means, in discussing the bill on the floor of the House (Vol. 80, Part 6, page 6215 of the Congressional Record) said:

"Under section 104, a rate of 15 per cent of the amount of net income of banks is imposed. A bank is defined as a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits and the making of loans and discounts.

"The argument has been used that because we make a flat rate for such corporations, that it is an admission that surplus should be permitted to be built up without restrictions. However, banks and trust companies occupy a peculiar situation in our economic structure. They are under supervision of either the State or Federal Government. They are required by law and by regulations to maintain certain reserves and because of such restrictions they are unable to pay out dividends and consequently they would be injured if they were subjected to the maximum rate.

"Again if they were to pay out in dividends their earnings and profits, it might be only the next day thereafter the bank inspector, either State or Federal, would require them to strengthen their financial structure in assessments upon the stockholders involved.

"There is another angle to it—the deposits in most of the banks of the country are insured, and it is thought necessary not only for the benefit of the depositors and stockholders, but for the Government as well, that the reserves provided for by law and regulations be securely and strictly maintained."

One of the exempted classes is domestic corporations in bankruptcy or receivership. This exemption will take care of a large proportion of the railroad industry at the present time. However, unless exemption is extended to all railroad corporations, this surtax will tend to prevent many railroad corporations now in bankruptcy or receivership emerging therefrom, a feature which will be later somewhat elaborated.

It appears that the exemption of banks and insurance companies was granted as a "wise public policy," in order that they might build up a surplus for the protection of depositors and policy holders. The same wise public policy should dictate the exemption of railroad corporations, in order that they may build up a surplus for the protection of their security holders. State laws recognize railroad bonds, within appropriate restrictions, as lawful investments of trust funds and they are very large and important class of investments of saving banks and insurance companies. We know of no estimate of the aggregate amount of railroad bonds held as investments in private trusts created by wills and otherwise, but the amount is very large.

According to Poor's Manual, the Metropolitan Life Insurance Company, at the close of the year 1936 held 695 million dollars of railroad bonds, however valued, and this holding was the largest of any class of investments of that insurance company except 733 million dollars of United States Government

bonds and one billion dollars of real estate loans—the foregoing out of a total of 4,626 million dollars of gross assets.

Obviously, there is a very important public policy involved in promoting the soundness of railroad bonds as investments, an objective which is of much greater importance than the securing of such small increase in the Government's revenue as may be obtained as the result of subjecting the railroads to the surtax on undistributed profits. If the railroads can retain any surplus over fixed charges and dividends as insurance of the payment of fixed charges for future years only at a prohibitive tax cost, the investment standing of their bonds will be impaired and, to an extent which cannot be adequately measured, destroyed. Only those railroads which have a sufficient margin of net income to pay substantial dividends will be able to show any margin of earning capacity which the investor can consider as affording assurance of the continued payment of fixed charges.

If it were possible for railroads with net income to avoid the surtax by distributing as dividends their entire net income in excess of fixed and other charges, such action would immediately destroy the investment standing of their bonds. It would probably result in the elimination of their bonds from the lists of legal investments for trust funds under the laws of many of the States. Should their obligations be removed from the legal list, railroads would be barred from an important source of low cost money for refunding maturing obligations and obtaining new capital. Inevitably, this would lead to increases in fixed charges, which could be met only by the public paying increased rates for their transportation.

But it is not possible, for reasons which will be advanced later, for railroads to distribute their entire net income, and any income which cannot be distributed because of the need for plant improvements and reserves necessary to maintain a solvent status is, under the act, "retained" and, therefore, subjected to the graduated surtax, ranging from 7 percent to 27 per cent, and this is superimposed upon their normal tax of 15 per cent, their capital stock tax and their excess profits tax.

Banks and insurance companies, which, as a matter of wise public policy, are exempt from the surtax, have no such standing as public servants as have the railroads. This fact differentiates the railroads from all other corporations and puts them, so to speak, in a class by themselves. President Roosevelt, in his pre-election speech delivered on September 17, 1932, at Salt Lake City, said:

"The railroad, that was first a miracle, next a sinister threat, has now become a part of our national economic life. We are now concerned about their preservation. The problem of the railroads is the problem of each and every one of us. No single economic activity enters into the life of every individual as much as do these great carriers."

We cannot regard it as other than an oversight that the investment standing of railroad securities was jeopardized in the enactment of the 1936 tax law by subjecting railroads to the surtax on undistributed profits.

THE NEED FOR DEBT REDUCTION

Section 14 of the Revenue Act of 1936 provides in paragraph (a) (1) for the ascertainment of "adjusted net income" by the deduction from net income of the normal tax on corporations and interest on certain obligations of the United States and Government corporations. No other adjustments are permitted, so far as railroads are concerned. Paragraph (a) (2) provides that the "undistributed net income" to be subjected to the surtax is the adjusted net income, minus the dividends paid and minus the credits provided in Section 25 (c). This section defines as credits, in its sub-paragraph (1), any amounts of income which cannot be distributed as dividends within the year without violating a contract made prior to May 1, 1936, and in its sub-paragraph (2), any amounts of income required by a contract made prior to May 1, 1936, to be paid or set aside within the year for the discharge of a debt.

The relief afforded by Section 26 (c) is negligible, because such contracts have not, in the past, been made to any considerable extent. As a matter of fact, the few existing contracts requiring payments in reduction of debt do not, in all cases, afford relief from the surtax for the amount of such payments, because of the harsh terms of the Act and regulations applying it.

Probably there is no industry about which there has been so much comment with respect to capital obligations and fixed charges as the railroad industry. In the Salt Lake City speech of the President, heretofore referred to, Mr. Roosevelt said:

"Concretely, I advocate:

"First—That the Government announce its intention to stand back of the railroads for a specified period; its help being definitely conditioned upon acceptance by the railroads of such requirements as may in individual cases be found necessary to readjust top-heavy financial structures through appropriate scaling down of fixed charges."

In the same speech, at another place, it is said:

"The railroad mesh is the warp on which our economic web is largely fashioned. It has made a continent into a nation. It has saved us from splitting, like Europe, into small, clashing units. It made possible the rise of the West. It is our service of supply. These are not matters of private concern; they have no place in the excesses of speculation, nor can they be allowed to become springboards of financial ambition. Such readjustments as must be made should be so made that they will not have to be done again; and the system must become, as it should be, secure, serviceable, national."

The Interstate Commerce Commission has adopted and is enforcing a firm policy of requiring sinking fund provisions in all new railroad bond issues which it approves, which will, over the life of the issue, retire a substantial part of the debt. In its 47th Annual Report, dated December 31, 1933, the Commission, mentioning the practice long indulged by railroads to refund maturing bond indebtedness, referred to the consequent gradual increase in the aggregate of funded debt and concluded as follows:

"We are giving consideration to methods of bringing about a reversal of the present trend in railway financing. We believe that the desired results can be obtained, in part at least, through the provision of sinking funds to be set up by the railway companies out of net income for the purpose of retiring a part of their funded debt before maturity. If such funds are not voluntarily established by the railway companies, their establishment may be required as a condition to our authorization of further bond issues under the provisions of Section 20a of the Interstate Commerce Act."

In accordance with the policy thus declared, as to the soundness of which no opinion is expressed in this memorandum, the Commission has been and is now requiring, as a regular practice, provision for sinking funds in mortgages and trust indentures covering new issues of funded debt, other than equipment trust issues which mature in yearly installments. *Lehigh & New England Railroad Co. Bonds*, 207 I. C. C. 106. *Wheeling & Lake Erie Railway Co. Bonds*, 207 I. C. C. 479. *Louisville & Nashville Railway Co. Bonds*, 212 I. C. C. 415. *Virginian Railway Co. Securities*, 212 I. C. C. 433. *New York Central Railroad Co. Securities*, 212 I. C. C. 495.

In its latest annual report, dated November 1, 1936, the Commission again discussed this matter and, after referring to its comments on this subject in its report for 1933, said:

"In all cases where we have been called upon to approve the actual issue of bonds we have insisted that the applicant make provision for the retirement of all or a part of the bonds before maturity and have required that sinking funds be provided unless good and sufficient reasons appeared for not doing so."

Following the enactment in 1936 of this undistributed profits surtax, the Interstate Commerce Commission had several occasions to become acquainted with the new tax and to consider its application. In its annual report of November 1, 1936, it said, regarding this tax:

"Recently our attention has been called to certain provisions of the Revenue Act of 1936, namely, those imposing a surtax on undistributed profits, and to the effect that these provisions will have upon sinking funds and additions and betterments funds to be set up out of income. For illustration, it has been represented to us that a sinking-fund payment of $35,000 a year required in connection with the issue of certain bonds of the Chicago Union Station Co. authorized by our order of August 26, 1936, in Finance Docket No. 11302, will necessitate the payment of a tax of approximately 21 per cent on the amount reserved, which would be avoided if the company distributed as a dividend the amount required to be reserved; and that to provide a sinking fund of $1,000,000 a year, as contemplated in the plan of the Chicago & North Western

Railway Co. would, if there were no 'dividends received' credit or other allowable deductions, require a net income of approximately $1,478,470, of which about $257,860 would be required for surtax, which would be avoided if the sinking fund were not required and the net income remaining after the payment of normal taxes, in this case about $220,610, were distributed as a dividend.

"The Revenue Act exempts from the surtax amounts paid out or reserved for retiring funded debt, or withheld from stockholders under written contracts of a certain kind executed prior to May 1, 1936. The exemptions do not apply in such cases if the contract was entered into subsequent to April 30, 1936. This means that the amounts used or irrevocably set aside under contracts entered into after the date last mentioned will be subject to the surtax and that companies that do not so use their income or set up such funds but distribute all their net income will not be subject to the tax. This also means that those companies which have weak financial structures and should use their income to improve their property, retire funded debt, and build up a liquid surplus against a day of future trouble will, if they undertake to do so, be subject to a penalty, whereas railroad companies with strong financial structures, and able to finance their requirements through the issue of stock, may distribute all their net income and thus escape the surtax.

"It is our view that railroads with weak financial structures, and those just emerging from receivership or reorganization proceedings under Section 77 of the Bankruptcy Act, should be encouraged to use their earnings, to the extent authorized or approved by us, to build up and improve their property, retire their funded debt, and create corporate surpluses in amounts sufficient to meet their emergency needs, support their borrowing powers, and afford insurance against obsolescence. We suggest that the situation of the steam railroads under the Revenue Act of 1936 should have the further consideration of the Congress."

This statement by the Interstate Commerce Commission, having had fifty years of experience in dealing with railroad problems and informed by that experience to a greater degree than any other agency of the Government, cannot be strengthened by any language which we could employ. Certainly Congress should give heed to the recommendation of so expertly informed a body, enjoying as it does the unlimited confidence of the country.

A special word may very well be said as to short time loans. What we have said heretofore applies particularly to reduction of funded debt. At the present time, the railroads have outstanding short term loans obtained from the Reconstruction Finance Corporation and other Government agencies, in an amount aggregating more than $350,000,000. Except to the extent that the terms of such loans entitle railroad borrowers to credits under Section 26 (c), the ability of the railroads to repay the loans will be seriously impaired by their subjection to this surtax. It is nothing short of absurd that a railroad with indebtedness outstanding to Government agencies should be subjected to surtax liability, ranging from 7 per cent to 27 per cent on the funds which it withholds from dividend distribution and pays to its Government creditor. Elaboration of this point would seem to be unnecessary.

EXPENDITURES FOR ADDITIONS AND BETTERMENTS

During the current depression period, the railroads have been obliged to reduce to an absolute minimum expenditures for additions and betterments. The Interstate Commerce Commission, in the *Fifteen Per Cent Case, 1931*, 178 I. C. C. 539, said, at page 583:

"The railroads, as cities expand and public highways multiply in number and use, have been and are being called upon to invest great amounts of capital in alterations of their properties which are often, from a strictly railroad point of view, very largely nonproductive."

The operating revenues of Class One railroads in 1929 amounted to $6,279,000,000. In 1933, this figure fell to a low of $3,095,400,000. It recovered in 1935 only to the extent of $3,452,000,000. In 1936, the figure amounted to $4,052,734,000. Such shrinkage of revenues was necessarily reflected in the reduction of expenditures for maintenance of way and structures and for maintenance of equipment. The result is perhaps most marked in respect of equipment. At the end of 1929, the railroads owned 57,571 locomotives and at the end of 1935, 46,594. At the end of 1929, they owned 2,277,000 freight cars and at the close of 1935, 1,835,000. Heavy retirements of equipment have resulted in

net decreases, in the depression years, of the aggregate of investment in road and equipment. For example, in 1935, while the gross charges to property investment amounted to $188,302,000, there was a net decrease of the aggregate property investment accounts of $87,954,000 at the close of the year, as compared with the close of the year 1934, and the net reduction of investment in equipment for that year was $121,564,000. The figures just given show (by subtracting the $87,954,000 from the $121,564,000) that the Class One railroads invested an aggregate of $33,610,000, net, in roadway and structures. The figure last given is interesting in that it may fairly be regarded as representing substantially net additions and betterments which were compulsory. The railroads are at all times obliged, to a great extent, to make additions and betterments. The compulsion is of two sorts, viz.: First, compulsion by public authorities, as, for example, separation of grades, removal of tracks from city streets and building of new stations. The three railroads serving Los Angeles are now engaged in the construction of a new union passenger terminal in that city, which will cost about $9,000,000, the construction of which was forced on these railroads by public authority after protracted litigation. In another instance, a single railroad was required by public authority to construct a new station at Houston, Texas, at a cost of approximately $2,600,000. These are by no means the only cases that might be cited. They are typical of demands made upon the railroads by public authorities for improvements to gratify civic pride.

Again, the railroads are compelled by sheer necessity to make many replacements which cannot safely be longer postponed. While the replacement may involve a large charge to operating expenses, through the process of writing out the cost of the property replaced, the cost of the new structure charged to property investment accounts, whether because of increased material and labor prices or because of a better structure, may exceed the cost of the original structure written out and thus result in a net increase in property investment.

There are also the so-called "maintenance betterments," which result in substantial charges to capital accounts. For example, when confronted by the necessity of relaying the rail in a section of track, the railroad may feel that changed operating conditions require heavier rail, and in that case the cost of the excess or additional weight of the new rail is charged to property investment accounts and constitutes a net increase thereof.

From 1922 to 1930, inclusive, the net income of all the Class One railroads amounted to $5,873,000,000. During the same period the net additions and betterments (after deducting the net increase in the depreciation reserves) amounted to $4,537,000,000. The constant increase in the property investment accounts in normal times is due to the fact that the aggregate railroad plant of the country is necessarily constantly growing, in recent years not in new mileage but in the improvement of the plant.

During the period from 1922 to 1930, inclusive, the increase in funded debt was $1,071,000,000. There was therefore an aggregate of $3,466,000,000 required during the period for the net additions and betterments from other sources than the sale of bonds. Part of this amount was raised by the sale of stock, but a large amount of the net income was used for the net increase in the aggregate property investment.

It is important in this connection to bear in mind that the railroad industry is now in an era of change, conspicuously in respect of equipment. New types of locomotives are required and are being developed. Light-weight, streamlined passenger trains and light-weight freight cars are in their infancy. The air conditioning of passenger cars is already recognized as a necessity. There is no reason, therefore, to believe that future expenditures for property investment will be less than those of the past; the contrary would seem to be the sounder prediction.

The foregoing facts demonstrate the unfairness and the unwisdom of subjecting railroad net income to the undistributed profits surtax. It is imperative for the railroads to withhold from dividend distribution a substantial proportion of their net income for investment in additions and betterments. The additions and betterments cannot be avoided.

It should be pointed out that if the railroads are permitted to set aside a reasonable amount of their earnings for improvements, the sums so expended will be of tremendous advantage in the field of private industry. The money will be spent for new materials, thereby adding to the employment of labor and to wholesome activity in the mines, in the factories, in the forests, and everywhere

where are produced the innumerable items which are included in the classification of materials and supplies purchased by the railroads.

There would have been a far less serious depression and far less need for extensive programs of relief if the purchasing power of the railroads could have been maintained throughout the period of the depression. This is not an extravagant statement when it is remembered that the operating expenses of the railroads in 1929 amounted, in round figures, to $4,500,000,000, and that if this figure had been maintained through the depression years the railroads would have poured into the channels of trade and commerce more than $10,000,000,000 in excess of what they expended for operating expenses alone.

Congress has indicated by its exemption of banks and insurance companies from the operation of the undistributed profits surtax the necessity of maintaining, without unduly burdensome taxation, these very important adjuncts to credit. We submit that the same considerations apply in the case of the railroads, public agencies essential to the welfare of the country, with their tremendous spending power. The Administration is on record as wisely interested in the welfare of the railroads and in their restoration to a condition of normal health. Certainly nothing can contribute more effectively to the restoration of prosperity than for the railroads to be allowed to expand their purchasing power, in the way of additions and betterments to their property, so that they may meet more adequately the needs of commerce and particularly the needs which have come about through recent developments in the field of competition as a result of the demand of the public for increased speed and for facilities which are adapted to modern conditions.

Our appeal, therefore, is for such a modification of the tax law as will permit the railroads to go forward with an expanding program, without having it checked, if not entirely destroyed, by a tax upon all sums which are expended for improvements to the property.

In this connection we desire to refer to the importance of permitting railroads to retain any surplus earnings for a certain year to offset inevitable losses which may occur in other years. The law should deal with actualities. A company which has been operating at a loss for a number of years and then in one particular year earns a net income insufficient to repair the losses should not be regarded as having an undistributed net income. There is no reason why the astronomical phenomenon which we call a year should have a controlling influence upon financial management. It is true, of course, that taxation is a periodic affair; we must have tax periods. But there is no magic in connection with any particular period which would require its being adhered to for all purposes of taxation.

For the information of those who are examining this question, we should like to append, as Exhibit A to this memorandum, a table dealing with Class One railroads and showing for the years 1923 to 1935, inclusive, their fixed charges, their net income or deficit after fixed charges, their cash dividends, and their gross expenditures for additions and betterments. We call attention to the fact that for this series of years $7,775,783,000 was spent for additions and betterments, which is almost twice as much as was expended in cash dividends.

THE INADEQUACY OF PRESENT REMEDIES

As we have previously stated in a somewhat different connection, under Section 26 (c) (1), credits are allowed equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends, without violating a provision of a written contract executed by the corporation prior to May 1, 1936, provided this provision expressly deals with the payment of dividends. We have referred briefly to the fact that this credit is far from being productive of beneficial results. On principle there would seem to be no reason why the relief should be limited to contracts made prior to May 1, 1936. The date was inserted, of course, in order to prevent corporations from making contracts the sole purpose of which is to avoid taxation.

However, in the case of the railroad industry, it should be remembered that every issue of railroad securities made after May 1, 1936, or before that date, if made subsequent to February 28, 1920, is necessarily made with the approval of the Interstate Commerce Commission. The Commission has the right, in authorizing the issue of securities, to impose terms and conditions. Therefore every contract providing for a sinking fund and every contract having any bearing upon the question we are considering must have the approval of the Interstate

Commerce Commission. Sinking funds created prior to May 1, 1930, should not, therefore, be in any different category from those created subsequent to that date.

Since Congress has declared the principle that certain sinking funds may be deducted, there is no reason why this principle should not be given universal application in any case where the quantum of the sinking fund has been approved or has been acquiesced in by the governmental body which Congress itself has endowed with jurisdiction in such matters.

There should be eliminated the requirement that the contract itself should provide that the sinking fund must be paid out of earnings of the particular taxable year in which the deduction is claimed. A railroad may have two loans, both providing for sinking funds, one which happens to contain the exact provision required, and the other may happen not to contain such a provision. There would seem to be no basis for different treatment of the two sinking funds.

It may be said, however, that railroads may secure the desired relief by adopting the suggestion contained in Section 27 (e), which provides for credits in case of a stock dividend or stock right, which is a taxable dividend in the hands of shareholders under Section 115 (f). We submit, however, that it is not in the public interest that expenditures for additions and betterments should all be capitalized. In view of the present policy of the Interstate Commerce Commission in favor of the reduction of funded debt, it would not be likely to sanction the adoption of a fiscal policy by the railroads of issuing additional stock for the cost of additions and betterments.

In *Stock of Delaware, Lackawanna & Western R. R. Co.*, 67 I. C. C. 426, the Commission's approval was sought for the capitalization by a stock dividend of the entire surplus of the applicant, computed by it as $90,000,000. The Commission approved a stock dividend for only one-half of that amount. It said at page 433:

"To render the proposed issuance 'compatible with the public interest,' within the meaning of the statute, we are convinced that a substantial surplus should remain uncapitalized as a support for the applicant's credit, providing for emergency needs, offsetting obsolescence and necessary investments in non-revenue producing property, and serving as a general financial balance wheel."

It must be remembered that railroads cannot issue securities at any time they see fit to do so. They must obtain permission from the Interstate Commerce Commission. This requires time and, furthermore, places under the control of the Interstate Commerce Commission the question of whether it is altogether desirable to have capital structures created of the type which must result from the issuance of taxable stock in order that the railroads may retain cash for improvement purposes.

There is another consideration. The continued imposition of the tax may result in the market being flooded with stocks of doubtful value. The railroads may conceivably distribute stock in lieu of a cash dividend, but as time goes on, the constant issue of securities in order to protect the cash position of the railroads will bring about so large a stock issue as to render them of doubtful value, resulting in the impairment of railroad credit. This will result in topheavy capital structures, unless, as is probable, the tendency is checked by the orders of regulating commissions, which cannot be expected always to ratify the issuance of stock for the sole purpose of avoiding tax payments. Eventually a chaotic condition will be created.

In the decision in the case entitled *The Greyhound Corporation—Issuance of Preference Stock*, rendered on December 28, 1936, the Commission said:

"Apart from the Revenue Act of 1936, it would be difficult to justify the issuance of preferred stock as a dividend, and it does not appear that applicant would seek such authority."

It must be remembered that amounts distributed to the common stockholders in the form of stock dividends are taxable in the hands of the stockholders, just as if cash had been paid to them. It might well come about that the common stockholders would have to borrow money to pay the income tax upon preference shares, represented by cash retained in the treasury of the issuing company, which cash is retained for the purpose of improving the property. The stockholder might very well be called upon to sacrifice his dividends in the interest of extending and improving the property. However, to impose upon him, in addition to the deprivation of a cash dividend, the burden of paying an income tax upon preferred stock would represent a hardship which the common stockholder, under ordinary circumstances, would be slow to approve.

SPECIAL SITUATION OF RAILROAD COMPANIES UNDERGOING REORGANIZATION

Attention should be called to the situation which confronts 27 per cent of the railroad mileage of the country, which is now in the hands of the courts, either in the form of receiverships or bankruptcies under Section 77 of the Bankruptcy Act. It is true that railroads and other corporations, while they are actually in the hands of the bankruptcy courts, are, under Section 14 (d) of the Revenue Act of 1936, exempt from the undistributed profits surtax. We are considering, however, the situation of railroads which are struggling to emerge from bankruptcy and to resume normal operations on a reorganized basis. It was the avowed purpose of Congress, in enacting Section 77, to facilitate the reorganization of railroads where it was found impossible for them to continue as solvent concerns with their burden of fixed charges. The plans which have been set up by trustees in bankruptcy and receivers of railroads for a reorganized and rehabilitated capital structure will be, in many cases, defeated if these railroads are subject to the undistributed profits surtax.

At the hearings which were had before the Senate Committee on Finance in 1936, the chief operating officer of the Chicago and North Western Railway, now in bankruptcy under Section 77, pointed out very clearly how this tax would operate to prevent the reorganization of his company and its emergence from the status of a bankrupt. It was there pointed out that the North Western was endeavoring to create a sinking fund to secure payment of interest on the bonds which it expected to issue under the new plan and to pay off obligations amounting to $42,000,000 due to the Reconstruction Finance Corporation. The plan contemplated that when the railroad emerged from bankruptcy, the cash reserves of the company should be built up so as to make reasonably certain the payment of interest on such first mortgage bonds as the court and the Interstate Commerce Commission might authorize. These reserves would, of course, be taxable under the present law, so that it would be impossible to go forward with this or any similar plan unless the law is modified to meet the needs of this class of railroads. Mr. Sargent stated (p. 467, Senate hearings):

"If we are to come out of bankruptcy proceedings under any reorganization plan that will enable us to reestablish our credit and meet those items of expense chargeable to capital account for ordinary maintenance of the property and undertake to stabilize employment and have a reasonable working cash fund, we will be most seriously handicapped for a number of years to come if we are compelled to pay 42½ percent of our net by way of taxes. As I see it this percentage will be a disastrous blow to those railroads that have not been able to weather the storm but could build themselves back into a sound and stable position with the return of reasonably prosperous times.

"It occurs to me that the committee in charge of the bill probably intended the 15 percent provision to help companies in receivership, but it only helps them so long as they stay in receivership. The minute they attempt to come out or do come out under any plan of reorganization they are immediately met with an almost impossible situation, since they would be unable to pay dividends until they have reestablished surplus cash reserves and working capital, and while trying to do so would have to pay 42½ percent of their net earnings in taxes."

This statement by an officer of a road in bankruptcy is typical of roads in that class.

In the case of another railroad, to wit: the Chicago and Eastern Illinois, which is now undergoing reorganization, a careful examination of the railroad's financial structure indicates that as of January 1, 1937, the principal amount of the company's fixed interest bearing debt was $42,940,353. This sum included $30,709,036 of general mortgage 5 per cent bonds, which were a junior lien on the property.

In order to meet the requirements of subsection (b) of Section 77 of the Bankruptcy Act that the plan must provide fixed charges in an amount that will be covered by probable prospective earnings, it was necessary in the light of the past earnings experience of the company, to replace the general mortgage bonds with securities, the return upon which would be contingent upon earnings. The debtor's amended plan of reorganization, which has the approval of the major parties in interest, provides for fixed charges, including rent of leased roads, in the amount of approximately $660,000. The general mortgage bonds are replaced with non-cumulative contingent income bonds, on which the annual interest requirement is approximately $768,000, non-

cumulative contingent preferred stock, on which the annual dividend requirement is approximately $768,000, and common stock.

In order to meet the requirements of subsection (d) of Section 77 that the plan must be compatible with the public interest, it was absolutely necessary, in the judgment of the major parties in interest, to create reserves out of earnings, for the purpose of financing future additions and betterments and providing for debt retirement. The reserve for additions and betterments is an amount equal to 2 per cent of railway operating revenue and is expected to amount to from $300,000 to $400,000 annually, on an average. The reserve for sinking fund is $150,000 annually. These reserves are appropriated only to the extent earnings are available after fixed charges.

It was also necessary, in order to meet the requirements of Section 77, that these reserves be appropriated out of earnings before payment of interest on the income bonds. The surtax will, of course, penalize the company for setting up the reserves for additions and betterments. The tax is imposed because that part of the earnings is set aside as a reserve, rather than being distributed in dividends.

Another curious fact is that until earnings are sufficient to pay dividends on the preferred stock, the highest rate of tax specified in the statute applies. The effect, therefore, of the Act is to impose the highest rate of tax upon railroad companies least able to bear it. If a railroad company has sufficient earnings to pay liberal dividends, the surtax on undistributed income disappears, or at least grows less. However, during its struggling period, when it is endeavoring to get up on its feet, when there is the greatest need for reserves to meet its expanding requirements, the tax so penalizes it as to make it impossible for it to discharge its duty as a useful public servant. This situation may be in accord with certain purposes sought to be accomplished by this special tax, but it makes it impossible for a railroad company to embark upon an orderly rehabilitation policy.

In the case of the New York, New Haven and Hartford Railroad Company, the principal features of its proposed reorganization plan, in so far as they are affected by this tax, are provisions that the Board of Directors may expend up to $1,000,000 in each year for capital improvements before the amount is determined on which the sinking fund requirements for the fixed interest bonds are computed. Payment into the sinking fund of 10 per cent of the balance after such capital expenditures is required before payment of contingent interest on the income bonds or dividends on stock.

It was necessary, of course, for those proposing reorganization to estimate the earnings available for fixed charges. They have, therefore, constructed a so-called prospective year. In this prospective year, allowance has been made for the present undistributed earnings tax, and it has been assumed that $130,000 would have to be paid to the Government on account of maximum capital expenditures of $1,000,000, to which he have referred, and the sinking fund payments. This sum, therefore, measures the estimated effect of the present tax upon the reorganized corporation under the proposed plan. We submit that it is not sound public policy, in the case of this bankrupt railroad, to require it to pay this $130,000, in order that it may set aside $1,000,000 a year for capital improvements. This is a penalty which should not be borne by a railroad honestly endeavoring to meet its public obligations.

In the case of the Rock Island, another railroad undergoing reorganization, the maximum reserve for additions and betterments under its plan is $2,500,000. This amount is stated, however, only as a part of the formula for ascertaining the amount available for interest on the proposed income bonds. The actual expenditures will undoubtedly be greater. All of these addition and betterment expenditures would be taxable, except those which are made directly from the proceeds of borrowed money. Many of these expenditures are in reality operating expenses. They are taxable, however, under the peculiarities which are found in the Interstate Commerce Commission's classification of accounts. These expenditures must be made in order to keep the property abreast of developments in the railroad world, such as the purchase of streamlined trains, the laying of heavier rails, additional ballast, and the like.

This railroad, as others, must go forward; it cannot stand still. While this observation is true of all railroads, it is peculiarly applicable to railroads emerging from bankruptcy. Many of them have fallen behind in their maintenance programs and the amounts of deferred maintenance must be made up.

In the Rock Island case, there is a provision for a sinking fund, which would

be 10 percent of the balance of income remaining after certain interest payments have been made. No one can say, of course, just how much this will amount to, but if the law is not amended, there will be a heavy tax on this sinking fund, which will be a direct blow at conservative financial principles. Furthermore, its effect will be to impair seriously the credit of the new company, even before the plan becomes effective. Junior securities, the value of which depends upon future earnings, will be injuriously affected in a very special sense.

These observations, applicable to railroads now undergoing reorganization, may be summarized by saying that the tax has a tendency to cripple seriously all such corporations as they emerge from bankruptcies or receiverships. Usually they have barely enough capital to provide for immediate needs, with no safe margin for such expansion as a new company should normally expect through future operations. They are barred, except at heavy cost, from using future net income in the upbuilding of the business until such a time as they are on such a sound financial basis as to permit distribution of earnings in dividends.

RESTRICTION UPON THE GROWTH OF CORPORATIONS

It has been said also that it is wise public policy to limit the growth of corporations through the medium of a surtax upon undistributed profits. It is thought that wise public policy demands the protection of small corporations from the overwhelming power and authority of the their larger competitors. It was considered that great corporations may become greater and more powerful through the accumulation of huge surpluses built up out of profits.

Obviously banks and insurance companies cannot contribute to this threat and, by the same token, neither can the railroads. A railroad cannot invade the territory of its competitor except upon a showing to the Interstate Commerce Commission of convenience and necessity. Its expansion is completely controlled. Nothing can be done, as we have heretofore observed, with reserves or surpluses, except to improve the plant and pay its debts, both of which are wholesome ends, clearly in the public interest.

It is often argued that this tax operates as a brake upon overexpansion, especially in the capital goods industries, during periods of business acceleration. It is said that as a result of this acceleration the market becomes glutted and that with the disappearance of shortages the durable goods industries slacken, men are laid off, general purchasing power is reduced, and a downward cycle sets in. It has been said that if all earnings are distributed this expansion would not be possible, with the consequent evil effects which have been mentioned. It is clear, however, that railroads do not fall in this category. They cannot expand except with the consent of the Interstate Commerce Commission. No brake upon undue expansion is necessary except the supervising authority of the Commission.

CONCLUSION

In conclusion we may mention a situation or two which are illustrative of the hardship imposed by this tax. In the case of the Great Northern an examination of its financial structure and its earnings record shows that if this law had been in effect in recent years and if, as a result, the entire net income had been paid out to stockholders in the form of dividends, the effect would have been to make it necessary in the lean years for the railroad to borrow large sums to meet interest requirements and pay unavoidable amounts for additions and betterments. In the year 1936 there would have been an increase of 31.4 per cent in the interest requirements made necessary by the distribution of the entire income as dividends. Furthermore, the capital structure would obviously have been greatly distorted if this law had been in effect over a long period of years. It is sufficient for our purposes to point out that the long term debt of the company would have been increased about $100,000,000 more than it stands at present, with a consequent reduction in surplus from $152,000,000 to $52,000,000. This is an illustration of just what practical harm will follow from continuing this tax over a period of years and making it applicable to railroads. Another illustration may be thus stated: As illustrative of the inequities of the surplus tax on railroads, consider for a moment the position with respect to separate corporate entities organized to operate large terminals in the interest of efficiency and better service. These terminals have outstanding mortgages

securing bonds containing a tax-free covenant clause. The users of the terminal agree to pay to it the costs of operation, all taxes and other charges, interest on the outstanding obligations, and a nominal return on the stock, all of the latter of which is customarily owned by the users.

In a particular case of record, the terminal was obliged to assume, by reason of the tax-free covenant bonds, a charge of $14,000. This sum was paid into the terminal company's treasury by the users and by it paid over to the Treasury of the United States. Nevertheless, in the statement of income for tax purposes, the terminal was not permitted to deduct from its rental receipts this assumed tax. It, therefore, had in theory, but not in fact, an undistributed net income of some $14,000 upon which it was obligated to pay a surtax of some $2,000. Of course, it did not have the $2,000 and had to go back to the railroads, its owners, to get this sum.

We think we have demonstrated here that this tax is one from which the railroads should be relieved. We are not undertaking to suggest the exact form which this relief should take. We think railroads should be exempted, just as are banks and insurance companies. If this is not practicable, we feel sure that they should be allowed further additional liberal credits for amounts expended in debt reduction and in additions and betterments.

We call attention to what was said by the Interstate Commerce Commission in the *Greyhound case*, decided December 28, 1936:

"Apart from the Revenue Act of 1936, it would be difficult to justify the issuance of preferred stock as a dividend, and it does not appear that applicant would seek such authority. Its prior policy of financing additions and betterments largely out of earnings would, moreover, taking all the circumstances into consideration, be consistent with the views which we have heretofore expressed, as in the above-quoted statement from *Stock of Delaware, Lackawanna & Western R. R.*, 67 I. C. C. 426, in regard to the desirability of a substantial uncapitalized surplus 'providing for emergency needs, offsetting obsolescence and necessary investments in nonrevenue-producing property, and serving as a general financial balancewheel.' However, the Revenue Act makes it impossible to continue this prior policy, except at a severe penalty, and was apparently designed to impel the distribution of a larger proportion of current earnings to stockholders.

"The question, therefore, is the practical one of determining the course which is 'compatible with the public interest' in these circumstances. The choice is between a course which imposes a severe financial penalty and one which carries with it certain other disadvantages. After careful consideration, our conclusion is that these other disadvantages are of lesser consequence, in the public interest, and that the proposed issue of preference stock should be approved."

We think that the following quotation from Poor's Manual, 1936, page 110, is justified:

"Equally embarrassing to rail finances, is the Revenue Act of 1936, imposing a 27 per cent tax upon undistributed earnings. For the stronger roads it will penalize their refunding as sinking fund bonds probably must be used and the tax must be paid on the sinking fund monies. As for the weaker roads, many of them stand in dire need of rehabilitation. Were this to be accomplished through the appropriation of surplus earnings, the latter would be severly penalized. For example, the Chicago & North Western estimates that to obtain a $6,500,000 fund for betterments it must set aside $11,000,000 from earnings."

Respectfully submitted.

ASSOCIATION OF AMERICAN RAILROADS,
By HENRY WOLF BIKLÉ,
SAMUEL H. CADY,
HENRY W. CLARK,
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WM. H. SWIGGART,
R. V. FLETCHER,
Special Committee.

JULY 15, 1937.

EXHIBIT A.—*Railways of class 1*

[000 omitted]

Year	Fixed charges	Net income or deficit after fixed charges	Cash dividends	Gross expenditures for additions and betterments
1923	$667, 616	$554, 995	$290, 127	$1, 059, 149
1924	684, 559	558, 466	320, 429	874, 744
1925	588, 387	700, 831	342, 020	748, 191
1926	701, 965	809, 054	399, 243	885, 086
1927	700, 284	672, 900	411, 581	771, 552
1928	706, 052	786, 824	430, 677	676, 665
1929	714, 638	896, 807	490, 125	853, 721
1930	703, 864	523, 908	497, 024	872, 608
1931	696, 463	134, 762	330, 150	361, 912
1932	690, 050	[1] 139, 201	92, 354	167, 194
1933	691, 169	[1] 5, 863	95, 725	103, 947
1934	682, 805	[1] 16, 887	133, 418	212, 712
1935	680, 004	7, 539	126, 282	188, 302
Total	9, 013, 856	5, 484, 132	3, 965, 155	7, 775, 783

[1] Deficit.

With one brief exception, that is the only subject that I have in mind to mention. That tax has proven to be a very serious matter, particularly in the effort which the railroads, that are now in bankruptcy, have been making to emerge from bankruptcy. I think the committee was favored with the views of Mr. Sargent of the North Western at a previous session of Congress on that subject, and that statement is available to the committee.

The CHAIRMAN. That was at the time that first draft on undistributed profits was drafted.

Mr. FLETCHER. That is right, Mr. Chairman. There is just one thing I would like to say. The House has left out of this bill a provision that we found to be of some help, and that was, in substance, this, that if there was a contract entered into in good faith prior to May 1, 1936, under which it was made impossible to distribute profits in the form of dividends, the amounts which they were not permitted to distribute in the form of dividends under these valid and bona fide contracts should be taken as a credit in computing the amount which would be the basis of the tax. That has been left out of this House bill. I think if the committee is going to retain that provision dealing with the tax on undistributed profits that section should be restored to the bill, because its omission puts the taxpayer in a position where he cannot help himself.

The CHAIRMAN. If there was a flat corporation tax it would eliminate a good deal of your argument and objections to the penalty tax?

Mr. FLETCHER. On the penalty tax itself, which now amounts, as I understand it, to substantially 4 percent, the position of the railroads is that they are in a position where they are hurt by that tax much more so than any other kind of industry, because they are burdened with debt. It is the public policy, as announced by the President of the United States, by the Interstate Commerce Commission, and by the Congress, insofar as Congress has dealt with it, that the railroads, instead of distributing their rofits, when they make any profits, in the form of dividends, should apply them to the retire-

ment of their debt. These railroads are quasi-public institutions performing a public service. Now a special tax upon undistributed income makes that virtually impossible. On the one hand you are told you must spend all of your profit to retire your debt and on the other hand you are told if you do do it you will be taxed by this special tax.

The CHAIRMAN. Your organization favors a flat corporation tax?

Mr. FLETCHER. Rather than this special tax on undistributed income.

There is one more thing I want to say and then I have finished. I call your attention to the fact that railroads in bankruptcy would like to see an amendment to this law which would permit, in connection with the capital-stock tax, a declaration of the value of the capital stock more frequently than is provided in the bill as it passed the House. You Senators understand perfectly all about this capital-stock tax.

The CHAIRMAN. How frequently would you suggest?

Mr. FLETCHER. I think it ought to be provided that any railroad coming out of bankruptcy should be permitted to make a declaration of the value of its capital stock when it starts on its new capital basis.

The CHAIRMAN. And then make a new declaration every 3 years?

Mr. FLETCHER. Then make a new declaration certainly as often as 3 years. May I file a little memorandum with the committee bearing on that thing? It will save me the trouble of taking up the time talking about it.

The CHAIRMAN. Yes.

(The memorandum referred to is as follows:)

MEMORANDUM COVERING PROPOSED AMENDMENTS OF SECTION 105 OF THE REVENUE ACT OF 1935

In order that corporations reorganized under the provisions of the act of July 1, 1898, entitled "An act to establish a uniform system of bankruptcy throughout the United States," as amended, shall be given the right to make a new declaration of value on their capital stock for Federal tax purposes, the following amendments of section 105 of the Revenue Act of 1935 are proposed.

(a) Subsection (f) of section 105 of the Revenue Act of 1935, as amended, shall be amended by striking out "which declaration of value cannot be amended," and inserting in lieu thereof "which declaration of value cannot be amended except as provided in subsection (l) hereof," and

(b) There shall be added to section 105 of the Revenue Act of 1935, as amended, a new subsection as follows:

"(l) Notwithstanding the provisions of subsection (f), any corporation adjudged bankrupt or entitled to relief under the act of July 1, 1898, entitled 'An act to establish a uniform system of bankruptcy throughout the United States,' as amended, shall, upon the termination of the proceedings and entry of final decree, have the right to declare the value of its capital stock, which said declared value, as reflected in its first return thereafter filed, constitutes the original declared value of such corporation. For any subsequent year ending June 30, the adjusted declared value of such corporation shall be such original declared value adjusted as provided in subsection (f).'"

Mr. FLETCHER. Pardon me, Mr. Chairman. May I put into the record what the Interstate Commerce Commission has said about this undistributed-income tax as applied to railroads?

The CHAIRMAN. Well, if you have it there, we will have it inserted in your remarks.

Mr. FLETCHER. This is the report of the Interstate Commerce Commission, the Fiftieth Annual Report. This report is to the Seventy-

fourth Congress. In discussing sinking funds and other reserve funds, they had this to say:

Recently our attention has been called to certain provisions of the Revenue Act of 1936, namely, those imposing a surtax on undistributed profits, and to the effect that these provisions will have upon sinking funds and additions-and-betterments funds to be set up out of income. For illustration, it has been represented to us that a sinking-fund payment of $35,000 a year required in connection with the issue of certain bonds of the Chicago Union Station Co. authorized by our order of August 26, 1936, in Finance Docket No. 11302, will necessitate the payment of a tax of approximately 21 percent on the amount reserved, which would be avoided if the company distributed as a dividend the amount required to be reserved; and that to provide a sinking fund of $1,000,000 a year, as contemplated in the plan of the Chicago & North Western Railway Co. would, if there were no "dividends received" credit or other allowable deductions, require a net income of approximately $1,478,470, of which about $257,860 would be required for surtax, which would be avoided if the sinking fund were not required and the net income remaining after payment of normal taxes, in this case about $220,610, were distributed as a dividend.

The Revenue Act exempts from the surtax amounts paid out or reserved for retiring funded debt, or withheld from stockholders, under written contracts of a certain kind executed prior to May 1, 1936. The exemptions do not apply in such cases if the contract was entered into subsequent to April 30, 1936.

This means that the amounts used or irrevocably set aside under contracts entered into after the date last mentioned will be subject to the surtax and that companies that do not so use their income or set up such funds but distribute all their net income will not be subject to the tax. This also means that those companies which have weak financial structures and should use their income to improve their property, retire funded debt, and build up a liquid surplus against a day of future trouble will, if they undertake to do so, be subject to a penalty, whereas railroad companies with strong financial structures, and able to finance their requirements through the issue of stock, may distribute all their income and thus escape the surtax.

It is our view that railroads with weak financial structures, and those just emerging from receivership or reorganization proceedings under section 77 of the Bankruptcy Act, should be encouraged to use their earnings, to the extent authorized or approved by us, to build up and improve their property, retire their funded debts, and create corporate surpluses in amounts sufficient to meet their emergency needs, support their borrowing powers, and afford insurance against obsolescence. We suggest that the situation of the steam railroads under the Revenue Act of 1936 should have the further consideration of the Congress.

The CHAIRMAN. Thank you, very much.

Mr. Henry H. Heimann, representing the National Association of Credit Men.

STATEMENT OF HENRY H. HEIMANN, NEW YORK CITY, REPRESENTING THE NATIONAL ASSOCIATION OF CREDIT MEN

The CHAIRMAN. Have you a brief to file?

Mr. HEIMANN. Yes, Mr. Chairman, I would like very much to file it, if I may, and then I will use part of it as a memorandum and skim over it rather hurriedly.

First of all I may say I represent an organization that has approximately 20,000 individual members. Most of these concerns are the smaller business concerns, but we have a rather large representation of the larger size organizations.

Next let me say that we have no particular interest in the bill other than the general interest of credit. That is, we are representing no particular industry. Our interest is in a tax bill that will be for the general welfare.

First, let me say this, to give you some idea of the size of our organization. Our gross turn-over, on a nonprofit basis, is about $40,000,000 a year.

I want to begin by saying that we feel very much encouraged by the action of the House. We feel that the bill represents a distinct improvement, and we are very grateful for that.

We were quite concerned over the so-called penalty tax, but now that that has been eliminated I will not discuss that any further.

The CHAIRMAN. Do you approve of the action of the House.

Mr. HEIMANN. I certainly do, in every respect.

Senator TOWNSEND. Do you approve of the bill as written by the House?

Mr. HEIMANN. I approve the House action with respect to the penalty tax, but I do not approve it with respect to the retention of the undistributed-profits tax. We think that the present undistributed-profits tax will not constitute the menace, the penalty that it has in the past, but nevertheless we still believe the principle of the tax is dangerous, and there is no assurance at any time that the law may not be changed with respect to rates so that the same danger that was inherent in the 1936 bill will again become included in the bill.

The CHAIRMAN. You think that is an improvement over the present law?

Mr. HEIMANN. We think it is an improvement, but we prefer that the revenue that is lost out of the repeal of the undistributed-profits tax, which we advocate, be secured through direct taxes.

The CHAIRMAN. Are you suggesting in your brief any particular flat rate?

Mr. HEIMANN. No; we think that the flat rate is a matter for your determination, having in mind the revenue that will be lost from the outright repeal of the tax.

The CHAIRMAN. Your organization favors a flat rate?

Mr. HEIMANN. We favor a flat rate. We also favor the flat rate expressly on the capital-gains tax. We believe that is advisable from the standpoint of providing more revenue and, from the standpoint of actually promoting trade and commerce. We believe that the capital-gains-tax rates are such as to restrict commerce and trade.

Senator TOWNSEND. Have you in mind the rate that you would suggest?

Mr. HEIMANN. I would suggest a maximum rate of approximately 15 percent. I am quite convinced that that type of rate would bring in more revenue for the Government. I do not contend it would bring in as large a proportion of the Government revenue as did the old act, for the simple reason that the capital-gains tax may have capital gains to work upon, because we are not in so prosperous a period of time. I am convinced that a 15-percent flat rate would yield much more revenue than the proposed capital-gains provision.

The CHAIRMAN. Is it the view of your organization that it would free some of their frozen credit?

Mr. HEIMANN. That is exactly the view of the organization.

Senator HERRING. Fifteen percent for the first year?

Mr. HEIMANN. We believe in maintaining the flat rate throughout the years, 15 percent.

The CHAIRMAN. Would you start that at 1 year, 2 years, or what?

Mr. HEIMANN. We would start that at the end of the first year.

The CHAIRMAN. You think that ordinary investment during the first year ought to be paid from the incomes?

Mr. HEIMANN. That is right, and then on the second year the 15-percent rate.

The third thing I want to call your attention to particularly, and one which refers to a matter in which we are highly interested, is that which refers to section 13, I think it is, which deals with taxes on corporations in bankruptcy or receivership. There is an inequity in that situation that I particularly want to call your attention to. We have many concerns that are in an insolvent condition, but by reason of the creditors' cooperation they are maintained in business it being our policy at all times to preserve a business organization where we possibly can. Those organizations that are maintained through the cooperation of creditors are, nevertheless, penalized by the undistributed-profits tax.

Let me illustrate: Suppose you have a concern that has liabilities of $100,000 distributed among 10 creditors, and the total assets are $70,000; it is insolvent. Now, if it goes into bankruptcy, or receivership it is free of the undistributed-profits tax, but if those 10 creditors would get together and through a cooperative arrangement agree to maintain that organization and free it of its indebtedness and help carry it through the struggling period of that corporation, nevertheless, on account of any earnings that might arise during that period of time it would be subject to the tax. We think that is wrong in principle, and we think the law should be so amended as to make possible the continuation in business of that type of organization, where the creditors are willing to underwrite the load. That refers to section 13.

With respect again to the undistributed-profits tax, we hold no brief for the tax evader. We believe that the tax evader should suffer a penalty and should be made to pay the tax, and we believe there are men here ingenious enough to write the type of section 102 which would catch the tax evader.

The CHAIRMAN. Have you any suggestion?

Mr. HEIMANN. Merely that it be placed in the hands of those most skilled to draw that type of legislation.

The CHAIRMAN. We have been with the experts for quite a while and have not been able to agree on anything. I thought probably you would like to make a suggestion.

Mr. HEIMANN. It is hardly within my province, Mr. Chairman.

The CHAIRMAN. It is a very difficult proposition.

Mr. HEIMANN. Yes; it is. There is one other fact that I want to call to your attention, which explains the reason why we are so interested in this tax. That is the fact that the average credit executive, and the concern he represents, are always faced with a double taxation barrel. Not only does the corporation pay its own tax, but every time it has an account that goes into liquidation it finds a tax against that account constituting a preference, with the result that its assets in that liquidated account are eaten up by taxation measures. Therefore, we are very much interested in having a tax bill which will be most equitable and for the good of the general welfare.

You might be interested in knowing that in recent years, while it may not bear particularly on the tax bill, many credit representatives

have been concerned about the expenditures of the Government. There has been put in process a considerable study with respect to the possible limitation of congressional expenditures by constitutional amendment, somewhat as the expenditures are limited in school districts upon a certain basis of assessed valuations. To illustrate, the basis is that one might determine the income of the Nation through forcing everyone to file a return. Whatever that income might be, there might be a ratable maximum limit which could be appropriated by the Congress, having that maximum limitation arrived at through a constitutional limitation, and providing a reasonable surplus to meet emergency periods.

It has been suggested, for instance, that if the national income was about $75,000,000,000 and you have an 8-percent limit, you have a $6,000,000,000 appropriation. In normal times you might reserve from that, we will say, 10 percent, which is $600,000,000, until you have accumulated approximately six or seven billions of dollars, and that accumulation would be useable for emergency purposes. I am merely giving that to you as a suggestion to indicate the type of thought that is in the mind of the credit executive, who is very anxious to see not only that the tax bill provide sufficient revenue, but that there be some method or program toward the amortization of the debt that is now outstanding.

Finally, let me say with respect to the bill that credit executives feel that the individual surtaxes are not as productive as they might be, and that they restrict and somewhat hamper trade. They want the base of the present tax program broadened, broadened to a considerable extent.

A great many people think that we should have a law requiring every man with an income of over $500 to file a tax return, not necessarily pay a tax, but possibly pay a filing fee of 50 cents. They think that the tax should be broadened so as to bring tax-consciousness to every citizen.

The CHAIRMAN. Are you in favor of the publicity provision requiring officers or employees that get over $15,000 salary to have it published?

Mr. HEIMANN. I personally am not. That is a matter that was not put up to the membership of my association. I would be very much opposed to it but I am not expressing that opposition in behalf of the membership.

The CHAIRMAN. Thank you very much.

Mr. HEIMANN. I would like to submit my brief here.

The CHAIRMAN. Very well.

(The brief referred to is as follows:)

BRIEF OF HENRY H. HEIMANN, EXECUTIVE MANAGER, NATIONAL ASSOCIATION OF CREDIT MEN

I appear in behalf of the membership of the National Association of Credit Men, a nonprofit organization comprising approximately 20,000 manufacturing and wholesaling concerns located in every State of the Union, Hawaii, and the Philippines.

The national association has been in existence for 42 years. A substantial part of its membership is composed of smaller business units, though the coverage is rather complete and is, therefore, representative of both big and small business. Its member representative in each of the concerns is the credit executive, treasurer, or financial executive of the company.

The interest of our members in taxation legislation is a broad interest. Credit is the common denominator of all business. Our recommendations, in their entirety, are based upon our desire to help develop a sound taxation policy for business in the interests of the general welfare. We represent no specific industry and have no particular "iron in the fire." Our sole objective is to maintain sound credit conditions which admittedly are essential factors in the promotion of the Nation's business activity and the restoration and maintenance of its general prosperity.

Taxation problems bear heavily upon the credit executive of a company. Injudicious taxation legislation, inequitable and excessive taxation rates, in many instances, impair the credit acceptability of a customer. Uncertainty or ambiguities in tax legislation make more difficult of appraisal the credit of a concern.

The credit executives of the Nation at the outset wish to compliment the House on the very constructive amendments to the undistributed-profits-tax section of the proposed law. We are also deeply grateful for the elimination of the so-called "third basket" tax which caused considerable alarm among our people, and which we felt would have been even more harmful in its effect than the undistributed-profits-tax law of 1936.

Since apparently the "third basket" tax has been definitely eliminated it is not our desire to take up the committee's time with testimony bearing on the adverse effects to business of this type of legislation.

Since the undistributed-profits tax has been reduced, it cannot farirly be said that the penalty for retention of earnings, even though at maximum it amounts to a 25-percent penalty, constitutes the menace that it did in the 1936 law.

But the uneconomic principle of taxing thrift, of penalizing those who would save for a rainy day, of injecting a taxation principle that diverts us from the objective of stabilization of employment and earnings, remains a menace. Such a principle, in our opinion, violates the tested rules of sound economics.

We recognize that the uses to which some corporations put their surpluses in the twenties were, at least, questionable. However, we do not believe that such abuses as did exist in some cases justify general penalties which discourage the accumulation of needed surpluses. Without the surpluses which business was able to build up during years of prosperity, the collapse of our economic structure would have been far more serious than that which we have experienced during the past few years, and our unemployment problem would have been greatly increased.

As long as the possibility of future recessions in business exist, care should be exercised that our taxation measures do not discourage the accumulation of surpluses which are needed for the general well-being in time of slackness in business income.

Day by day, evidence comes to hand of distribution of earnings under the present law of such large proportion that the company, seeking to escape the hardships of the undistributed-profits tax, has made its credit less acceptable. In some instances, the very injudicious practice of paying dividends with notes, thus adding to future liabilities, has been resorted to. While primarily it is true that a directorate which resorts to these practices must answer for its actions, the fact nevertheless remains that such action would never have been taken had it not been for the undistributed-profits tax.

The wide distribution of earnings by way of dividends in 1937 in itself indicates the abnormal situation and, in our opinion, prolongs the present recession inasmuch as it prevents an even flow of dividend distribution. Funds that would have normally gone into surplus for dividend-stabilization purposes have been distributed and present business will make available a greatly reduced sum for distribution by way of dividends during the current year.

The higher distribution of dividends in 1937 simply meant an increase of purchasing power in that year at the expense of the current year. Thus the undistributed-profits tax could not help but have a tendency to accent recovery artificially and emphasize a period of recession. Under the undistributed-profits-tax law we have promoted "feast or famine" conditions.

Since this tax, in our opinion, is wrong in principle we urgently request the consideration of its entire repeal, having in mind that as long as the principle remains a part of our taxation program there is no assurance that rates may not again be established which would prove as uneconomic as those found in the present law.

Our members recognize that the repeal of this act involves an increase in other taxes. The loss in revenue from such repeal could be recaptured partially,

at least, through an increase in the normal corporate tax. They, in keeping with other citizens, feel the tax bill is inordinately high. But since the expenditures have been made, they are willing to meet the taxation program Congress may legislate. They respectfully urge, however, that the bill be simplified and that the principle of the undistributed-profits tax be eliminated through outright repeal.

With respect to the proposed tax law, however, there are several items which credit executives feel need more equitable treatment. They feel some improvement could be made in providing certain considerations for these corporations that have an accumulated indebtedness. They believe the present system of limiting deductions for capital losses establishes, in effect, a gross income tax, rather than a net income tax.

One inequity in the present law they would particularly like to call to your attention. It is found in section 13 which deals with corporations in bankruptcy or receivership. In effect, it provides for corporations in bankruptcy or insolvency, or those in receivership, an exemption from the proposed undistributed-profits tax.

If the undistributed-profits-tax provision is not repealed outright, it would seem to be in order that this same exemption should apply to these concerns that are, in effect, in an insolvent condition but which, through friendly cooperation of creditors, have been saved from bankruptcy or insolvency through out-of-court agreements.

Credit executives generally use every means at their command to keep a distressed business alive if through their helpfulness they foresee any possibility of that business reestablishing itself on a sound basis. The present law, in effect, grants immunity from the surtax to corporations which have taken the legal step of going into bankruptcy or receivership. But it penalizes cooperation of creditors, endeavoring to work their way out of difficulties and continue in business.

Let me give an illustration to make my point clear. A manufacturing concern owes 10 creditors $10,000 each. It has a total liability of $100,000. It possesses assets of but $70,000. It is insolvent.

If this concern goes into bankruptcy or receivership, and in the course of the liquidation or receivership operations earnings are realized, such earnings under the present law are exempt from the undistributed-profits tax.

Now, assume the same concern faced the same situation. Assume that the 10 creditors met with the management of that concern and agreed not to press their claims but, as is often the case, agreed to freeze their obligations and aid in the conduct of the business until the concern could reestablish itself. In this latter case, if any earnings arose out of the operations the concern would be subject to the undistributed-profits tax. Under these conditions creditors frequently feel the first loss is the least loss and make no effort to salvage the concern and keep its doors open.

This premium which the present law puts on liquidation or going out of business is wrong in principle. It contributes to further unemployment.

Admittedly, one of the difficulties of carrying the exemption over to these concerns that are trying to reestablish themselves through out-of-court liquidations is the difficulty of administration. However, the collector of internal revenue could be vested with discretionary powers to rule on each case. His office in turn could draft a paragraph protecting the Government from the tax evader who might seek to use this means to evade taxes, the collector of internal revenue requiring that such paragraph be made part of every creditor's agreement as a condition precedent to exemption. The exemption would hold until the return to solvency.

The penalties in the present undistributed-profits tax are insufficient to check the willful tax evader. The credit executives hold no brief for him and they recognize the unfairness, both to stockholders and the Government, of unnecessarily accumulating earnings within a corporate structure for individual tax-evasion purposes. They suggest that the tax evader be dealt with under section 102 and that all corporations improperly accumulating surpluses be called to account under that section. They feel section 102 could be strengthened—and see no reason why it should not be—to deal with the so-called tax slacker.

The credit executives, having in mind the need of additional revenue, further suggest the adoption of a flat rate to replace the present capital-gains and losses tax. It is their firm conviction that, with respect to this section of the proposed tax law, the adoption of a flat tax rate would not only yield more revenue than the present law—which has put into effect the inevitable law of diminishing

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returns—but that a flat rate would do much to stimulate trade and commerce and, consequently, réemployment.

They suggest a flat rate not in excess of 15 percent. Previous experience with the capital-gains tax indicates that a flat rate, if reasonable, is actually a stimulus to capital gains, thus permitting a greater capital-gains tax harvest by the Government. The credit executives feel that the yield from a capital-gains tax, if a flat tax of 15 percent were put into effect, would exceed receipts under the proposed law.

Aside from the added revenue there would be some comfort to the average taxpayer using a simple tax form as against the terrifying cross-word puzzle he must now solve in reporting his capital gains and losses.

We are convinced that the present high surtax rates in the upper brackets are ineffective because they restrict trade too severely. We believe a reduction of these rates would be stimulating to trade and would insure greater tax receipts. We also favor broadening the income-taxation base so that every citizen will be required to do his part.

The credit executives of the country believe they represent business as a whole accurately, when they say business is willing to absorb a heavy tax if the end justifies the means. They would like to see present Government expenditures reduced, however.

The committee may be interested in the fact that many credit executives of the Nation feel that if present expenditures continue to increase year by year, it may eventually be necessary to attempt to limit expenditures through constitutional amendment, if such a procedure is possible. Such limitation, they feel, might well be based upon the total national income of previous years, expressed in percentage, just as school-district taxation, in many instances, is now limited to a certain percentage of assessed valuation.

To illustrate what is in the minds of many credit executives, let us assume the existence of a constitutional amendment limiting annual Federal taxation of all kinds to 8 percent of our annual national income.

Under this plan there would first be a requirement that every individual and organization, whether subject to tax or not, file a report of income. This would then establish the total income of the Nation.

Assume this to be $75,000,000,000. If the constitutional maximum tax limitation of 8 percent prevailed, appropriations in the following fiscal year could not exceed $6,000,000,000.

Of this six billions of taxes collected, 10 percent, or $600,000,000, would be set aside as an emergency reserve. A limit to such reserve would be established at $6,000,000,000. Such reserve would be subject to disposition by Congress.

If, in years of severe depression, our national income dropped to a figure under which the maximum appropriations under the 8-percent clause would prove inadequate for necessary expenditures, Congress would have power to declare an emergency and draw necessary additional appropriations beyond the 8-percent maximum from the reserve.

In closing, may I repeat that credit executives are very much encouraged by the evident desire of both the House of Representatives and the Senate to make more equitable the present tax laws. They sincerely believe an outright repeal of the undistributed-profits tax and the adoption of a flat rate for capital gains would be a most potent influence for the immediate restoration of confidence and the resumption of recovery.

Not only is the credit department of each organization faced with the tax problem of its own organization, but in more recent years it has, in fact, had to face a pyramided tax cost. Bad-debt losses have returned a steadily diminishing amount through bankruptcy, receivership, or friendly liquidations because the assets of the concern involved have largely been absorbed by the preferential-tax levies and tax obligations of the Federal and State Governments and political subdivisions. The firm, therefore, not only pays its own tax but, indirectly, helps liquidate the tax bill of its distressed debtor.

I have discussed the position of the credit executive and his problem in such detail so that the members of the committee may know the reason for the credit executive's interest in an equitable and constructive tax bill.

The CHAIRMAN. Mr. C. C. Clayton, from Cleveland, Ohio, representing the Wellman Engineering Co.

STATEMENT OF C. C. CLAYTON, CLEVELAND, OHIO, REPRESENTING THE WELLMAN ENGINEERING CO.

Mr. CLAYTON. Mr. Chairman and gentlemen, the Wellman Engineering Co. is an Ohio corporation of just under $3,000,000 net worth.

Our business consists of designing and building heavy equipment for the steel industry, dock equipment for railroads, and special heavy equipment for the Government and other interests. During the World War our plants were almost entirely placed at the disposal of the Government for the manufacture of the heavier war equipment. At this time several new buildings were erected and equipment purchased and installed at one of our plants by the Navy Department, later to be purchased by us from the Government, and we are still carrying the burden of trying to pay for them, even though we were compelled to abandon the plant over 11 years ago due to the forced overexpansion of war purposes.

We have learned, during the more than 35 years of our existence, that in good times we must conserve our resources in order to live during the inevitable times of depression. As evidence of following this rule we have paid no common dividends since 1920 and on our cumulative preferred capital stock, of which there is outstanding $1,142,400, there are unpaid accumulated dividends aggregating $87.50 per share or $999,600 at January 1 of this year.

Following are figures which will show you how we prepared ourselves for the long depression of the 1930's, and after 60 consecutive months of losses we were able to come back and make new strides forward in modern and commendable engineering achievements.

After a loss from operations in 1928 we started on January 1, 1929, with a surplus of $33,281.67. During 1929 our operations resulted in a net profit of $328,692.63. The total income tax on this very satisfactory result was only $3,985.80 due to the fact that we were able to apply the previous year's loss of over $300,000 as a deduction in accordance with the provisions of the Federal income-tax laws of that year. In 1930 our net earnings after paying income taxes of $56,-089.31 amounted to $368,779.67. In 1931, although operating at a loss for several months, we showed a small net gain for the year and at the end of the year, December 31, 1931, our house was in order and we were prepared to face any reasonable depression safely. This was due in a great measure to the fact that Federal income taxes were reasonable, that we were able to use our previous year's loss as a deduction, and, in short, retain the major portion of our profits for productive use in the business.

After paying current dividends on our preferred stock from July 1, 1929, through 1931, we had increased our surplus of $33,281.67 on January 1, 1929, to $606,557.61 at December 31, 1931. During this period the peak of our financial strength came on June 30, 1931, when our balance sheet showed cash on hand and on deposit of $194,705.13 and an investment in Government bonds of $475,382.09, a total of $670,087.22 of cash and bonds, with no obligations for money borrowed.

Then came the year of 1932 with a loss of $210,344.32; 1933 with a loss of $207,585.67; 1934 with a loss of $157,469.97; 1935 with a loss of $95,981.34; or a total loss for the 4 years of $671,381.30. At the end

of 1935 what was once a substantial surplus was now reduced to a deficit of $63.226.35. Our balance sheet at December 31, 1935, showed cash of $10,272.82 and no investment in Government bonds, but a past due mortgage on our plant for money borrowed in the amount of $220,000 as well as other past due obligations.

Our losses continued for a few months into 1936, but a turn for the better in business conditions enabled us to finish the year with better than an even break—a net profit of $4,434.76.

In 1937 our business continued to improve and the results for the year were very satisfactory. Again we started to prepare ourselves for safety in the future. No dividends were declared or paid during the year, as the management thought that our stockholders' interests would be better protected if once again we started to accumulate some working capital instead of paying them a small return on their investment.

At the beginning of the year our bank mortgage was in the dangerous position of being past due. During the year a total of $12,000, plus interest, was paid on this obligation and it has now been revamped and placed in a current condition. A year ago there was past due on our Government notes for wartime buildings and equipment, an amount of $130,500; during 1937 a new agreement was made removing this past-due feature.

A year ago our county and State real and personal taxes were delinquent in an amount of over $80,000; during 1937 the necessary payments were made to place this obligation on a long-term deferred basis under provisions of the Ohio State Whittemore Act. Naturally, we are justly proud of our accomplishments in a financial way in our first really profitable year since 1930.

However, today we face a problem that is more serious to us than any of the obstacles which we were able to overcome last year. Our annual audit report shows that we made a profit for 1937 of $144,649.28, but after providing for Federal income tax and surtax on undistributed profits, aggregating some $47,500, our net for the year is $97,108.28. This profit is not reflected in cash but has gone into increased receivables, inventory, and a small part into new equipment. Of the total tax on our income, approximately $26,250 is the amount due for surtax on undistributed profits.

In view of the aforementioned burdensome past due obligations, it is quite evident that we could not pay any dividends whereby our income-tax liability could have been reduced.

Since June 1934 we have operated on working capital borrowed from the bank and have secured these loans by pledging customers' accounts receivable as collateral. To meet our first quarterly installment of the 1937 income tax, due March 15, it was necessary to borrow funds and pledge accounts receivable.

In November 1937 our sales once again dropped down to "depression" levels. Unless there is a substantial improvement in business in the near future, our operations will again become unprofitable and the gains made in 1937 soon lost, leaving us with no cash surplus to face an extended period of low production.

From our picture, which is no different than perhaps thousands of others, it can be seen that a tax on undistributed profits works the greatest hardship on those least able to pay. On the other hand, had we been more fortunate during the depression and were able in 1937

to pay most or all of our profits to stockholders in the form of dividends, we could have made several times the profit we did and not pay any more undistributed-profits tax than the $26,000 we now owe.

Surely the unfairness of this burden on the financially weaker companies merits your most serious consideration. If this law is to continue, should not some provision be made giving relief to companies such as ours where it is found that the withholding of dividends was made absolutely necessary due to their financial condition?

The future of our company is at stake as well as the continued employment of over 300 people.

The CHAIRMAN. How many people do you employ?

Mr. CLAYTON. From 300 to 500. It is a little over 300 at the present time.

The CHAIRMAN. You would rather have a flat corporation tax?

Mr. CLAYTON. Yes.

The CHAIRMAN. You do not like the undistributed-profits tax?

Mr. CLAYTON. Not very well.

The CHAIRMAN. All right; thank you very much.

Mr. Comstock, of Boston, representing Comstock & Wescott, Inc.

STATEMENT OF A. BARR COMSTOCK, COMSTOCK & WESTCOTT, INC., CAMBRIDGE, MASS.

Mr. COMSTOCK. I am a director and general counsel of this company, gentlemen.

The CHAIRMAN. Have you a brief to present to the committee?

Mr. COMSTOCK. I do not have it prepared yet. May I file it some time this afternoon? It is being typed.

The CHAIRMAN. That is all right.

Mr. COMSTOCK. We come under, legally and technically, the personal holding company provisions. I do not believe that Congress ever for a moment intended that a company of our type should come under those provisions. We organized in 1912. Prior to that time we did business as a partnership, but finding that we could only do business properly and fully and adequately as a corporation, we incorporated.

Our business is that of research, consulting engineers or industrial engineers. We employ from about 115 to 150 trained personnel, Harvard graduates and others, some of whom are, I think, rather distinguished men.

We have been responsible for a number of developments, some of which have been commercialized to advantage to all concerned, others of which are now just reaching the commercial stage.

My brother is president of the company. He was the principal inventor of the Technicolor motion-picture process. Possibly some of you who have seen Snow White and the Seven Dwarfs will admit that it has quite a public appeal. We developed Technicolor commercially and finished it up, I think, in 1925, and since then we have had no legal relation with the company, as it has been paddling its own canoe. I understand it is now dominating the motion picture industry in England, and I hope it will succeed to the same extent perhaps in this country. At any rate, that was one of our developments.

Another development some years ago was a development involving the invention and commercialization, patenting, and so on, of a process of manufacturing an abrasive, something like carborundum, that was called by some of the men later a little gold mine.

We are now engaged in three, I think, rather important developments, two of which we have worked on for about 11 years. One of them involves a new patented process of extracting from lean ore certain metals such as nickel, iron oxide, sulphur, cobalt, and so forth. We now control, through another company, a very large amount of lean ore from which we believe we can extract nickel to advantage. As the United States apparently has very little, if any, native nickel supply, we think that this might well be of interest, from the point of view of perhaps national defense as well as commercially. At any rate, we have a plant about built, and it has been so thoroughly tested in the last 11 years that we know ourselves that it will work, and it has worked.

Another development is about at the same stage, and the company owning it, by whom we have been employed, now has a plant in Connecticut, involving the use of capital put in by Rhode Island capitalists, mostly Providence. It involves a household duplex unit. It looks like the ordinary modern icebox, and it furnishes all the refrigeration you want and at the same time all the hot water you want for the average household. This can be done, and is now being done at very low cost, and the utilities from all over the eastern part of the country have already ordered all of the machines we can get out, and we haven't got any more. Incidentally, they told us to name our own price. Now, that presumably will develop as soon as we get thoroughly equipped; that is, the owning company is building a new plant down in Connecticut, which will develop a new industry employing a good many men or women, or both, and supplying the household needs at low cost, which it is obvious ought to be of considerable value from many points of view.

Another development in which we have only spent about 2½ years, which is not a very long time for these things, is a still-color process based on the Technicolor patents, the still color rights to which we retained, and that process involves a production, at low cost, of still-color prints for use in advertising and other fields.

We think it will have a very wide commercial use at low cost in multiple lots of three or four, perhaps several hundred, not competing, of course, with newspaper and magazine color photography, which is another proposition.

Now we were organized, as I say, in 1912. We have been doing business about 25 years. We have paid a good deal of money to the Government in taxes—not a large amount, because we are a small company—throughout the years. We certainly are fairly well known in New England as people of honor. We pay our taxes. The president of the company advanced over $11,000 from his personal funds a few years ago to pay a deficiency tax. He could not afford to do it, the company could not afford to pay it; but it had to do it, because we had to throw up our hands at the last minute before the Board of Tax Appeals.

Now in regard to the loophole law, I have estimated that we would be subjected to the personal holding-company tax on what we hope will be a substantial income this year—which I will explain in a

moment—of from 65 to 75 percent. In addition to that we are subjected to the other four Federal corporation laws. In addition to that we are subjected to the Massachusetts and New York excise-tax laws, and figuring the tax on a conservative basis, if we are lucky enough to have any income, from $100,000 to $200,000 this year, making 109 percent at least. That is in addition to the State taxes. Just how that extra 9 percent can be collected and paid I do not know.

Senator KING. Out of your hides, possibly.

Mr. COMSTOCK. I imagine so. I do not know of a provision of the law for the collection of such an excess, and I do not know what would happen, but that is true; it is a fact.

Now, our type of business, coming down to the tax feature a little more, involves this: We will take this chlorine process in metallurgy as an example. A wealthy man in Massachusetts said to my brother, "If you can invent some method of extracting from lean ores these metals there is a gold mine in it for all. Mr. Longyear put in his money, and the court even allowed them to invest the money of the estate in that development since his death, showing perhaps the confidence of at least the judges and court officials in the possibility of success in this development. Now Mr. Longyear put in money and Comstock & Westcott put in brains, whatever we have. At any rate, we invented and developed, and are carrying now to the commercial stage that development. He took stock for his money, for his investment in a new company, several new companies which own the process. We took stock for our patent rights, services, and so forth. We furnish our personnel under contract, engineering contract with the owning company. We do the same in other developments. I think it is a rather unique business. We do not know any other company, here or abroad, which does this kind of business.

At any rate, we have in our treasury perhaps 100,000 shares of these development-company stocks that were not worth a nickel when we took them in, of course, because it was nothing in the world but a hopeful laboratory experiment which we carried on. As I say, in three cases we have been in the development up to 11 years, and in some other cases a little shorter. Those stocks, for tax purposes, we had taken in at zero. When we sell any we return the proceeds as a 100 percent taxable gain. We are now reaching the stage where some of those stocks are worth something. We are morally obligated not to sell any of those stocks in substantial amounts until the developments have reached the commercial stage.

Now we are caught technically under one of the sections—I will refer to this in my brief, I will not go into the particular wording unless you desire me to do so—we are caught under this section of the personal holding-company law that imposes this tax of 65 to 75 percent of undistributed profits derived from the sales of securities. Generally speaking, our only income is through the sale of these stocks, if they are worth anything, and if they are not worth anything, we make no money. We show our faith in these developments in that way.

Now mind you, because of the fact that these stocks when we take them in are worth zero, any gain from the sale of these stocks is certainly, in effect, personal service income. There is no question

The other section of the law, the personal holding company law, I think it is section 353 (e), if I remember rightly, expressly exempts personal-service income. So that if these stocks had any value whatever when we took them in, and we were then taxed on that value, we would not be taxed at all under the personal-holding-company law.

Congress, the Ways and Means Committee, expressly stated, in their explanation of that law, their belief that the law was so framed that companies like ours, not by name, of course, should not be taxed under that law at all. The House bill does not affect this situation at all, I am sorry to say.

Senator KING. It leaves you in the dilemma in which you find yourself.

Mr. COMSTOCK. Yes.

The CHAIRMAN. Would you agree that the consent dividends feature is a proper feature?

Mr. COMSTOCK. It was suggested that we distribute. We cannot distribute for the reasons I stated. I wanted to reorganize this company some time ago and they said no, that we ought to stick to our moral obligation to hold the stocks until the companies are commercial. I figured the other day that my brother, as president, for instance, if the dividend credit were taken he would be taxed on what we hope to make this year, perhaps 68 percent.

Any way you take it the taxes on the personal-service group are still onerous. So you soak the corporation or soak the individuals, it is exactly the same.

Furthermore, we have an element of good will here in a personal-service corporation of course. We are now labeled as tax evaders. Not many people in New England believe that, but that is what we are labeled. I do not think we ought to be labeled that.

Congress has already exempted many good old line companies from this tax, and this is what the Ways and Means Committee, in its explanation of this loophole law said, just two or three lines:

> The provision that some third party must have the right to designate who shall perform the services contracted for, or that the person to perform the services must be designated in the contract, will prevent this rule from applying in general to operating corporations engaged primarily in rendering personal services and which necessarily enter contracts to render such services, selecting such members of their staff as they desire to render such services. Thus, corporations which let out the services of architects, engineers, and advertisers would not as a general rule be required to report such income as personal holding company income.

It is believed that the proposed amendment will take care of the "incorporated talent" loophole. (Note: Reference to the law ends here.) We do not feel we are that kind of a loophole that ought to be plugged up in this way.

Senator KING. Nevertheless, from the words which you have just read, and I suppose the spirit of those words was incorporated in the act, you have been subjected to the taxes?

Mr. COMSTOCK. We have been subjected under another section. As I say, we are probably unique. I do not blame anybody in framing this law, all I ask is that you add about 15 words to the law, and I would suggest to you some of the same words that are used here.

The CHAIRMAN. What is the suggestion you make?

Senator KING. What section does that refer to?

Mr. COMSTOCK. That is section 353 (e), personal service contracts. We are of the general type, of course, of a personal holding company, closely held, and so on. It is title I-A, section 353.

Senator KING. What page is it?

Mr. COMSTOCK. I am sorry, I do not have the bill, Senator.

Senator GUFFEY. Page 293.

Senator DAVIS. What language did you want to insert in there?

Mr. COMSTOCK. Well, may I just say this section (e) would exempt us if our development stocks were worth anything when we take them in. That would be personal income of the type that is exempted under (e). Now, because these stocks are worth nothing, and our income is only derived from sales of these stocks, we come under section 353 (b), namely, gains from the sale or exchange of stock or securities.

Now, I suggest a few simple words, using the very same language. It would not open the door to anything dangerous but would give us a little justice, if these words were added. Add to section 353, subsection (b), these words:

> If said stock or securities would constitute amounts received under a contract under which the corporation is to furnish personal services,

namely the type of personal services that is exempt in subsection (e),

> and if said amounts, if of some ascertainable value, would be taxable under subsection (e) of this section 353.

So that section 353 (b) shall read as follows, and this would take care of it, I think:

> Stocks and securities transactions: Except in the case of regular dealers in stock or securities, gains from the sale or exchange of stock or securities,

and they are the original stocks——

Senator KING. Comma?

Mr. COMSTOCK. Comma—"if" and underline that, if you will—

> if said stock or securities would constitute amounts received under a contract under which the corporation is to furnish personal services, and if said amounts, if of some ascertainable value, would be taxable in subsection (e) of this section 353.

The CHAIRMAN. Mr. Comstock, I suggest you file your brief with this suggestion.

Mr. COMSTOCK. Yes, Mr. Chairman.

The CHAIRMAN. We will give it every consideration.

Mr. COMSTOCK. Thank you very much. May I conclude in just 2 minutes?

The CHAIRMAN. Yes.

Mr. COMSTOCK. We, of course, are hit by the undistributed-profits tax. My brief suggestion as to that undistributed-profits tax is this: I had an active part, perhaps, in this little-business men's conference. It was very interesting.

The CHAIRMAN. You had a good time up there.

Mr. COMSTOCK. Well, we did, Senator. I believe, perhaps, that a consensus of opinion was reached with regard to taxes. We had four tax planks, which were good. I did not write them, but I wish I had, because they were good. It wiped out the closely held third basket; that is, it eliminated it. I hope that would be done.

Second, it wiped out the defect of this kind that I pointed out, including operating companies under the personal holding company

law. Next the undistributed-profits taxes, and next spread the base for more revenue.

I know that that crowd were practically unanimous in their feeling that the undistributed-profits tax is a very bad thing, especially for small business.

I do not see any reason in the world why section 102 should not be strengthened, and I would respectfully suggest that you wipe out all question of motive, and leave it that any unreasonable accumulation of earnings, that is, the unreasonable portion, not reasonably required for the business be taxed. I do not think a businessman in the country would seriously object to paying taxes, even 75 percent or 80 percent, on that excess. As I understood Mr. Alvord at the hearing before the Ways and Means Committee, there were 16 Federal cases, 9 of which were won by the Government even with this improper motive in them. Courts now have jurisdiction of stockholders, bills to require directors to distribute dividends, that part of the earned surplus which is not reasonably required for the business. The little fellows in that case would get their legal rights, which they cannot get now because of the expense involved in the litigation. I do not think business would object to that at all.

The CHAIRMAN. We thank you for the suggestion and the Committee will consider the points that you made.

Mr. COMSTOCK. Thank you.

The CHAIRMAN. Mr. Whalen.

Senator DAVIS. In regard to the process you mentioned, do you think you could extract any low-grade iron ore as well as nickel?

Mr. COMSTOCK. Well, we are doing it. We have got 100,000,000 tons, and we are doing it, and getting nickel out of it, too.

(Subsequently, Mr. Comstock submitted the following brief.)

BRIEF FOR TAXPAYER, COMSTOCK & WESCOTT, INC., RESEARCH INDUSTRIAL ENGINEERS, IN RE PROPOSED REVISION OF THE REVENUE LAWS, 1938

1. The taxpayer, Comstock & Wescott, Inc., organized in 1912, is a personal-service group of research industrial engineers. The company has been in active and successful operation since its incorporation. It now employs a trained personnel of some 115 persons, headed by a number of technical experts of recognized ability and high standing. It has plants in Cambridge, Mass., and Niagara Falls, N. Y.

2. Under the provisions of section 351 et seq. of title IA of the Revenue Act of 1936, amended by section 1 of title I of the Revenue Act of 1937, popularly known as the "loophole law" (which was not changed as applying to this case by the House bill), the taxpayer will probably realize income from certain proposed 1938 transactions involving gains on the sale of securities under section 353 (b), taxable at the 65-percent and 75-percent rates provided therein. It is respectfully submitted that Congress never intended to subject companies of this type to the onerous tax provisions of this law, and that the addition of a few simple words to subsection (b) would relieve such a business from a hardship which now threatens its successful operation, if not its very existence. As the taxpayer is on a cash basis and, therefore, gets no 1938 credits (against 1938 income) for other Federal taxes, it is anticipated that from its 1938 income from this source it cannot even retain in its treasury sufficient funds to insure the payment by the company and the collection by the Government of Federal taxes without being subjected to a tax on the same at the 65-percent and 75-percent rates.

Such income may well constitute substantially all of the taxable net income of the taxpayer for 1938, and the amount may be sufficient to subject the company to total Federal taxes—normal surtax, excess profits, capital stock, and personal holding company—of over 100 percent of its entire net income in addition to the excise taxes assessed by the States of Massachusetts and New York.

(This total tax liability may be somewhat less under the revenue bill as passed by the House of Representatives.) As to the liability of the taxpayer for an amount in excess of its entire net income, I will venture no opinion.

3. As more fully described, the type of business conducted by the taxpayer has been, since its organization, over 25 years ago, substantially as follows:

(a) At the request of some financial group interested in some certain industry, the taxpayer, through its expert personnel, will devise and invent processes and patent rights presumed to be valuable in such industry. This financial group and the taxpayer promote and organize a new company (hereafter referred to as Y company), which acquires from the taxpayer the processes and patent rights referred to, and an engineering contract is made between Y company and the taxpayer under which the latter, as engineers, agrees to develop these processes to the commercial stage. This financial group advances to Y company funds for the expenses of the development work, taking therefor stock in Y company. The taxpayer likewise takes stock in Y company as compensation for its engineering services and the processes and patent rights, title to which pass to Y company under the contract.

(b) The taxpayer at the present time has stock of several such development companies in its treasury. Such stock obviously has no market value when originally acquired as the enterprise is for a considerable period merely a technical, industrial experiment. Such stock (instead of cash) is taken by the taxpayer so that Y company may conserve cash to the maximum extent and because the taxpayer is willing that the value of its compensation shall be largely contingent upon the ultimate success of the venture. All of these enterprises are now, however (after more than 10 years of development work in several cases), approaching the commercial stage, and it is hoped that these development stocks may acquire substantial value. These stocks are taken in by the taxpayer, for income-tax purposes, at no value and when and if any of them are sold from time to time in small amounts the proceeds are returned 100 percent as taxable gains, the Treasury Department having acquiesced in this practice for many years.

(c) These development stocks have not been distributed to the stockholders of the taxpayer for the primary reason that the directors feel that the various financial groups have advanced their funds with the hope, if not the expectation (although there is no agreement to this effect), that the stock of Y company will, for the most part, be held in the taxpayer's treasury, and that the taxpayer's top personnel will remain stockholders of the taxpayer, at least until the development has reached the commercial stage (except for the reasonable cash requirements of the taxpayer and its stockholders, one of whom, the president of the company, has, until recently, taken practically no salary whatever in any form for many years), so that the continued active interest of the most important members of the taxpayer's organization in the enterprise and their continued professional group service in the development work may be assured during the development period. (In one instance the taxpayer recently became entitled to moderate compensation in the form of cash rather than stock, most of which, however, it has refrained from collecting.)

4. May I briefly describe a few of these technical industrial developments for which the taxpayer is responsible.

(a) Some years ago the taxpayer completed, to the commercial stage, the technical development of the Technicolor Motion Picture process, of which up to that time the president of the taxpayer, Dr. D. F. Comstock, was the principal inventor. (The taxpayer has had no connection with the business or financial operations of the Technicolor Co. for a considerable period, except that it still owns a few shares of Technicolor stock.) Dr. Comstock is well known in Boston and elsewhere as an engineer of conspicuous ability and high standing in the field of industrial technology. This development has proved highly successful from both a technical and a commercial point of view. The wide public interest in the Technicolor picture, Snow White and the Seven Dwarfs, is an illustration of the popular appeal of the products of this new industry.

(b) Another development commercialized some years ago by the taxpayer and/or its former personnel is based on a patented process of manufacturing an abrasive somewhat resembling carborundum. This company also has had a very successful history.

(c) A current technical development of considerable promise has been in progress for more than 10 years under the immediate direction of the vice-president of the taxpayer, Dr. Ernest W. Wescott, at Niagara Falls, involving patent rights and new processes relating to the cyclic use of chlorine, on an

economical basis, for the extraction of nickel, sulphur, iron oxide, and other valuable mineral products from lean ores. As large ore deposits of this type within the territorial boundaries of the United States have been made available for treatment by this process, which it is believed may now be profitably worked for nickel, and in view of the fact that practically no nickel is now derived from strictly American sources a commercialization of this process might well have a strategic value for national defense purposes, as well as proving of considerable value in industry. Well-known business and financial groups in this country and abroad are interested in this development, which has now practically reached the commercial stage.

(d) An enterprise of a widely different nature developed by the taxpayer over a period of some 11 years has just reached the commercial stage, and a plant of substantial capacity has recently been acquired for manufacturing and assembling purposes in Plainfield, Conn. The finished product, of greatest immediate value, is a duplex machine, resembling in appearance the modern household refrigerator, designed to supply the average family at low cost with both refrigeration and hot water for all household needs. This machine, among other features, has no moving parts, is absolutely silent, and should have unusually long life. It may be operated either by gas or electricity.

(e) Another of the taxpayer's developments now in progress which has aroused considerable interest in Boston and New York involves experimental work on a new patented process of producing high quality, low priced, reproducible, natural color photographs, or "prints" in small-lot multiples.

5. May I venture the opinion, voiced by many of our political and business leaders, that industrial technology may well prove at this time, as often in the past it has proved, of great value in the revival and readjustment of our national economy through the building up of new industries, creating and satisfying new human needs and substantially increasing employment. If this be true, it would seem that the taxpayer and other incorporated groups performing similar functions in like manner should be fostered rather than handicapped, or even possibly destroyed, by tax laws such as the provisions in question which, I submit, could never have been intended by Congress to apply to the type of business conducted by the taxpayer—a 25-year-old successful operating company of high standing, taking fees for engineering services only, or primarily, in the contingent form of stock in the new enterprise, holding this stock in its treasury so as better to protect the financial group and until the stock acquires some appreciable value, selling this stock in small quantities from time to time for necessary cash requirements and returning the proceeds 100 percent as taxable gains, the company having paid substantial taxes to the Federal Government during the more prosperous years and expecting, if granted this tax relief, that the same will be true in the years to come.

That the present law does not represent the true intent of Congress is evidenced by the report of the Committee on Ways and Means on the Revenue Act of 1937 (the so-called loophole law) covering a full explanation of the new provisions, the report of the Joint Committee on Tax Evasion and Avoidance provided for by joint resolution of House and Senate on June 11, 1937, and reports of the congressional discussions and explanations relating to the personal holding company provisions of the 1934 act, as well as the provisions of the 1937 Holding Company Act, themselves, particularly those incorporated in section 353 (e). That the administration, congressional leaders and this committee desire to remove undue hardships and unjust discriminations involved in the revenue laws as they now exist, particularly those affecting legitimate operating business companies, would seem clear from a consideration of news items and editorials in the daily press and the report of the Ways and Means Committee recently published.

6. I respectfully suggest that, to remove the hardships and inequalities referred to herein, the following brief, simply worded amendment could safely and properly be adopted—add to subsection 353 (b) of title 1-A of the Revenue Act of 1936, as amended by section 1 of title I of the Revenue Act of 1937, the following words: ", if said stock or securities would constitute amounts received under a contract under which the corporation is to furnish personal services, and if said amounts, if of some ascertainable value, would be taxable under subsection (e) of this section 353," so that said section 353 (b) shall read as follows:

"Stock and securities transactions: Except in the case of regular dealers in stocks or securities, gains from the sale or exchange of stock or securities, if

said stock or securities would constitute amounts received under a contract under which the corporation is to furnish personal services, and if said amounts, if of some ascertainable value, would be taxable under subsection (e) of this section 353."

It should be noted that in the type of business to which I have referred, gains from the sale of such securities constitute in effect personal service income in the same manner as would the original receipt of such stock if the same had a market value at that time. I sincerely hope that your committee will find it possible to recommend the above amendment or some other change in the existing law which, in your opinion and the opinion of the Treasury Department, will properly accomplish the desired result. If this is done, the taxpayer, and other companies of this type, if any, would still, of course, be subject to the provisions of section 102 of the 1936 Revenue Act relating to the improper accumulation of surplus, as well as to the other four types of corporate taxes imposed by existing law.

7. It is no answer to suggest that we distribute these stocks or the proceeds of their sale or invoke the dividend credit provision. Why should we, if we do not properly come under this personal holding company law, except in a technical, legal sense? Furthermore, as I have explained, we are under a moral obligation to retain these stocks for the most part, in our treasury for the present. The device of the dividend credit would mean that one or more of the individual stockholders might well be subjected to an individual tax as high as 68 percent on dividend income actually received by him.

8. In this connection it should be noted that onerous surtax burdens on the individual members of this personal-service group may be as disastrous for the business as the application of the personal holding company law to the company itself. Let me point out, also, that the goodwill of a business of this kind is a rather important factor in its success and that, in the present state of the public and official mind, for us to be classed as tax evaders under this personal holding company law might seriously impair our goodwill. It has been suggested that we might devise some method involving an increase of capitalization or other change in our set-up to relieve us from some of this tax burden. Obviously, however, any attempt of this or any similar nature might be very dangerous as it would subject us to the criticism that we had resorted to these devices for the purpose of evading or avoiding just taxes; and, furthermore, this whole tax situation is getting so complicated that it is difficult to determine just what tax avoidance device the courts would sustain even after perhaps long and expensive litigation.

9. All we ask is simple and obvious justice. I have consulted with congressional and Treasury experts on this question and none of them has even intimated that my interpretation of the law and its implications, as applicable to our company, are in any degree erroneous. Businessmen throughout the country are beginning to believe that this committee and the Senate may well propose tax legislation along realistic, proper lines. I think you will agree with me that this attitude will hardly prove justified unless this committee recommends some change in the existing law, along the lines I have suggested or otherwise, to relieve our company of the grossly unjust and discriminatory burden which Congress never intended that we should be required to bear.

10. We have no knowledge of any other companies doing a business just like ours. In any event, no budgetary problem, of any consequence, would be presented if tax relief is granted to us in this manner. On the other hand, that our company should be permitted to live and function is of some concern to these commercial companies soon to get under way. I think it is a fair statement that we are somewhat in the position of the keystone of a rather important industrial arch. These three new industries, which we believe will become of some size and importance, and therefore be a source of tax revenue in the near future, can hardly function properly, or perhaps even exist if these onerous tax burdens continue to threaten seriously the efficiency or even perhaps the very business life of our company and our personal-service group which functions in this incorporated form. I submit, therefore, that we are not a negligible factor in the industrial life of the Nation.

While our company is naturally most seriously concerned with obtaining relief from this 65 to 75 percent tax burden under the personal holding company provisions, we are, or would be, also adversely affected by the undistributed profits tax and the so-called third basket. I am sure that thousands of companies throughout the country would urge you as we do (for we might well come under it this year) not to reinstate this third-basket provision. The

statement of the Ways and Means Committee that only a few hundred companies would be affected is undoubtedly based on the assumption that companies now earning below the exempted amounts would continue in this position. From that point of view many companies, including some in which I am interested, now in red ink, would not be affected by tax rates or other provisions which might be proposed. Of course, executives all over the country are hoping and expecting that, if general conditions and the tax laws improve, their red-ink figures will be converted into substantial figures in black ink.

12. As for the undistributed profits tax, I submit that it, like the "third basket" provision is based on an erroneous and very dangerous theory and should be repealed, leaving section 102, in some stronger and clearer form, to reach that portion of earned surplus which is unreasonably retained, that is, beyond the reasonable requirements of the business, with even increased rates. I cannot agree with those in Congress and the Treasury Department who claim that section 102 is unworkable, and therefore must be ignored for this purpose. Motive is often difficult to prove and this feature of section 102 should be eliminated entirely, leaving as the only criterion the reasonableness of the accumulation. The rule of reason, while not always easy to apply, runs all through our laws and court decisions on taxes and other subjects, and it is to be noted that the courts already have jurisdiction of stockholders' bills to require directors to distribute as dividends that portion of earned surplus which is unreasonably retained. If section 102 were amended as I suggest, it would fulfill a useful business and economic function by enforcing the legal rights which small minority stockholders already have but upon which they usually cannot rely because of the prohibitive expense of court action, as well as be a source of additional revenue. As a matter of fact, I understand that instead of only the two cases in Federal courts referred to by the Ways and Means Committee as having been lost by the Government, there have been in all some 16 cases involving section 102, 9 of which have been won by the Government even on the present wording of this section.

13. For many years I have been fairly closely connected in both a professional and business capacity with many of the smaller companies and recently I took an active part in the so-called conference of the smaller businesses, here in Washington. I submit that small business in this country is today in a very serious situation due in no small part to some of these existing tax laws which, whether rightly or wrongly, impress businessmen all over the country as grossly unjust, discriminatory and unduly complex. The great majority of these executives are honest and hard-working and by no stretch of the imagination could be termed "tax evaders." They are becoming very seriously concerned and discouraged over the apparent tendency of Congress and the administration in this direction and they are much worried because they cannot tell when, if at all, this tendency will cease. The House bill, of course, is a step in the right direction, but why retain, at all, provisions which so many honest businessmen believe are so unjust, discriminatory, and complex? Increased flat rates on some fair, broad principle that we can understand and respect, would be far preferable, based, in part, on surtaxes, that is, ability to pay. I know good businessmen today who are seriously considering going out of business entirely rather than wrestle further with these conditions over which they have apparently had, in the recent past, so little control. The great majority of American businessmen are honest and reasonably intelligent. They know that substantial revenue must be raised by taxes, and that much of this tax burden must be borne by business. If some of these provisions to which I have referred could be eliminated, I believe much would be done to restore reasonable business confidence and prosperity without which the very source of tax revenue may soon be threatened.

14. The Little Business Conference, to which I have referred, recommended to the President practically the same changes in the tax laws which I have urged upon your consideration this afternoon, that is, the repeal of the undistributed-profits tax, the elimination of the so-called "third basket" proposal, an amendment to the present personal-holding company law so that it will not apply to operating companies, and in addition, spreading the tax base for additional revenue. These recommendations of that conference, I can assure you, represented the consensus of opinion of the 800 to 1,000 representatives of smaller businesses from all over the country, who attended the conference and who, I have no doubt, expressed the views, on tax matters, of a great many other businessmen who were not present on that occasion.

The late Justice Holmes said, some years ago: "We need education in the obvious rather than investigation of the obscure." In closing, let me urge upon

Congress a clearer recognition and application of this principle in the preparation of laws involving the taxation of business enterprise in this country.

Respectfully submitted.

A. BARR COMSTOCK,
Goodwin, Parker, Raymond, and Comstock.

The CHAIRMAN. Mr. Ward Whalen, New York City, who is going to discuss the basis for determining gain or loss from sales of stock, as I understand.

STATEMENT OF WARD WHALEN, NEW YORK CITY

The CHAIRMAN. Have you a brief that you want to file?

Mr. WHALEN. Yes; I have.

The CHAIRMAN. All right, Mr. Whalen.

Mr. WHALEN. I appear on behalf of Robert A. Young, and others, who are trustees of certain trusts who are clients of the office of Baldwin, Todd & Young, 120 Broadway, New York, a firm with which I am associated.

These taxpayers find themselves in the very unfortunate position of the possibility of being required to pay a second income tax upon income on which the tax has once been paid, unless the provisions of the tax law with respect to the basis for determining gain or loss from the sale of preferred stock based on surplus included in gross income by the shareholder and subsequently received as a stock dividend are clarified. The facts, briefly, are as follows:

The stockholder of a corporation for several years included in his individual income-tax return all of the distributive net income of the corporation, although the income was not actually distributed in the form of dividends or otherwise. This was done under the provisions of section 102 (d) of the Revenue Act of 1936, and corresponding provisions of prior acts which expressly permit a shareholder to report in his individual return his pro rata share of the retained net income of the corporation. Such a policy released the corporation from any charge of, or liability to the surtax for, an unreasonable accumulation of surplus.

Subsequently this corporation distributed a dividend in preferred stock out of the earned surplus, on which the shareholder had paid the income tax when the retained income of the corporation was reported in his individual return. The prior acts expressly provided that this earned surplus of the corporation, on which the stockholder had paid the tax, if distributed in the form of cash was exempt from taxation, and the distribution of the stock dividend itself, as you know, was also exempt from taxation under the statutes as interpreted by the Supreme Court in the recent Gowran decision.

The difficulty is, however, that the basis for determining the gain or loss upon the sale or exchange, or other disposition of such stock received as a stock dividend, is not clear in the existing law, or in the proposed bill, and the Treasury may hold that under the decision of the Supreme Court in the Gowran case the basis of zero should be applied to all stock dividends, including the stock dividends which represent a distribution of surplus on which the taxpayer has once paid a tax.

Senator KING. Your case is one of double taxation, as you are contending?

Mr. WHALEN. That is right.

Senator KING. You want to be relieved of double taxation?

Mr. WHALEN. That is right.

Senator KING. Have you suggested an amendment that will accomplish that result?

Mr. WHALEN. Yes; I have one here which I would like to submit.

Let us assume that this corporation had an income of $1,000,000 during the year 1934 and that this shareholder had reported in his individual return the entire million dollars of the earnings of the corporation. The tax on that, the individual tax would have been about $530,000. Assumed that the corporation distributed a preferred-stock dividend by capitalizing this million dollars of earnings, which is a reasonable policy because the stockholder had actually paid the tax upon those earnings. Assume that in the next year, 1935, the stockholder disposed of that preferred stock. If the basis of zero is assigned to that preferred stock, the result will be that the million dollars will be taxed again to the full extent. One hundred and six percent of the proceeds will be subjected to the tax. If this amount of corporate income was reported by the stockholder in 1936 and the sale of the stock occurred in 1937, the tax each year, if the basis of the stock is zero, would be $670,000, a total tax of 134 percent of the income. For those reasons I earnestly recommend to the committee that the statute be amended to provide that the basis for determining gain or loss upon the sale or exchange of stock that represents a distribution of surplus, on which the stockholder has paid a tax, shall be the face value of the stock, or its fair market value, whichever is lower. This proposal, I believe, is in complete harmony with the other provisions of the proposed bill, particularly those relating to the consent dividends provisions.

As I understand the proposed bill, a shareholder who elects to pay the tax upon net income of the corporation may do so even if it is not distributed. That is precisely the same principle which the stockholder to which I refer adopted under section 102 (d).

Now, the proposed bill expressly provides that the stockholder who elects to take advantage of the consent-dividends provisions shall have the basis of his stock increased to the extent of the income which he includes in his individual return.

Our situation is precisely the same, with the exception that we are not urging that the basis of the old stock be increased, we are urging that the basis of the preferred stock received as a dividend be increased to the extent of the earned surplus, the earnings and profits of the corporation which were returned as income of the shareholder. The effect is exactly the same.

The CHAIRMAN. Have you ever brought this to the attention of the Treasury Department?

Mr. WHALEN. Yes, we have, Senator. We brought it up and asked the approval of the Treasury Department, and I am not certain whether it has the complete approval of the Treasury Department. Not being considered by Treasury as a question of major national importance, Treasury has probably not reached and considered it.

Senator KING. Is that recent?

Mr. WHALEN. Yes; that was at the time of the hearings in the House.

The CHAIRMAN. You must not have gotten very far.

Mr. WHALEN. Well, I do not know. I also testified briefly before the House committee, but I notice that this amendment is not included in the proposed bill. We are firmly convinced that it is something that, in fairness and in equity ought to go in.

I am also quite sure that the Treasury Department probably does not want to tax this income twice, but the fact of the matter is that the decisions in regard to the taxability of stock dividends, as you probably know, are very conflicting. The firm with which I am associated was required to go to the Supreme Court to compel preferred stock received as a stock dividend by another corporation to be exempted from taxation. We are not content to rely upon the action of the Treasury in assigning to this preferred stock the basis of its fair market value. We think that safety requires that it be put right in the statute. The Treasury—this is not a complaint, I suppose it was compelled to do so—but to repeat, the Treasury required one of our clients to go to the Supreme Court to sustain its position that preferred stock received as a stock dividend is exempt from taxation under section 115 (f).

The CHAIRMAN. Your client was not the first one that the Treasury ever compelled to go to the Court.

Mr. WHALEN. No, sir.

The CHAIRMAN. This committee will give that every consideration. You file your brief on this feature.

Mr. WHALEN. Yes.

The CHAIRMAN. We will take it up with our experts and go into it.

Senator TOWNSEND. What will be the effect, in your opinion, from the failure to include the provision which you have requested?

Mr. WHALEN. Well, Senator, one effect will be, of course, that anyone who has received stock dividends of this character cannot dispose of them or sell them because of the probability, I might say, or at least of the real possibility that that same income will be taxed twice; and if the income is at all sizeable, the double taxation will be more than 100 percent of the proceeds from the sale.

Senator KING. You are not satisfied to deal merely in futuro, but you want to make it retroactive as to the transactions which have occurred?

Mr. WHALEN. That is correct, Senator.

Senator TOWNSEND. How general is this condition?

Mr. WHALEN. Well, I might say I do not really know; but I know the people for whom I appear, five trusts, and those people certainly will be affected. Irrespective of the number of persons affected, we think that it is something that is so manifestly and obviously right and just that it should be included in the bill.

Senator KING. You think to rob one man is a crime; it is a crime if it is only one man.

Mr. WHALEN. Yes, sir.

Senator TOWNSEND. You think the amendment will cure the situation if it is put in there?

Mr. WHALEN. I think so, Senator; yes.

Senator KING. If we amend the law as to 102 (d) transactions, it would not affect the future transactions, would it?

The CHAIRMAN. That would cure it in the future.

Mr. WHALEN. About the future, I am not just sure of that; but, of course, section 102, subdivision (d), as I understand it, has been repealed. Is that correct, Mr. Stam?

Mr. STAM. The consent dividend provision takes care of the future.

Mr. WHALEN. Yes; as to returning corporate income and the basis for gain or loss on sales of stock then held, but not as to sales of stock held when income was returned under section 102 (d).

The CHAIRMAN. All right. Thank you very much.

(The brief submitted by Mr. Whalen is as follows:)

MEMORANDUM IN SUPPORT OF AMENDMENTS OF THE REVENUE ACT TO ASSURE AN EQUITABLE BASIS OF CERTAIN STOCK DIVIDENDS WHICH REPRESENT THE DISTRIBUTION OF "TAX PAID" SURPLUS

The recent decision of the Supreme Court in the case of *Helvering* v. *Gowran*, decided December 6, 1937, has changed substantially the rules theretofore applicable to the determination of gain or loss from the sale or other disposition of capital stock received as a stock dividend which constituted Income under the Sixteenth Amendment. The Court held, first, that all stock dividends are exempt from taxation under the provisions of Section 115 (f)[1] of the Revenue Act of 1928; and, secondly, that the basis for the ascertainment of gain or loss from the sale or other disposition of a stock dividend which represented a distribution of Income is zero. This decision, of course, is applicable to the corresponding provision of the Revenue Acts of 1921 to 1934, inclusive. The Court had previously held, in the case of *Koshland* v. *Helvering*, 298 U. S. 441 (1936), that a dividend of common stock on preferred stock was Income under the Sixteenth Amendment. In the *Gowran case* the Court extended that principle to include a dividend of preferred stock on common where other preferred stock of the same classification is outstanding. It may very well be that under this decision all classes of stock dividends except common on common (see *Eisner* v. *Macomber*, 252 U. S. 189) will be held to represent a distribution of income instead of a readjustment of capital.

This decision, invalidating, as it does, Treasury Regulations of long standing with respect to the basis of such stock dividends, necessarily will result in uncertainty, litigation, and hardship when the principles therein announced are applied to the administration of taxing statutes enacted prior to the decision. Unless the statutes are clarified to give effect to this decision, the result in some cases will be loss of revenue and in others severe tax liabilities which no prudent person could have foreseen.

The purpose of this memorandum is to point out a situation where the literal application of the Gowran decision will be in direct conflict with the underlying reasoning of Mr. Justice Brandeis, and will result in double taxation of a character entirely inconsistent with the spirit and the plan of the income tax statutes.

We refer to the case where the individual shareholder[2] of a corporation has reported as taxable Income the entire distributable Income of the corporation under the provisions of Section 102 (d)[3] of the Revenue Act of 1936 or the corresponding provisions of a prior Revenue Act, with the result that the corporation had on hand a large surplus consisting of earnings and profits which would be exempt from taxation if distributed to such shareholder in the form of cash or property dividends. Section 102 (d) expressly so provides.

If a corporation so situated had distributed, prior to the year 1936, a stock dividend from the surplus fund consisting of earnings or profits upon which the shareholder had previously paid the tax, the stock dividend would have been exempt from taxation under the provisions of Section 115 (f) of the Revenue Act of 1934 or the corresponding provisions of prior Revenue Acts, the same as any other stock dividend, even though the dividend stock was of a quality which Congress might have taxed as income (*Helvering* v. *Gowran*, supra).

The Courts may construe the decision of the *Gowran case* as holding that the basis of all stock dividends constituting Income, including those which represent the distribution of the aforesaid "tax-paid" surplus, is zero. Likewise, Congress at this Session may give legislative sanction to the decision in the

[1] "A stock dividend shall not be subject to tax."
[2] For simplicity, we have assumed a case of a single shareholder. The principle is equally applicable to a corporation having several or numerous shareholders.
[3] Quoted in the Appendix of this Memorandum.

Gowran case by expressly providing that the basis of all stock dividends constituting Income under the Sixteenth Amendment but not taxable when received is zero. If Congress is not forewarned, the statutory declaration may be in such comprehensive terms as to include a stock dividend which represented a distribution of the "tax paid" surplus.

Such an application of the Gowran decision or such a statutory provision would result in double taxation—one tax having been paid under Section 102 (d) of the several Revenue Acts and the other upon the entire proceeds from the sale or other disposition of the stock dividend. The inequity of such a double tax is apparent. It would nullify the express command contained in Section 102 (d) that "any subsequent distribution made by the corporation out of earnings or profits for such taxable year shall * * * be exempt from tax in the amount of the share so included." Manifestly, the Supreme Court did not contemplate or intend this result. The Gowran decision is predicated squarely upon the proposition that the distribution of income in the form of stock dividends had escaped taxation by virtue of the complete statutory exemption granted by Congress in the several Revenue Acts. The language of Mr. Justice Brandeis is perfectly clear on this point. He said:

"Furthermore, unlike Section 22 (b) (3), excluding from gross income the value of gifts and legacies, Section 115 (f) cannot, in view of its history, be taken as a declaration of Congressional intent that the value of all stock dividends shall be immune from tax not only when received but also when converted into money or other property. Gain on them is, therefore, to be computed as provided in Sections 111 and 113, by the 'excess of the amount realized' over 'the cost of such property' to the taxpayer. As the cost of the preferred stock to Gowran was zero, the whole of the proceeds is taxable."

Clearly, this reasoning is not applicable to the situation under discussion, because here the surplus distributed in the form of a stock dividend has borne its full measure of tax the same as if it had been distributed to the shareholder in the form of a cash or property dividend.

We submit, therefore, that Congress should expressly provide in Section 113 that the basis of a stock dividend constituting Income under the Sixteenth Amendment which represents a distribution of earnings and profits on which the tax has been paid under the provisions of Section 102 (d) of the Revenue Act of 1936, or of a corresponding provision of a prior Revenue Act, shall be its fair market value at the time of receipt, provided, of course, that the dividend was received by a shareholder who had reported such earnings or profits in his individual return.

A precedent for this amendment is found in Sections 113 (b) (1) (D)[4] of the Revenue Acts of 1932, 1934, and 1936, which except the distribution of earnings or profits of a personal service corporation from the class of tax-free distributions which require an adjustment of the basis of the old stock. The reasoning underlying this provision is precisely the same as the amendment here proposed—namely, that the shareholder of the corporation has paid the tax upon the earnings and profits of the corporation.

We submit, therefore, the following as an appropriate addition to Section 113 of the Revenue Act of 1936:

AMENDMENT OF SECTION 113 (B) (1)

(b) * * *

(1) * * *

(G) *Stock dividends representing a distribution of earnings or profits on which tax had been paid.*—In the case of stock of a corporation issued as a stock dividend which constituted income within the meaning of the Sixteenth Amendment to the Constitution, and if such stock represented a distribution of earnings or profits of the corporation (as defined in Section 115 of the Revenue Act of 1936 (or of this Act)) which the distributee had included as gross income in his income tax return under the provisions of Section 102 (d) of the Revenue Act of 1936, or a corresponding provision of a prior Revenue Act for the face value of such stock or its fair market value at the time of its issuance, whichever is lower. The provision of this sub-paragraph shall be applicable under the Revenue Acts of 1926 to 1938, inclusive.

It is important that this amendment shall apply to all of the previous Revenue Acts from 1926 to 1936, inclusive. If preferable, the last paragraph may be omitted, and a new subsection may be inserted to provide that the foregoing provision shall apply under the Revenue Acts of 1926 to 1936, inclusive.

[4] Quoted in the appendix.

The section corresponding to Section 102 (d) of the Revenue Act of 1936 originated in the Revenue Act of 1926 (Section 220 (d)). Accordingly, it is unnecessary to amend any statute prior to the Revenue Act of 1926.

AMENDMENT OF SECTION 115 (H)[5]

Consideration of the situation here discussed also indicates the advisability of amending Section 115 (h) of the Revenue Act of 1936 provide that a stock dividend representing a distribution of "tax paid" surplus shall be considered a distribution of earnings or profits of the corporation even though the dividend was exempt from taxation under the provisions of Section 115 (f) of the applicable Revenue Acts. Section 115 (h), as it is understood, is simply a legislative approval of the principle established by the Board of Tax Appeals that the distribution of a stock dividend which is exempt from taxation does not diminish the earnings or profits of the declaring corporation. (*Horrmann* v. *Commissioner*, 34 B. T. A. 1178, and cases cited therein.)

The presumptive purpose of this decision of the Board and of the legislative adoption thereof was to protect the revenue by foreclosing the claim that a stock dividend diminishes earned surplus with the result that a subsequent cash or property dividend would not constitute a taxable dividend under the definition contained in Section 115 (a)[5] of the Revenue Act of 1936.

The purpose which Section 115 (h) was intended to accomplish is not present where the tax has been paid upon the earned surplus of the corporation under the provisions of Section 102 (d) of the Revenue Act of 1936 and the corresponding provisions of a prior Revenue Act. Indeed, a literal interpretation of Section 115 (h) would permit a corporation having a "tax paid" surplus to distribute a stock dividend which constitutes income without diminishing the tax-exempt fund.

It is, therefore, to the advantage of the revenue, in so far as the taxability of future distributions is concerned, to amend subsection (h) to correct this inconsistency. Moreover, this statutory provision is inconsistent with the amendment herein proposed relating to the basis of a stock dividend distributed from the "tax paid" surplus of a corporation because it expressly says that such an exempt stock dividend, whether distributed before or after January 1, 1936, "shall not be considered a distribution of earnings or profits of any corporation." There would be a lack of uniformity in the law if the statute should provide that the basis of such a stock dividend shall be the equivalent of its fair market value unless the stock dividend represented a distribution of earnings or profits.

We suggest the following amendment to accomplish this purpose, the addition to the present statute being underscored:

"(h) Effect on earnings and profits of distributions of stock.—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

"(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or

"(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

"As used in this subsection the term 'stock or securities' includes rights to acquire stock or securities."

This subsection will not apply to a distribution by a corporation of its own stock or securities or stock or securities in another corporation which represent a distribution of earnings or profits which the distributee had included as gross income in his income tax return under the provisions of section 102 (d) of the Revenue Act of 1936 or a corresponding provision of a prior Revenue Act.

AMENDMENT OF SECTION 113 (b) (1) (D)[5]

For substantially the same reasons, Section 113 (b) (1) (D) of the Revenue Act of 1936, relating to the basis of stock on which a non-taxable distribution

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[5] Quoted in the appendix.

has been made, should be amended to classify distributions of "tax-paid" surplus, whether in the form of cash, property, or stock dividends, the same as distributions of a personal service corporation. As above indicated, the "tax-paid" surplus is of the same quality as the surplus of a personal service corporation in that the tax upon the annual earnings and profits of each of these classes of corporations has been paid. Accordingly, there is no justification for requiring an adjustment in the basis of the stock on which the distribution was made.

This purpose could be accomplished by amending Section 113 (b) (1) (D) to read as follows, the addition to the present statute being in italics:

"(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * * * * * *

"(D) in the case of stock (to the extent not provided for in the foregoing subparagraphs) for the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax-free or were applicable in reduction of basis (not including the distributions made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or 1921, and not including distributions made by a corporation as a dividend in cash, property or its own stock or securities, representing a distribution of earnings or profits which the distributee had included as gross income in his income tax return under the provisions of section 102 (d) of the Revenue Act of 1936 or a corresponding provision of a prior Revenue Act)."

We are confident that the Treasury will endorse these amendments and the Congress will be pleased to adopt them. In our opinion, they are imperatively needed to reconcile the statutes with the provisions of Section 102 (d) and the decision of the Supreme Court in the Gowran case. Their effect will be beneficial to the Government and to taxpayers alike in that the Government will be able to collect expeditiously taxes justly owing and taxpayers will obtain legislative assurance that they will not be unjustly penalized as a result of having followed the literal language of Section 102 (d) of the Revenue Act of 1936 and the corresponding provisions of a prior Revenue statute.

The only possible objection is that these proposals are legislative recognition of a self-evident principle which the Treasury will concede or the Courts enforce. Unfortunately, this is an inadequate answer. There is no assurance that the Treasury will make this concession unless Congress gives legislative approval. Enforcement by the Courts would involve prolonged and expensive litigation. The uncertainty in the present situation is established by the fact that the question of the basis of the old stock on which a stock dividend had been declared was appealed to two Circuit Courts of Appeals,[8] and each Court having reached a different conclusion, it was necessary for the Supreme Court to resolve the doubt by granting a writ of certiorari in the Koshland case.[9] Likewise, the questions of the taxability of the stock dividend when received, and of the basis of the new stock, were appealed to two Circuit Courts[10] and again the Supreme Court[11] was obliged to determine the questions on writs of certiorari.

For the foregoing reasons, we submit that these proposed amendments should be adopted in the interest of a sound public policy.

Respectfully submitted.

BALDWIN, TODD & YOUNG,
Counselors at Law, New York.

Of Counsel,
ROBERT A. YOUNG,
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Washington Counsel,
PREW SAVOY.

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[8] *Tillotson Manufacturing Company* v. *Commissioner*, 76 Fed. (2d) 189; *Helvering* v. *Helvering*, 81 Fed. (2d) 641.

[9] *Koshland* v. *Helvering*, 298 U. S. 441.

[10] *Gowran* v. *Helvering*, 87 Fed. (2d) 125; *Pfeiffer* v. *Helvering*, 88 Fed. (2d) 3.

[11] *Helvering* v. *Gowran*, supra; *Helvering* v. *Pfeiffer*, decided December 6, 1937.

Appendix

SECTION 102 (D), REVENUE ACT OF 1936

(d) *Payment of surtax on pro rata shares.*—The tax imposed by this section shall not apply if (1) all the shareholders of the corporation include (at the time of filing their returns) in their gross income their entire pro rata shares, whether distributed or not, of the retained net income of the corporation for such year, and (2) 90 per centum or more of such retained net income is so included in the gross income of shareholders other than corporations. Any amount so included in the gross income of a shareholder shall be treated as a dividend received. Any subsequent distribution made by the corporation out of earning or profits for such taxable year shall, if distributed to any shareholder who has so included in his gross income his pro rata share, be exempt from tax in the amount of the share so included.

SECTION 115 (H), REVENUE ACT OF 1936

(h) *Effect on earnings and profits of distributions of stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law; or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection, the term "stock or securities" includes rights to acquire stock or securities.

SECTION 113 (B) (1) (D), REVENUE ACT OF 1936

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

(D) in the case of stock (to the extent not provided for in the foregoing subparagraphs) for the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax-free or were applicable in reduction of basis (not including distributions made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or 1921).

SECTION 115 (A) OF THE REVENUE ACT OF 1936

(a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Proposed Amendments To Be Included in Revenue Act of 1938

Amendment of Section 113 (b) (1):

(G) In the case of stock of a corporation issued as a stock dividend which constituted income within the meaning of the Sixteenth Amendment to the Constitution, and if such stock represented a distribution of earnings or profits of the corporation (as defined in Section 115 of the Revenue Act of 1936 (or of this Act)) which the distributee had included as gross income in his income tax return under the provisions of Section 102 (d) of the Revenue Act of 1936, or a

corresponding provision of a prior Revenue Act, for the face value of such stock or its fair market value when issued as a stock dividend, whichever is lower.

The foregoing provision shall apply under the Revenue Acts of 1926 to 1938, inclusive.

Amendment of Section 115 (h), addition to the present Statute being underscored:

(h) *Effect on earnings and profits of distributions of stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

This subsection will not apply to a distribution by a corporation of its own stock or securities or stock or securities in another corporation which represent a distribution of earnings or profits which the distributee had included as gross income in his income tax return under the provisions of section 102 (d) of the Revenue Act of 1936 or a corresponding provision of a prior Revenue Act.

Amendment of Section 113 (b) (1) (D), the addition to the present statute being underscored:

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * * * * * *

(D) in the case of stock (to the extent not provided for in the foregoing subparagraphs) for the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax-free or were applicable in reduction of basis (not including distributions made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or 1921, *and not including distributions made by a corporation as a dividend in cash, property, or its own stock or securities, representing a distribution of earnings or profits which the distributee had included as gross income in his income tax return under the provisions of section 102 (d) of the Revenue Act of 1936 or a corresponding provision of a prior Revenue Act*).

The CHAIRMAN. The next witness will be Mr. Lozier, of Washington, D. C., representing the National Institute of Oil Seed Products.

STATEMENT OF HON. RALPH F. LOZIER, REPRESENTING THE NATIONAL INSTITUTE OF OIL SEED PRODUCTS

Mr. LOZIER. My name is Ralph F. Lozier. I reside in Carrollton, Mo. I represent the National Institute of Oil Seed Products, a group of crushers and processors of vegetable oils. I also speak for the National Paint, Varnish, and Lacquer Association, a Nation-wide organization, composed of the principal manufacturers of paints, varnishes, and lacquers. I am handing to the reporter for inclusion in the record a statement of the organizations which constitute the National Institute of Oil Seed Products.

(The statement referred to follows:)

Member companies of San Francisco, Calif.: Pacific Vegetable Oil Corporation, R. J. Roessling & Co., C. B. Jennings & Co., S. L. Jones & Co., and El Dorado Oil Works.

Member companies of Berkeley, Calif.: Durkee Famous Foods, Inc., and Berkeley Oil & Meal Co.

Member company of Oakland, Calif.: Western Vegetable Oil Corporation.

Member companies of Los Angeles, Calif.: Snow Brokerage Co., California Flaxseed Products Co., Copra Oil & Meal Co., Pacific Nut Oil Co., Globe Grain & Milling Co., Pacific Oil & Meal Co., Vegetable Oil Products Co., California Cotton Oil Corporation, and Producers Cotton Oil Co., Fresno, Calif.

Spencer Kellogg & Sons, Inc.: Buffalo, N. Y.; Edgewater, N. J.; Chicago, Ill.; Des Moines, Iowa; St. Paul, Minneapolis, and Duluth, Minn.; and Kansas City, Mo.

I call the attention of the committee to page 301 of the pending bill, subparagraph (D).

The Chairman. Are you in favor of this provision?

Mr. Lozier. This provision, as written in that paragraph, is simply a restatement of the existing law.

Senator King. Which section is that?

Mr. Lozier. Subsection (D) on page 301. This is simply a restatement of the existing law which was incorporated in the revenue bill of 1936. I am opposing this provision and am asking the Congress to rectify a possible error, a miscarriage in legislation.

Senator King. Will you pardon us for one moment? What page is that?

Mr. Lozier. This is the bill as it came from the House. It is on page 304 of the original House bill, but on page 301 of the bill as passed by the House. It is paragraph (D), page 301, section 702.

Senator King. That is the old perilla-seed law.

Mr. Lozier. Yes, sir.

The Chairman. The provision that you are talking about is hempseed, perilla seed, rapeseed, sesame seed, and kapok seed?

Mr. Lozier. Yes. The proposed amendment is this: Perilla seed, 1.31 cents; hempseed, 0.76 cent; kapok seed, 0.51 cent; sesame seed, 1.05 cents; and rapeseed, 1.23 cents per pound.

Senator King. You mean that is the excise?

Mr. Lozier. That is the amendment which we are asking the committee to incorporate in this bill.

The Chairman. Have you a brief?

Mr. Lozier. I do not have it completed. I will be glad to file it.

Senator King. You would make it less than the 2 cents?

Mr. Lozier. Yes, sir. Until the enactment of the revenue bill of 1936 these seeds were duty-free and tax-free. In the 1936 revenue bill, without any hearings in either the House or Senate, this amendment was engrafted on that bill by the Senate Finance Committee.

Senator King. You ought to see one of the Senators in North Carolina about this.

Mr. Lozier. I am quite sure that the Senator from North Carolina, when he sponsored this amendment, was not informed or advised as to the effect of this amendment, as to really what this amendment proposed to do.

Senator King. What about the Farm Bureau?

Mr. Lozier. The Farm Bureau as a Bureau I do not think was interested in it. But some people who collaborated with the members of the Farm Bureau I think were responsible for this provision.

Let me say that here is a provision that nobody in or out of the Government approves, nobody in Congress or out of Congress with whom I have conversed, justifies these rates. Here is a flat rate of 2 cents a pound on five commodities that are imported for their oil yield exclusively, and this 2-cent rate does not take into consideration

the variable oil content of these five seeds. The oil content ranges from 18 percent to 48 percent. Kapok, 18 percent; hemp, 24 percent; rape, 35 percent; perilla, 37 percent; and sesame, 48 percent.

Now this is not a flat and uniform tax, and if translated into terms of oil, it means a tax on the oil processed from these seeds, as follows: Sesame, 4.16 cents a pound; perilla, 5.41 cents a pound; rape, 5.71 cents a pound; hemp, 8.33 cents a pound; and kapok, 11.11 cents a pound. In other words, this is a rate structure that is absolutely unscientific, that is indefensible, which violates every concept of every political party in the United States and all schools of political thought.

In response to the suggestion of the chairman I will say that a study of the 187 major tariff laws adopted since the formation of the United States, you cannot find a provision that was deliberately inserted in any tariff or revenue bill of that kind, because it places the tax upon the raw material high above the tax upon the finished product. In other words, the duty upon finished sesame oil imported from China or Japan is only 3 cents a pound, and yet this imposes a duty upon the oil that comes from these imported seeds of 4.16 cents a pound, and when you take all of these seeds and reduce them to terms of oil, it brings the tax up as high as 11.11 cents a pound.

Senator KING. Are there any oils produced in the United States comparable with them in texture, or in quality, chemically or otherwise?

Mr. LOZIER. There are not, with this modification: Two of these oils, perilla and hemp, are drying oils. Rape oil is essentially a lubricant. Sesame oil and kapok oil are edible oils and they belong, in a general way, to the cottonseed group, but, as a matter of fact, sesame possesses certain qualities and properties which are not found in any other oil; that is, the property of holding up, not breaking down, when used for prepared flours, lard substitutes, compounds, salads, shortenings, and so forth.

Senator KING. Pardon the interruption. In connection with lacquers, paints, and varnishes, how many of these oils are used?

Mr. LOZIER. Perilla and hemp oil are drying oils and belong in the same general class as linseed oil.

Now, you ask as to whether or not they interfere in any way with our domestic products. Of course, perilla and hemp oil belong to the linseed-oil group, but as a matter of fact we have, for years, been on an importing basis, as far as our drying oils are concerned. We only produce about one-fifth of the linseed oil which is utilized in our domestic consumption.

Perilla oil, by reason of its high-drying power, or iodine number, or capacity to absorb oxygen from the air, is very much in demand for several reasons: In the first place, it is an aid to the domestic linseed oil, which frequently is deficient in drying power or iodine number, or capacity, to absorb oxygen from the air. So, as a matter of fact, it does not enter into competition with any of these oils.

Take for instance flaxseed out of which linseed oil is processed. We produced last year about 6,000,000 bushels. About 700,000 bushels were necessary for seed, and last year we imported into this country 28,000,000 bushels of flaxseed, more than 1,533,000,000 pounds of flaxseed, and, as a matter of fact, it makes no difference to the processors of flaxseed, or growers of flaxseed of the United States, whether

perilla and hemp seeds come in or not, because if they are displaced and embargoed, it simply means, as the departments have pointed out, an opportunity for other oils of the same type to come in and take their place. It is just like creating a vacuum. Whenever you create a vacuum in the ocean, other waters rush in to fill the place of the displaced waters. So, as a matter of fact, the domestic flax growers are not vitally interested in this matter, because they only produce about one-fifth of all the linseed oil that is consumed in this country. Of course there is about five or six hundred million pounds of Argentine flaxseed coming in every year, and the introduction of these few million pounds of seeds, two of which produce drying oils, viz, hempseed and perilla seed, would not in any degree affect the competitive situation in the United States.

Senator KING. My recollection is we went into it very fully at the last hearing. The rapeseed would occupy a more advantageous position than perilla or any of the others.

Mr. LOZIER. Of course, rapeseed is a go-between oil.

Senator KING. A sort of a catalyst.

Mr. LOZIER. It is classified as edible oil, but is essentially a lubricant, and I think, as a national policy, inedible rapeseed oil ought to be admitted, as it was admitted under section 1732 of the Tariff Act of 1930, because it performs a useful function in airplane lubrication and the reciprocating type of engine. As a matter of fact, the present rapeseed tax has transferred our rapeseed market to Europe. The 2-cents-per-pound tax on rapeseed has practically destroyed our domestic rapeseed market.

Now, I must close. Before this bill was passed, without a hearing, my clients were profitably processing these seeds. Their mills have been closed by the present taxes, and as a result, as pointed out by the Department of Agriculture, and as pointed out by the Department of Commerce in their bulletins on several occasions, the effect of this bill has been to transfer the processing of these commodities to the Orient. I have a bulletin in which they call attention to the fact—a bulletin issued by the Department of Agriculture—that within the last few years there have been 160 mills built in Japan for the processing of the one commodity, namely, the processing of rapeseed. So it is just simply a question of whether or not this Congress, and the United States Government, will give to this deserving and useful industry the same consideration that it gives to other industries.

Now, we do not ask that these seeds come in free of tax or duty. We are willing to have whatever the Congress of the United States says is a fair and reasonable tax on these seeds, but let us show what the situation is at the present time. The present law penalizes the domestic processer of these seeds from $3.22 to $24.64 a ton. In other words, before the American processor can get upon an equal status, upon the zero line with the foreigner, he has to pay a penalty of $3.22 to $24.64 a ton, and, as a matter of fact, on all of these seeds our domestic producers are penalized and placed below the parity line in favor of foreign producers.

Now, it is a fundamental policy of the United States and of all governments that where foreign commodities are to enter a nation they should enter in the form of raw material, so that they may be processed in our American mills by American workmen, but that policy has been reversed, and one of the results of the 1936 Revenue

Act has been to suspend the processing of these oils in the United States, and to accentuate their production in the Orient. So as a matter of fact, if the committee please, when we analyze these present rates there is absolutely no defense that can be offered for them.

Now, someone says, "We do not want these oils to come in from Japan." Over before the Ways and Means Committee the issue was raised that some of the seeds came from Japan. Well, we are not importing those oils for the benefit of Japan, we are importing those oils for the benefit of the American people. We are bringing those oils in for the same reason that we bring tin in from the Federation of Malay States.

We are bringing these seeds in for the same reason that we bring coffee from Brazil, mahogany from Latin America, raw silk from Japan, or rubber from Sumatra and East India. We are bringing in these seeds for the same reason that we bring in many other raw materials which we need and must have to meet our national needs and in order to build up our domestic industries. So it is not a question of accommodating Japan, but of satisfying our domestic requirements. As I was told at the Japanese Embassy, "We do not want the Bailey amendment repealed. We prefer to process these seeds in Japan and then we will have the cake, which is very valuable in Japan." The cake is a residue of these seeds.

I have watched tariff bills for years; I have been a diligent student of our tariff system, but probably not an efficient one, and I have never been able to find another bill where Congress intentionally placed the duty upon the finished product imported from the foreign lands down here [indicating] and placed a duty upon the raw material way up here [indicating].

So, as a matter of fact, what my people want is not special favors. We want the same treatment that Congress gives to every other American industry. We want a schedule of rates enacted by this Congress that will be reasonable, that will be defensible, that will enable these manufacturers to open their mills and again process these commodities by American capital and American labor. The present taxes are absolutely unjustifiable and indefensible.

I want to say, since you mentioned Senator Bailey——

Senator KING. I have not mentioned any Senator.

Mr. LOZIER. You mentioned "a Senator from North Carolina." I want to say I am quite sure that had he understood at that time what 2 cents per pound meant, if the men that handed him that amendment had said to him that 2 cents a pound on kapok seed meant 11.11 cents a pound on the oil, or that the 2 cents a pound on hempseed meant 8⅓ cents a pound, I am quite sure Senator Bailey, and the other members of the Finance Committee and Senate would not have given their sanction to 2 cents per pound tax on these seeds.

The CHAIRMAN. That amendment was offered on the floor. They had quite a bit to say on it.

Mr. LOZIER. It was first offered, I think, in the committee, and the committee disallowed it.

The CHAIRMAN. The first time the public hearing on this oil question was had we had quite a time of it. Then, afterward, it was amended to stop some loophole, and it went out in a third basket clause, so to speak, and it caught all these different kinds of seed.

Mr. LOZIER. Yes.

Senator TOWNSEND. What percent of the seed is processed here?

Mr. LOZIER. All of it that is imported is processed here. As a matter of fact, there is another thing I want to call your attention to, and that is that while under the present law these seeds are embargoed the oil is coming in here, it is coming in right along, and that oil is processed in Japan by Japanese labor.

Senator KING. Your position is that we have driven the processing out of the United States over into Japan, China, and other countries?

Mr. LOZIER. Yes. In other words, last year, 1937, 44,239,000 pounds of sesame came in here, which is only 15,000,000 pounds less than came in here and was domestically processed when sesame seed was on the free list.

The CHAIRMAN. Mr. Lozier, some days ago Senator Johnson took this matter up with the chairman of the committee and we requested of the Tariff Commission and the State Department certain facts respecting this matter. When we go into executive session we will go over your argument and the facts that you present, as well as the facts furnished to us by the State Department and the Tariff Commission.

Mr. LOZIER. I thank you.

Senator KING. Mr. Chairman, I think it might be fair to Mr. Lozier to say that the State Department and the Department of Commerce have their views, and that he ought to have an opportunity to reply to them.

The CHAIRMAN. You may take these letters and look over them [handing papers to Mr. Lozier].

(The letters from the Department of State and the Tariff Commission referred to by the chairman are as follows:)

MARCH 16, 1938.

The Honorable PAT HARRISON,
United States Senate.

MY DEAR SENATOR HARRISON: I refer to your letter of March 12, 1938, enclosing a copy of a letter addressed to you by Senator Johnson, of California, regarding the correction in the pending revenue act of the excise tax of 2 cents per pound imposed on imports of certain oil seeds.

The situation is briefly as follows. The subcommitte of the Ways and Means Committee on the proposed revision of the revenue laws recommended (recommendation No. 61) that this uniform rate of 2 cents per pound be amended to rates varying from 0.73 cent per pound on kapok seed to 1.51 cents per pound on rapeseed. This recommendation was not included in the bill as reported by the Ways and Means Committee. According to my understanding, the major reason for the elimination of this recommendation of the subcommittee was that the Ways and Means Committee was not convinced that the specific rates had been appropriately determined.

I believe that the question of altering the flat 2-cent rate may have originally been brought to the subcommittee of the Ways and Means Committee in a letter which I addressed to the Honorable Fred M. Vinson, chairman of the subcommittee, on October 5, 1937 dealing with certain types of excise taxes which have been included in recent revenue acts and which, if one may judge by the number of bills introduced into the Congress in recent sessions, strongly tend to increase in number. These are the excise taxes levied on imports but not on domestic production of materials and taxes which are levied on the processing of materials, none or practically none of which is produced in continental United States. In this letter I was transmitting the recommendations of the Executive Committee on Commercial Policy, which had given careful study to the question of these taxes.

Among the recommendations transmitted to the subcommittee of the Ways and Means Committee one was the "adjustment of the rates applicable to the taxes on oil seeds so that there shall exist no less inducement to crush

the seeds in the United States (rather than to import foreign oil) than existed prior to the imposition of the excise taxes." As indicated above, this suggestion was apparently reflected in the subcommittee's recommendation No. 61.

The determination of the appropriate specific rates to give effect to this recommendation is a matter requiring technical competence which this Department does not presume to have. On that part of the question I believe that the United States Tariff Commission is in a position to advise your committee, and I gather from Senator Johnson's letter to you that you may already have referred that part of the question to the Tariff Commission.

So long as the excise tax on oil seeds remains substantially higher than the equivalent tax on the oils produced from those seeds, a stimulus is naturally given to the imports of oils rather than of seeds, to the detriment of domestic crushers without affording additional protection to producers in this country whose products compete with the oils so imported. It is the correction of this situation which is the objective of the amendment of the rates on oil seeds which was included as recommendation No. 61 of the subcommittee of the Ways and Means Committee.

Because of the urgency of the matter this letter has not been submitted to the Acting Director of the Budget.

Sincerely yours,

CORDELL HULL.

MARCH 15, 1938.

The Honorable PAT HARRISON,
Chairman, Senate Finance Committee, United States Senate.

MY DEAR SENATOR HARRISON: I have your letter of March 12 enclosing a copy of a letter to you from Senator Johnson of California concerning the excise taxes on perilla, hemp, sesame, kapok, and rapeseeds. I am submitting a memorandum answering, so far as it can be done, the questions raised in Senator Johnson's letter.

The situation with respect to the excise taxes may be summarized as follows:

1. The excise tax of 2 cents per pound applying to imports of perilla, hemp, sesame, kapok, and rapeseeds is higher (except as noted in the accompanying memorandum) than the combined tariff duties and excise taxes applying to imports of oils and oil cakes derived from these seeds. In consequence, any imports are almost entirely in the form of oil. This places domestic crushers in a disadvantageous position with respect to the imported oils and oil cakes.

2. This disadvantage would not be removed by merely reducing the rates on the seeds in question so as to establish compensatory relationships between them and the import charges on the corresponding oils and oil cakes; that is, so as to make the rates on each seed equivalent to the charges now applicable to the imports of the corresponding oil and cake, taking into account its oil and cake yields. To make such reduction in the case, for example, of perilla oil, would merely mean a reversion to the situation existing before August 1936 when, with both the oil and seed on the free list, seeds were crushed here only sporadically.

3. In order to make it possible for domestic crushers to supply a regular and considerable part of any domestic consumption of the oils in question, it would be necessary to reduce the rates on the seeds in relation to the charges on the corresponding oils so as to afford the domestic oil-crushing industry a protective, as well as a compensatory, differential. Domestic crushers make the point that on perilla and hemp seeds, which are competitive with flaxseed, they should have the same protective differential, about fifty-three one-hundredths of 1 cent per pound, as they have on flaxseed. The point is a strong one, but it should be pointed out that under this differential imports of linseed oil have been negligible. If it should be applied to the oil seeds in question, it is probable that in their case also imports would be confined largely to seeds instead of as now largely to oils. It is probable also that the rates on seeds, based on such a differential, would have the effect of reducing somewhat the protection afforded domestic producers of oil-bearing materials by existing duties and excise taxes.

4. The Tariff Commission has no data on the seeds in question indicative of the differences between the crushing and other costs here and abroad. It cannot, therefore, specify the differentials which will protect domestic crushing without significantly changing the protection at present afforded domestic producers of oil-bearing materials. The differential might, however, be arbitrarily fixed by act of the Congress. Computed rates based upon a number of specified differentials are set forth in the accompanying memorandum.

If there is any further information which we can give, we shall be glad to supply it.

Sincerely yours,

RAYMOND B. STEVENS, *Chairman*

MEMORANDUM ON THE ADJUSTMENT OF RATES ON PERILLA SEED, HEMPSEED, KAPOK SEED, RAPESEED, AND SESAME SEED SO AS TO AFFORD DOMESTIC CRUSHERS ADEQUATE OPPORTUNITY TO SUPPLY THE LARGER PART OF THE DOMESTIC CONSUMPTION OF THE OILS MADE FROM THESE SEEDS

Under existing legislation, imports of perilla seed, hempseed, kapok seed, rapeseed, and sesame seed enter free of tariff duty but are subject to an import excise tax of 2 cents per pound. This excise tax exceeds (with only two exceptions which probably can be ignored for the purposes at hand)[1] the combined tariff duties and excise taxes applicable to imports of the oil and oil cake derived from each of such seeds. Under these circumstances, it will not ordinarily be possible to import these seeds for crushing here. In fact, except for relatively small quantities of sesame seed, there have been practically no imports of these seeds imported for crushing since the present excise taxes went into effect in August 1936.

If the excise taxes on the above-mentioned seeds were to be adjusted so that they would be the equivalent of the charges now applicable to imports of the corresponding oil and cake, taking into account the different oil yields of the various seeds (but not taking into account differences in foreign and domestic crushing costs), the rates on the seeds (in cents per pound) would be as follows:

TABLE I

	Cost per pound		Cents per pound
Perilla seed	1.84	Rapeseed	1.76
Hempseed	1.65	Sesame seed	1.58
Kapok seed	1.26		

If the rates on oil seeds were to be adjusted so that domestic consumption of the oil and the cake derived from each of the seeds would be supplied principally by domestic crushers using imported seed, these rates would have to be lowered to afford a protective differential to domestic crushers. The rates on linseed oil and flaxseed have been suggested by domestic crushers as a proper basis to use in calculating rates on the seeds in question, particularly on perilla seed and hempseed, since the oils derived from these seeds compete with linseed oil. The protective differential which domestic crushers of imported flaxseed now have amounts to 0.53 cent per pound of seed, without including adjustment for the draw-back on cake.[2] Under this differential, imports of linseed oil have been negligible as compared with imports of flaxseed.

If the differential of 0.53 cent per pound of seed should be applied to the rates on the oil seeds under consideration, the rates in cents per pound would be as follows:

TABLE II

	Cents per pound		Cents per pound
Perilla seed	1.31	Rapeseed[3]	1.23
Hempseed	1.12	Sesame seed	1.05
Kapok seed	.73		

The rates shown in table II, except on rapeseed,[3] are identical with the rates contained in the recommendation which was prepared by the subcommittee of Ways and Means Committee. If these rates were enacted, the probabilities

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[1] Rapeseed used for making edible oil and sesame seed used for making inedible oil. Inasmuch as the computed rates on these would be respectively higher than those applicable to rapeseed used for making inedible oil and to sesame seed for making edible oil, only the pair of rates applicable to the latter are hereinafter shown.

[2] This figure is obtained by subtracting the duty on a pound of flaxseed from the sum of the rates on the quantity of oil and cake which would be obtained from it. The figure would be higher if the computation included the draw-back on linseed oil cake.

[3] The compensatory rates on rapeseed are: Edible, 2.04 cents per pound, and inedible, 1.76 cents per pound, which, with the 0.53 cent per pound deducted, become 1.51 and 1.23 respectively. We have shown the 1.23-cent rate (see footnote 1, p. 52).

are that little or none of the oil or cake derived from these seeds would be imported, but instead would be supplied by domestic crushers using imported seed. This does not mean that there would necessarily be imports of all of the seeds in question under these rates, but merely that such imports as there were would probably be principally, or entirely, in the form of seed rather than oil. The extent to which any of these oil seeds would be imported would depend not only on the import charges applicable to them, but on such other factors as fluctuations in the prices of the various oils and oil seeds.

It must be emphasized that the rates shown in table II are based on the protective differential of 0.53 cent per pound of seed now existing for domestic crushers of imported flaxseed. The application of this differential to the five seeds in question might result in some reduction in the protection at present afforded domestic producers of oil-bearing materials. To the extent that this differential proved to be more than sufficient to compensate for the differences between. foreign and domestic crushing and other costs, it would have this result.

The rates on seeds shown in table I provide merely for the compensatory relationship between the oils and the seeds from which they are made, whereas the rates shown in table II would appear to provide protective differentials so high as to insure that practically all import will be in the form of seed. The rates which, without appreciably altering the effective charge on the corresponding oils, would provide protective differentials sufficient to assure that any domestic production of the oils would be supplied principally by domestic crushers, would probably be somewhere intermediate between the rates shown in tables I and II.

The Tariff Commission, however, does not have the information necessary to determine the proper protective differentials on the five seeds in question, which would assure that the bulk of the domestic requirements would be supplied by domestic crushers. Although it has on two occasions in the past obtained data with respect to domestic and foreign costs with respect to producing linseed oil, it has no data indicative of what protective differential would correspond to the differential in such costs under present conditions. It has never obtained any data regarding the costs of crushing the five seeds under consideration. In order to determine what, for them, are the differentials which would correspond to the differences in crushing and other costs in the United States and in foreign countries would be exceedingly difficult, if at all possible. For example, not even the domestic cost data would be satisfactory because most of these seeds have not been crushed here recently in appreciable quantities, and several have never been crushed here except in small amounts.

Under these conditions, it will probably be necessary to determine arbitrarily the rates on the five seeds in question which, if the duties and excise taxes on the corresponding oils remain unchanged, would afford an adequate protective differential for the crushing industry without materially changing the protection at present afforded domestic producers of oil-bearing materials. As previously mentioned, such rates should probably lie intermediate between those shown in tables I and II.

The rates, for example, might be those shown in table I less either some percentage thereof as suggested by Senator Johnson, or, what appears to be preferable, some arbitrarily chosen constant. The following tables show the rates which result from the application of these methods, using various differentials:

	Cents per pound				
	Perilla seed	Hemp-seed	Kapok seed	Rape-seed	Sesame seed
Compensatory rates (table I)	1.84	1.65	1.26	1.76	1.58
Compensatory rates less specified constants:					
Compensatory rates less 0.2 cent per pound	1.64	1.45	1.06	1.56	1.38
Compensatory rates less 0.3 cent per pound	1.54	1.35	.96	1.46	1.28
Compensatory rates less 0.4 cent per pound	1.44	1.25	.86	1.36	1.18
Compensatory rates less specified percentages:					
Compensatory rates less 15 percent	1.56	1.40	1.07	1.50	1.34
Compensatory rates less 20 percent	1.47	1.32	1.01	1.41	1.26
Compensatory rates less 25 percent	1.38	1.24	.94	1.32	1.18

Mr. LOZIER. I am quite sure, from my familiarity with the State Department and Tariff Commission, that no intelligent governmen-

tal body would or ever has or ever will approve the existing rates, because they represent economic nonsense. There is only one ground upon which you can defend the present rates, and that is if you want to create an absolute embargo against the seeds for the benefit of some other imported competing oils.

The CHAIRMAN. You will not find very much fault with those (referring to the Tariff Commission and State Department correspondence).

Mr. LOZIER. I am quite sure of that.

The CHAIRMAN. Be sure to give them back to me.

Mr. LOZIER. Yes, sir; I will.

Senator KING. You may have this comfort, that they are opposed to it, and I think your argument today only corroborates the views I had in the past.

Mr. LOZIER. Thank you. All we ask is for you to examine the matter, and I will take the judgment of any Senator on that subject after he studies the facts.

Supplementing my testimony before this committee, March 17, 1933, and my statement, page 725 of the hearings before the Ways and Means Committee, January 21, 1938, at this time I desire to submit a detailed analysis of this oilseed excise-tax problem, a thorough knowledge of which is necessary, if the committee and Congress are to give this question the intelligent consideration to which it is entitled, for the reason that the subject is obviously technical, and in order to determine what rates are fair and just, it is necessary to know the variable oil content of these seeds and the relation of the seeds and their oils bear to other competing seeds and oils.

I

FOREWORD

(*a*) *The issue presented.*—Will Congress correct a manifest legislative mistake made by a previous Congress, and rectify an obviously maladjusted tax schedule, enacted without hearings or sufficient understanding of its real purport and practical operation, which legislative provision substantially benefits no individual or class of our citizenry, wrongfully penalizes a deserving vocational group, deprives American workingmen of employment, destroys an important and heretofore prosperous domestic industry, and transfers its activities to the Orient?

(*b*) It is a fundamental tenet of the American Congress that it is just as much a duty, and just as imperative to repeal an existing bad law as it is to enact a good new law.

A great Government like ours should move swiftly to undo a legislative wrong, whether committed intentionally or by inadvertence. "To no one will we deny justice, to no one will we delay it" (Magna Carta).

(*c*) If the 1936 rates should not have been enacted, then by every sound principle of reason and legislative ethics, they should not be permitted to remain in force, and should be repealed.

(*d*) The supreme purpose of all just governments is, not only to enact wholesome and benevolent new legislation, and protect the many from the aggression and exploitation of the powerful few, but to correct previous legislative mistakes, right legislative wrongs, and to repeal laws that have been weighed in the balances and found wanting. While justice may be blind, it should not lame, laggard, or entangled in a net of delay.

(*f*) The rates prescribed by the 1936 Revenue Act operated as an embargo, halted the crushing of these five seeds in our domestic mills by American labor, and automatically compelled their processing in oriental mills by oriental labor. The retention of the existing rates will benefit no one and continue to punish American labor, and ultimately give the Orient, or Europe, a monopoly

on the world-important oils processed from these seeds, and compel the American people to buy the imported finished products to supply their ever-increasing needs, to their economic debasement and the destruction of a deserving and useful domestic industry.

(*g*) The proposed reduction of taxes on these seeds will lift the embargo, enable the crushers to resume operations, and rebuild this important industry which was bludgeoned into insensibility by the 1936 Revenue Act. These commodities will continue to enter our ports. Why not reduce the tax rates so as to permit their entrance in the form of seed to be processed in our domestic mills by American labor, instead of being processed in foreign mills by foreign labor?

(*h*) Now that Congress has discovered the joker ("the Senegambian in the woodpile"), will either Democrats or Republicans deliberately go on record as favoring a continuance of the present excessive, discriminatory, and embargo-creating excise taxes on these seeds?

II

1. *Subject.*—Proposed amendment of section 601 (c) (8) of the Revenue Act of 1932, as amended by title V, section 701 of the Revenue Act of 1936.

2. *Where in the pending revenue bill does the provision appear which is sought to be amended?*—Subparagraph (D) of section 702 of H. R. 9682.

3. *To what commodities do this section and the proposed amendment relate?*—To five oil-bearing seeds, viz, hempseed, perilla seed, rapeseed, sesame seed, and kapok seed.

4. *What is the present duty or tax on these seeds?*—All duty free; each subject to an excise tax of 2 cents per pound under the 1936 Revenue Act (Title V, sec. 701, which amended sec. 601 (c) (8) of the Revenue Act of 1932).

5. *Tariff and tax status of these seeds prior to the Revenue Act of 1936.*—All duty free and tax free.

6. *What are the duties and/or taxes on the imported oils from these seeds?*—Hemp oil, duty 1.5 cents per pound; excise tax 4.5 cents per pound; total, 6 cents per pound.

Perilla oil, excise tax, 4.5 cents per pound, no duty.

Rape oil, excise tax, 4.5 cents per pound; duty 6 cents per gallon (equivalent to 0.8 cent per pound); total tax and duty 5.3 cents per pound.

Sesame oil, duty 3 cents per pound, on edible, and 4.5 cents per pound on inedible.

Kapok oil, duty 20 percent ad valorem, equivalent to 1.2 cents per pound; excise tax 4.5 cents per pound; total tax and duty 5.7 cents per pound.

7. *Have these five seeds the same or practically the same oil yields?*—No. The oil yields are strikingly variable, ranging from 18 to 48 percent.

8. *In imposing the excise tax of 2 cents per pound on each of these seeds, was any consideration given to their variable oil yields?*—No.

9. *What is the oil yield of each of these five seeds?*—Kapok, 18 percent, hempseed, 24 percent, rapeseed, 35 percent, perilla seed, 37 percent, and sesame seed, 48 percent.

10. *Considering their variable oil yields the 2 cents per pound tax on these seeds is equivalent to what tax on their respective oils?*—

(*a*) A tax of 2 cents per pound on sesame seed is equivalent to a tax of 4.16 cents per pound on the oil expressed therefrom.

(*b*) A tax of 2 cents per pound on perilla seed is equivalent to a tax of 5.41 cents per pound on the oil expressed therefrom.

(*c*) A tax of 2 cents per pound on rapeseed is equivalent to a tax of 5.71 cents per pound on the oil expressed therefrom.

(*d*) A tax of 2 cents per pound on hempseed is equivalent to a tax of 8.33 cents per pound on the oil expressed therefrom.

(*e*) A tax of 2 cents per pound on kapok seed is equivalent to a tax of 11.11 cents per pound on the oil expressed therefrom.

BY WHAT PROCESS OF REASONING, BY WHAT SCHOOL OF POLITICAL THOUGHT, BY WHAT CODE OF GOVERNMENT ETHICS CAN THESE UNDENIABLY HAPHAZARD AND DISCRIMINATORY RATES BE JUSTIFIED?

11. *Are these five seeds grown in the United States?*—They are not. Rape is grown for hog or sheep pasture but not for seed. To a very limited extent hemp is grown for fiber but not for seed. Experiments have been conducted in the

United States looking to the growing of perilla and sesame seeds, but without any satisfactory results. Kapok seed is a tropical product.

12. *From what countries are these five seeds imported?*—

(*a*) Sesame from the Netherlands, Mexico, China, Japan, Kwantung, Hongkong, and British India.

(*b*) Kapok, from the Netherlands, India, and Japan.

(*c*) Rape, from Belgium, Germany, Argentina, British India, Japan, Netherlands, Hungary, and the United Kingdom.

(*d*) Hemp, from China, Japan, and Kwantung.

(*e*) Perilla, from China, Kwantung, and Japan.

III

Why should the present rates be revised downward?—

(*a*) The present rates are haphazard, excessive, and discriminatory.

(*b*) The 2-cent-per-pound tax on the seeds is equivalent to a tax on the oils expressed therefrom ranging from 4.16 to 11.11 cents per pound.

(*c*) Because the present rates impose (when translated into terms of the oils expressed therefrom) a much higher tax on the raw material than is laid against their respective imported finished products.

(*d*) The present tax operates as an embargo on the five seeds, which cannot now be imported and profitably processed in our domestic mills.

(*e*) Inasmuch as the tax on these five imported seeds (expressed in terms of their oil yields) is higher than the tax on the corresponding imported oils, the natural and inevitable effect has been to force American mills to discontinue crushing these seeds, and to transfer such crushing operations to the mills in the Orient, to the great loss of American industry and labor, a result not contemplated by Congress when these taxes were imposed, nor justified by any rule of reason or public policy.

(*f*) The present grossly excessive excise taxes on these seeds is destroying an important, deserving, useful, and unoffending domestic industry.

(*g*) As a result of the present haphazard taxes these seeds that formerly had been processed in American mills by American labor, are now being processed in foreign lands by foreign labor.

(*h*) The 2-cent-per-pound tax discriminates against American industry, American capital, and American labor, in favor of foreign industry, foreign capital, and foreign labor.

(*i*) The oil-bearing seeds which prior to the 1936 Revenue Act were imported and crushed in American mills, are now being crushed abroad and their oils, as finished products, are being imported into the United States, thereby depriving domestic capital and labor of employment without diminishing the volume of foreign oils entering our domestic markets.

(*j*) The present 2-cent-per-pound tax is indefensibly and unconscionably high, being equivalent to an ad valorem tax ranging from 54$\frac{8}{10}$ to 142$\frac{8}{10}$ percent.

(*k*) The 2 cents per pound tax on these seeds imposes a much higher tax on the imported raw material (when expressed in terms of the oil recoverable therefrom), than on the imported finished product, which formula violates the principles of all political parties and of all schools of political thought, and the long-established and universally accepted policy of our Government, viz, that when commodities are imported, either as raw material or as finished products, the duty or tax on the raw material should be substantially lower than the duty or tax on the imported finished product.

(*l*) If the commodity is to be imported, its entry as raw material should be encouraged, so its processing may be done in American mills by American labor, in preference to having the commodity imported as a finished product, after having been processed in foreign lands by foreign labor; and the tax on the imported finished product should be at such higher rate as will afford American industry a fair and reasonable differential between the tariff or tax on the raw material, and the tariff or tax on the imported finished product; and it is universally agreed that this sound and wholesome policy temendously benefits American labor, builds up, diversifies, and stabilizes American industry, and increases our national wealth.

The taxes on these seeds should be reduced to a point sufficiently below the seed equivalent, compensatory or parity rates as to afford our domestic crushers a reasonable preferential or protective differential over corresponding oils processed abroad and imported into the United States.

(*a*) In its letter to Chairman Harrison, the United States Tariff Commission stated that the exact charge on these five oil-bearing seeds that would be

equivalent to charges now in effect on their respective imported oils and cake are, perilla seed, 1.84 cents per pound; sesame seed, 1.58 cents per pound; hemp seed, 1.65 cents per pound; rape seed, 1.76 cents per pound; and kapok seed, 1.26 cents per pound.

(b) The foregoing taxes, if enacted, according to the findings of the Commission, would establish a parity between the imported oils and oils processed in our domestic mills from imported seeds, but would not provide any preferential or protective differential in favor of the domestic crushers.

In other words, the foregoing schedule of rates would place our domestic mills on an exact equality with foreign mills, and unless there is a substantial reduction from the hereinbefore-mentioned compensatory or seed-equivalent taxes, by reason of cheaper labor and lower production costs in the Orient, these seeds would continue to be crushed in the Far East, enter the United States as finished products, and be sold in our domestic markets at prices appreciably below the price at which American mills could afford to sell them; and to avoid this monopoly of our home markets by substandard, undernourished oriental labor, it is not only permissible, but highly desirable to grant our domestic mills such reasonable and necessary differentials as will enable them to import and profitably process these seeds, thereby affording an investment for American capital and employment for American labor. No patriotic American can or will question the soundness of this policy.

(c) It is the established policy of the Congress, regardless of its political complexion, in writing tariff or tax bills involving importation of raw materials, not to stop when it finds the compensatory or exact parity relationship between imported raw materials and their corresponding imported finished products, but the Congress goes further and allows the American manufacturers a fair and reasonable preferential or protective differential to equalize the differences in foreign and domestic labor and other production costs, as for instance, the protective differential between imported flaxseed and imported linseed oil is 0.53 cents per pound.

(d) Therefore it is not sufficient to merely ascertain the seed equivalent or so-called compensatory or parity rate, which would make no allowance for the admitted difference in the cost of labor and other production costs in domestic and foreign mills, but American mills should be afforded a fair differential which will enable them to resume operations, at least on a basis of equality with the Japs, when difference in labor and other production costs are taken into account in fixing the tax.

V

Specifically, what is the proposed amendment?—To strike from subparagraph (D), section 702, of the pending bill the words "hempseed, perilla seed, rapeseed, sesame seed, and kapok seed, 2 cents per pound," and in lieu thereof insert the following: "Hempseed, 0.76 of 1 cent per pound; perilla seed, 1.31 cents per pound; rapeseed, 1.23 cents per pound; sesame seed, 1.05 cents per pound; and kapok seed, 0.51 cent per pound" (the amendment to be framed so as to repeal the existing 2 cents per pound excise tax and substitute in lieu thereof the foregoing rates, or such rates as the Congress considers appropriate and just under existing conditions).

VI

Are the rates proposed by the National Institute of Oilseed Products fair and reasonable?—

(a) Yes; they represent the approximate seed equivalent taxes, i. e., the appropriate compensatory charges against the raw materials, based on present duties and excise taxes on their corresponding imported oils and cakes, after allowing a protective differential of 0.53 cent per pound to compensate domestic crushers for the difference in labor and other production costs in foreign and domestic mills, which is the same differential allowed crushers of imported flaxseed.

(b) The milling and other costs incident to the processing of these seeds are approximately the same as the costs of processing imported flaxseed. The experience of the crushers, extending over a period of years, is that they must have a spread of approximately one-half cent per pound, or from $10 to $12 per ton, between the c. i. f. cost and the market price of the finished products. The rates suggested by the domestic crushers is approximately one-half cent

per pound on the raw materials, and it is the deliberate judgment of the members of the institute that the crushers of these seeds should be granted the same, or approximately the same, differential as now prevails between imported flaxseed and imported linseed oil.

(*c*) However, the present excise taxes on these seeds having closed our domestic mills, and in view of the tragic condition of the industry, our domestic crushers appeal to Congress to grant them substantial relief; and if Congress should conclude that the crushers of these seeds should not be granted the same differential now granted crushers of imported flaxseed, then very obviously that differential should be approximated so as to permit our domestic mills to resume the processing of these commodities. The members of the National Institute of Oilseed Products are not greedy, dogmatic, or unreasonable in their requests, and only ask the same treatment and consideration that has been consistently, traditionally, and ungrudgingly accorded all other domestic industries.

All my clients ask is a sane, intelligent, and equitable adjustment of these inapt, bungling, and undeniably excessive taxes. As reasonable citizens, appealing to an impartial, conscientious, and just committee and Congress, they ask only for such reduction in the existing oilseed excise-tax structure as will enable them to resume their legitimate and useful activities.

(*d*) I believe it was John Stuart Mill who said "Every battle for human freedom has been fought around the standard of taxation"; and while my clients, like all good citizens, recognize the necessity and justice of taxation, if organized society is to be preserved and function efficiently, and while they willingly pay their part of the expenses of government, they are justified in protesting when the taxing powers carelessly and wrongfully used to destroy property or an industry and drive unoffending citizens to a condition of penury.

VII

(*a*) On the initiative of Senator Johnson of California, Senator Harrison, chairman of the Senate Finance Committee, addressed communications to the United States Tariff Commission and Secretary of State Hull requesting certain information in reference to the present oil-bearing seeds excise-tax structure.

The replies of the Tariff Commission and Secretary Hull appear in connection with my testimony at the hearings before the Senate Finance Committee, March 17, 1938.

These communications are illuminating and worth-while contributions to the study of the Finance Committee to reach a rational and just conclusion as to appropriate taxes that should be laid on these seeds entering our ports.

(*b*) The findings of the Tariff Commission are an official ascertainment of the already well known and obvious facts, that—

1. The present 2 cents per pound tax on these seeds is higher than the combined duties and excise taxes applying to oils and oil cakes derived from these seeds.

2. In consequence, any imports are almost entirely in the form of oil (which of course is processed in foreign lands by foreign labor).

3. This places domestic crushers in a disadvantageous position with respect to the imported oil and oil cakes.

4. This disadvantage would not be removed by merely reducing the rates on the seeds in question so as to establish compensatory relationships between them and the import charges on the corresponding oils; that is, so as to make the rates on each seed equivalent to the charges now applicable to the imports of corresponding oil and cake, taking into consideration its oil and cake yields.

5. To make a reduction of the present tax to a point where the oils processed from imported seed would be on an exact parity with imported oils, would not cure the situation, as for example, if the the tax on perilla seed is only reduced to a point where the oil processed therefrom would be on an exact parity, with imported perilla oil, this would mean a reversion to the situation existing before August 1936, when with both the oil and seed on the free list, practically all of our sesame comes in as oil, and seeds were domestically crushed only sporadically.

6. In order to make it possible for domestic crushers to supply a regular and considerable part of any domestic consumption of the oils in question, it would be necessary to reduce the rates on the seeds in relation to the charges on the corresponding oils so as to afford the domestic oil-crushing industry a protective as well as a compensatory differential.

VIII

THE FINDINGS AND CONCLUSIONS OF THE TARIFF COMMISSION ARE SOUND

(*a*) The National Institute of Oilseed Products registers its approval of the findings of facts and conclusions submitted by the Tariff Commission, not only in its letter of March 15, 1938, to Chairman Harrison of the Senate Finance Committee, but also to its findings of facts and conclusions in its letters to Chairman Doughton of the Ways and Means Committee, dated March 27 and April 24, 1937. The formulas used in ascertaining the compensatory or parity rates on the several seeds were those generally used for that purpose. In these recent studies, the Commission maintained its long-established and well-deserved reputation as an eminently fair, absolutely impartial, and thoroughly competent fact-finding body.

(*b*) In these studies, of course, the Commission had to start with the duties and taxes on imported oils and cake of the respective seeds, which lack uniformity, and may I respectfully suggest, are haphazard, and in several instances strikingly unreasonable, unbalanced, and obviously inappropriate, as the following table graphically illustrates:

Duties and/or excise taxes on certain imported vegetable oils and seeds

Oils	Duty (cents per pound)	Excise tax (cents per pound)	Combined duty and tax (cents per pound)
Perilla		4.5	4.5
Hemp	1.5	4.5	6.0
Sesame:			
Inedible		4.5	4.5
Edible, same as cottonseed oil	3.0		3.0
Rape:			
Edible	.8	4.5	5.3
Inedible		4.5	4.5
Kapok	1.2	4.5	5.7
Cottonseed oil (same as edible sesame oil)	3.0		3.0
Sunflower (inedible)		4.5	4.5
Linseed	4.5		4.5
Cotton	½		½
Flax	1.16		1.16
Perilla, hemp, sesame, rape, and kapok		2.0	2.0

NOTE.—Oil yield of respective seeds: Perilla, 37 percent; hemp, 24 percent; sesame, 48 percent; rape, 35 percent; kapok, 18 percent; cottonseed, 15 percent; flaxseed, 33 percent. All imported oil cake carries a duty of 0.3 cent per pound.

(*c*) Now, with the foregoing motley, heterogeneous, hodge-podge schedule of duties and taxes on imported oils as a basis, the Commission determined the compensatory charges on these seeds. The grossly excessive combined duties and taxes on imported hemp, rape, and kapok oils made the compensatory rates on these seeds excessive and disproportionate in comparison with the compensatory rates on other seeds, the oils from which come in under a lower combined duty and tax.

Indeed the total tax load on imported hemp oil, rape oil, and kapok oil is so great as to constitute an embargo, in view of which it does not seem quite fair for Congress to be tied down to the compensatory rate on these three seeds, when that rate was based on a total duty and tax so high as to exclude their importation. This suggestion is particularly pertinent as regards hempseed, the oil from which must compete in our domestic market with oils processed from imported flaxseed on which the duty is only 1.16 cents per pound; and by this token it would not be unfair for Congress to fix a tax on hemp and perilla seeds that would place the oils processed therefrom on a parity with the competing oils processed from imported flax and perilla seeds.

IX

NOTHING LESS THAN THE RATES SUGGESTED BY THE TARIFF COMMISSION AS PROVIDING 25-PERCENT PREFERENTIAL PROTECTION SHOULD BE ADOPTED

(*a*) In the last table submitted by the Tariff Commission in its letter to Chairman Harrison, certain rates were enumerated as affording varying degrees of protection, viz, 15, 20, and 25 percent. The members of the National Institute of Oilseed Products are firmly convinced that nothing short of a 25-percent protective differential would enable our domestic mills to resume the importation and crushing of these seeds. This conviction is based on their practical experience in milling these commodities in the past, and their knowledge of competitive conditions which these oils would encounter in our domestic markets.

With taxes on these seeds based on 15 or 20 percent preferential differential the greater volume of these seeds would continue to be processed abroad and the oil exported to the United States.

(*b*) These oils, processed abroad, are now entering our ports in ever-increasing volume. Why should Congress hesitate to prescribe a schedule of rates which will result in these commodities entering in the form of seed, so they may be crushed in American mills by American labor?

X

THE REPORT OF THE TARIFF COMMISSION IRREFUTABLY DEMONSTRATES BOTH THE NECESSITY AND WISDOM OF REDUCING THESE OILSEED EXCISE TAXES

It is difficult to conceive how anyone who reads the findings and conclusions of the Tariff Commission can escape the conviction that the present oilseed excise-tax rates should be immediately and radically revised downward.

Apropos a reduction of these rates, the Commission said: "If the rates on oilseeds were to be adjusted so that domestic consumption of the oil and cake derived from each of the seeds would be supplied principally by domestic crushers using imported seed, these rates would have to be lowered to afford a protective differential to domestic crushers."

Which prompts me to propound the following inquiry: Can any logical reason be advanced why these rates should not be adjusted so as to bring about the crushing of these seeds in American mills by American workmen? Would not that situation be infinitely better than the present state of affairs wherein our domestic mills are closed and the crushing of these seeds transferred to the mills of the Orient?

Continuing, the Tariff Commission said: "The rates on linseed oil and flaxseed have been suggested by domestic crushers as a proper basis to use in calculating the rates on the seeds in question, particularly on perilla seed and hempseed, since the oils derived from these seeds compete with linseed oil. * * * Under this differential 0.53 cent per pound imports of linseed oil have been negligible as compared with imports of flaxseed."

And again I say, should not these rates be so adjusted as to permit these commodities to enter in the form of seeds so they may furnish investments for American capital and employment for American labor? Why not frame our tax schedules so as to favor domestic industry rather than foreign industry? By continuing the 2-cent rate, we are playing into the hands of Japan, who is now processing these seeds in her mills, keeping the cake, and exporting the oil to America.

I quote again from the Tariff Commission: "If the differential of 0.53 cent per pound of seed should be applied to the rates on the oilseeds under consideration, the rates in cents per pound would be as follows: Perilla seed, 1.31; hempseed, 1.12; kapok, 0.73; rapeseed, 1.23; and sesame seed, 1.05. The rates shown in table II, except on rapeseed, are identical with the rates contained in the recommendation which was prepared by the subcommittee of the Ways and Means Committee. If these rates were enacted the probabilities are that little or none of the oil and cake derived from these seeds would be imported, but instead would be supplied by domestic crushers using imported seed. This does not mean that there would necessarily be imports of all of the seeds in question under these rates, but merely such imports as there were would probably be principally, or entirely, in the form of seed rather than oil."

To which I reply in the language of the Melancholy Dane, "'Tis a consummation devoutly to be wished."

XI

SECRETARY HULL SPEAKS FOR AMERICAN INDUSTRY

In his letter to Chairman Harrison, Secretary Hull, with the perspicacity, sound judgment, and grasp of public problems that have characterized his long, honorable, and useful public service, tersely and convincingly stated the issue:

(a) "Among the recommendations transmitted to the subcommittee of the Ways and Means Committee one was the 'adjustment of the rates applicable to the taxes on oilseeds so that there shall exist no less inducement to crush the seeds in the United States (rather than to import foreign oil) than existed prior to the imposition of the excise taxes.' As indicated above, this suggestion was apparently reflected in the subcommittee's recommendation No. 61. * * * So long as the excise tax on oilseeds remains substantially higher than the equivalent tax on the oils produced from those seeds, a stimulus is naturally given to the imports of oils rather than of seeds, to the detriment of domestic crushers without affording additional protection to producers in this country whose products compete with the oils so imported. It is the correction of this situation which is the objective of the amendment of the rates on oilseeds which was included as recommendation No. 61 of the subcommittee of the Ways and Means Committee."

XII

THE EMBARGO ON THESE SEEDS PRODUCED BY THE 2 CENTS PER POUND TAX DID NOT REDUCE ONE IOTA THE COMPETITION OF A SINGLE DOMESTIC PRODUCT

(a) When a few million pounds of these seeds were excluded by the present taxes, several times as many million pounds of other foreign commodities of the same class came in to take the place of the five embargoed seeds. As, for instance:

1. In 1936 flaxseed imports were 860,000,000 pounds; in 1937, 1,569,000,000 pounds, nearly double the 1936 importations.
2. In 1937 we imported 175,000,000 pounds of tung oil, as compared with 135,000,000 pounds in 1936.
3. In drying oils alone our importations in 1937 were 190,000,000 pounds more than in 1936.
4. While the 2 cents per pound tax shut out about 134,000,000 pounds of perilla and hemp oil in 1937, yet in that year the importations of flaxseed were 709,000,000 pounds more than in 1936.
5. Which offered more competition to the domestic flax grower, 134,000,000 pounds of perilla and hempseed or 241,000,000 pounds of additional foreign linseed oil?
6. The exclusion of perilla and hempseeds by the Revenue Act of 1936 did not to any extent decrease the competition of domestic flax growers, but the vacuum created by the embargo on perilla was filled by increased importations of foreign flaxseed and tung oil. I quote from Fats and Oils Trade of the United States, released by the Department of Commerce February 1938:

"Flaxseed imports in 1937 were heavier than the total of all oilseeds combined in the 5-year average and not much less than all oilseed imports in 1936. A low domestic crop, decreased imports of other drying oils and increased demands of the paint industry were the principal factors in imports of a billion and a half pounds of flaxseed last year, of which all but 36,000,000 pounds came from Argentina."

7. I quote further from the above-mentioned Government release: "The estimated 1937 flaxseed production of 6,974,000 bushels * * * was only about one-fifth of the total amount of flaxseed reported crushed for oil last year."
8. I quote from Fats and Oils Trade, supra: "Heavy sesame seed imports in 1936 were displaced to a considerable extent in 1937 by edible sesame oil (not included in the additional taxes of 1936), imports reaching 39,000,000 pounds, this Chinese oilseed being diverted from domestic to foreign crushing mills in 1937."
9. I quote again from the foregoing Government publication: "Imports of hemp, perilla, kapok, rape, and sesame seeds in 1937 were curtailed by the excise tax of 2 cents per pound placed on these oilseeds in the Revenue Act of 1936, effective August 21 in that year. Suggested amendments designed to reduce these taxes with the object of crushing these seeds in American mills have been presented to Congress."

SESAME AND KAPOK OIL NO MENACE TO THE COTTON-OIL INDUSTRY

(*a*) Sesame and kapok oils furnish no real competition of domestic cottonseed oil. The big competition to cottonseed oil comes from imported cottonseed oil, which in 1937 was imported in much larger volume than in 1936 or previous years. The imports in 1937 of foreign cottonseed oil were 104,000,000 pounds. This oil, and not sesame and kapok, furnished the chief competition to cottonseed oil and other domestic edible products.

CONCLUSION

I respectfully submit that on the record the existing oilseed excise taxes should be immediately revised downward so as to permit the processing of these commodities in our domestic mills. I do not doubt the willingness of Congress to rectify the legislative miscarriage of 1936.

I believe a large majority of the Members of our National Congress are always actuated by two controlling and commendable motives, viz:

First. As far as possible under our legislative system, to prevent the enactment of hastily considered, unsound, and unwise legislation.

Second. To repeal as quickly as legislatively possible any unsound and unwise legislation previously enacted without sufficient consideration of its probable practical operation and effect.

By this traditional touchstone of legislative ethics all individuals, classes, and vocational groups are assured equal and exact justice, which, in the last analysis, is the supreme purpose for which all good governments are created.

Respectfully submitted.

RALPH F. LOZIER,
General Counsel, National Institute of Oil Seed Products.

The CHAIRMAN. Senator Hawes, I do not want to keep you waiting here too long. I understood you wanted to be heard in connection with the matter in which Mr. Mercier is interested.

STATEMENT OF HON. HARRY B. HAWES, WASHINGTON, D. C.

The CHAIRMAN. Gentlemen, this is Senator Hawes, whom you all know.

Mr. HAWES. Mr. Chairman, I appear here today in a rather unusual capacity. I am not employed in this matter and I merely want to try to give the committee the benefit of my experiences in the Philippines, especially within the last 2 months.

A representative of the Government appeared in the Philippines in 1937 for the first time.

Senator KING (interrupting). You mean of our Government?

Mr. HAWES. Of our Government—attempting to secure the payment of taxes which he claims were due from the year 1917 to the present time.

Senator KING. That included the Haussermann matter, did it not?

Mr. HAWES. It includes some 2,500 or 3,000 American for the period 1917 to 1920 and some 300 for the period thereafter.

The CHAIRMAN. Senator, in that connection, I do not want to influence what you have to say, but there have been two propositions set forth, with which you are familiar, I presume. The House has put one amendment in here that will restrict, in the future, the fact that an American citizen living in the Philippines will be put in the same category that he was in the year 1917, and the other day Governor McNutt came before the committee and presented the situation to us also, and told us of the difficulties in the Philippines because of the failure to adjust those taxes for the years 1917, 1918, 1919, and 1920.

Mr. HAWES. Mr. Chairman, I will not occupy much of your time. I think this is a short matter that can be heard quickly. This claim of back taxes was startling to those Americans in the Philippines. They did not anticipate the claim and had made no provision for it.

A little of their background may not be out of place. When our Admiral Dewey entered Manila Bay and sank the Spanish squadron he lost one man. That man died of heart disease. That was the total casualty of the American fleet. I will have to give you this little background to get to the tax again.

The Filipinos had driven the Spaniards within the walls of the old city of Manila. After the American forces landed, Aguinaldo requested the American commander that the insurgents be allowed to enter the city with the American Army. This was refused because the Spaniards objected. They were then left outside and the 3-year war began. We lost only 353 men in conquering the Spaniards in Cuba, but before we got through fighting with the Filipinos we had lost 4,000 men and they had lost 16,000 men.

That brought to the islands a fine body of Americans, big, strapping fellows most of them were, and after the 3 years of war President McKinley and the administration in power used every effort to induce Americans to remain there, and amongst others naturally were the soldiers, and they stayed.

Then later we had some 600 school ma'ams that went out there on one ship and many stayed.

So that this claim today, I state without fear of contradiction, is levied either at the old soldier, who is still alive, or the children of the soldiers who came on afterward.

There is a most peculiar condition that we find in the Philippines. Of some 15,000,000 people, there are about 14,500,000 Christians. The other 500,000 are Moros and Pagans, but in addition to these there are 6,000 Americans, some 6,000 Japanese scattered throughout the islands, an additional 14,000 concentrated in one portion of Mindanao raising hemp, and about 7,500 Spaniards and Europeans. The Americans have always lived there, since we first went in.

Now the American today, and he has since his occupancy of the island, pays the same proportion of taxes that the Filipinos pay, that the Chinese pay, that the Japanese pay, and the other Europeans pay in the Philippines. They have the same power to vote and participate in the affairs of the island that the Filipino citizens have.

Senator KING. Have any of them renounced their American citizenship?

Mr. HAWES. No. Now, none of the oriental people that live there, none of the European people that live there pay an income tax to their home government, none of the Filipinos do.

So these 6,000 Americans, descendants of the old soldiers—I do not want to be sentimental about it because I believe that to be a correct statement—are now called upon, after 20 years have passed, to pay an income tax to the United States Government, with all its accrued interest.

There is no businessman in this country that could do that and live. It means the crushing of these men, because they came there with nothing but possibly a suit of clothes and as they prospered they put their money back into their business as fast as they made it, and what they have today is an accumulation of over 30 years' effort.

Every once in a while some reference to this establishment of an income tax has been brought up.

From the first governor to the last governor general of the Philippines it has been opposed. Beginning with Harrison in 1917, and following Harrison, I think, was Wood, Stimson, Davis, Roosevelt, Murphy, and now our own High Commissioner McNutt; they have all opposed it.

The Filipinos have no direct official interest in this subject——

Senator KING. May I interrupt right there, Senator?

Mr. HAWES. Yes, indeed.

Senator KING. Has an effort been made by American authorities to distrain from time to time against persons against whom taxes are claimed?

Mr. HAWES. No; they have not gone to that extreme.

Senator KING. They have not brought any suit or attempted to distrain?

Mr. HAWES. No, sir.

A gentleman, Mr. Mercier, an expert economist and tax expert, is to follow me and can answer any of the technical questions. As you know, I am not an economist——

Senator KING. That is to your advantage.

Mr. HAWES. But speaking for the Filipino people, as their counsel in Washington, I am taking the liberty of reading a letter which was given to me to hand to this committee from the Honorable Quintin Paredes:

DEAR MR. CHAIRMAN: I have been advised that your committee will consider providing some legislative relief for American citizens residing in the Philippines. The matter does not officially concern the Philippines Commonwealth, but I cannot resist the temptation of supplementing the position taken in this matter by the American High Commissioner, Mr. Paul V. McNutt.

The early American settlers in our islands who have lived there all their lives and established homes and business form a most substantial and essential element in the Philippine Commonwealth.

No citizen of any country can, after the lapse of a quarter of a century, be suddenly confronted with a claim for back taxes that had not been presented before and for which no provision had been made.

It would mean bankruptcy, the wiping out of lifetime savings, and the disruption of homes.

No Filipino, grateful as we are to the great American Republic, could view such a catastrophe without fear of its broad financial consequences.

While the matter is an American problem, if we destroy the life work and achievement of the American group in the islands, it will precipitate a very serious financial situation for the entire Philippine Commonwealth.

May I urge upon your honorable committee thoughtful consideration of the equities and justice of the claim for relief.

I have served in the Philippine Legislature, have been its Speaker, and have been a practicing lawyer all my life. I know of no situation analogous to this, either in the Philippines or in any other country.

The Americans residing in the Philippines should not have a more serious handicap applied to them than citizens of foreign nationalities, either European or oriental, who reside in our country and compete in business enterprise with Americans.

May I have that made part of the record?

Your chairman refers to a statement made by High Commissioner McNutt. It is unfortunate he could not appear here today; I know he desired to appear——

The CHAIRMAN. The only reason he was heard before the public hearings started was because he was leaving that night, and we accommodated him by listening to him that day.

Senator KING. Would this be an analogy: Under the Chinese Trading Act, American citizens who live in China and derive an income there from their activities, their business in China, we do not tax them on that, but if they have an income from sources in the United States, we tax that income, but we do not make them pay taxes on the income derived in China, and we have discriminated against the American citizens in the Philippines as against an American citizen in China?

Mr. HAWES. Exactly. In addition, the German, Englishman, Spaniard, Japanese, and Chinese who compete with our Americans in all lines of professions are exempt from this tax; only Americans pay it.

Mr. McNutt, in speaking of these Americans, said:

As I read over the annals of American occupation, I feel proud of that list of distant proconsuls who so honorably acquitted their tasks in so distant an outpost, and I feel a humility in joining their company.

But my pride goes deeper than the governors. No community has ever harbored a more attractive group of Americans. Ex-soldiers and officers who stayed on and others who followed became honest merchants, founders of new industries, miners, lumbermen—a goodly concourse who believed in the Filipino and paid him higher wages than he had ever previously earned; who believed in the Philippines and gave it their last ounce of thought and Yankee ingenuity. There was not an exploiter or enslaver among them. They worked hard, plowed back their profits, held their counsel, and assisted mightily to lay the foundations of American culture in the Orient, Christianity, and American culture.

Now, gentlemen, there is no man that lives, no matter what his wealth may be, who can be suddenly confronted with a claim for back taxes running over a period of over 20 years—it just cannot be done.

Senator KING. Outlawed.

Mr. HAWES. Mr. Mercier will present for your consideration two or three amendments that will put the American that has lived there all of his life and his children born there, on a parity with Orientals, Spaniards, Englishmen, Germans, Japanese, and Chinese.

If that is not done, due to the general uncertainty regarding the future of the Phillippines, these Americans will be ruined.

There is no place for them back here; they cannot return to their various States and take up occupations after 30 years or more; they would be ruined, and that is the reason why I have not heard from any branch of the American Government opposition to this request because without a settlement the uncertainty in itself is murderous for these people.

I hope that your committee will consider the fact that all of our Governors General sent there by the American Government must understand this and that the High Commissioner must understand it and that Commissioner Paredes must understand it; that the Press representatives over there [indicating] certainly must understand it. There is no objection to this claim that I know of from anyone.

In a short while the great questions in the Pacific must be solved in some way with some certainty and some definite policy; but we should not strike down the old Americans, the old soldiers and their children and the school marms who during all of these years have, at the request of our Government, stimulated the progress of the Islands and had been asked to stay there—they should not have their investments and fortunes wiped out over night by these back taxes.

The CHAIRMAN. Thank you very much, Senator.

STATEMENT OF LUCIEN H. MERCIER, WASHINGTON, D. C., REPRESENTING THE AMERICAN CHAMBER OF COMMERCE IN THE PHILIPPINES, ETC.

Have you a brief with you, Mr. Mercier?

Mr. MERCIER. I have just fixed one up.

The CHAIRMAN. You may hand it to the reporter.

(The brief referred to is as follows:)

BRIEF OF LUCIEN H. MERCIER, WASHINGTON, D. C.

MARCH 17, 1938.

The COMMITTEE ON FINANCE,
United States Senate.

SECTION 251

GENTLEMEN: The above section was enacted in 1921 in an endeavor to correct the competitive situation existing between Americans in the islands and the foreigners heretofore mentioned from the tax standpoint. Up until but a few months ago, all of the Americans in the islands felt, whether mistakenly in law or not, that they were not liable for Federal taxes because of said section; and undoubtedly, the various administrations from 1921 to 1937 were also of the same mind because no machinery was ever set up to collect Federal taxes from the Americans and the domestic corporations residing or doing business in the islands.

In 1936 the Senate passed an amendment to section 251 to correct the unjust situation existing under its interpretation; but this amendment was lost in the conference between the two Houses, because, so we are told, of lack of time for its consideration by the conference committee.

From the legislative history of section 251, it would appear that its broad purpose was to exempt Americans in the islands from Federal taxation; but every time the construction of the section has come up, such strict interpretations of it have been made as to result in denying to the great body of American citizens residing in the islands the benefits of the section.

An instance of this is the *Haussermann case* (finally decided in 1933), which holds that dividends are not to be comprehended within the 50-percent clause. Another instance relates to the definition of "gross income" as it appears in the 80-percent clause. It is now held by the Bureau that in the case of a person owning an apartment house, "gross income" means gross rentals, and not the rentals less taxes, maintenance and repairs, and operating expenses. Another example is that of an individual who makes transactions in securities. If on 12 he makes a profit, and on 8 makes losses, "gross income" is now held to mean only the profits on the 12, without deductions for the losses. These latter two examples, and other strict interpretations have now resulted, we are told, in depriving certain of our American citizens from the benefits which Congress wished to grant them by section 251.

We say "now resulted" advisedly for heretofore, our Americans in the islands used the net of their security transactions and of their rental properties in figuring their qualification under section 251; but they are now told by the revenue agent who went to the Philippines in 1937 that they were wrong in this, and that they are liable for taxes for a great many years back.

Section 251 was worded as it was by Congress in order to assure that tax dodgers would not use one of our possessions as a haven; and the entire history of Federal taxation with respect to the Philippine Islands is wholly consonant with the thought that Congress meant said section 251 to be broad enough to cover the bona fide residents and businessmen in the islands, and to exempt them from taxation because of the performance of services to this Government both in the help rendered to it in its administration of the islands, and in the procuring for this Government of the trade of the islands.

The various administrations since the conquest of the Philippines have each in turn announced that the United States was trustee of the islands, not for its advantage, but for the benefit of the Philippines; that no taxes would be levied there for the benefit of this Government; and that this Government would never levy taxes which would tend to penalize or repress industry and enterprise in the islands.

Congress, in enacting revenue legislation, followed out these administrative pronouncements, and whenever it levied import taxes on products from the Philippines, it provided by law that the taxes so collected would be returned intact to the Philippine government. When it came to levying an income tax in 1913, the Congress provided that in the Philippines this tax was to be collected and kept by the Philippine government; and that the American citizens in the islands should file a return and pay that tax to the Philippine government. This provision was continued through the subsequent revenue acts, even including the Revenue Act of 1918 (sec. 261).

However, despite the provisions of section 261, and without considering said section, the Court in the *Lawrence case* (273 Fed. 405), held that an American citizen in the Philippines was liable to the full United States tax. It was that decision which led to the passage of section 251 (then 262).

The situation of the Americans in the islands is now no different from what it was then, with the single possible exception that a revenue agent has been sent there this year to endeavor to collect all back taxes from 1917 to date; the collection of which would probably result in ruination for most Americans in the islands, and which would also result in a probable wiping out of the remunerative Philippine-United States trade procured for this Government by our Americans there.

Two years ago we gave you the complete history of the matter; and we attach hereto a copy of our memorandum.

It is needless to here repeat these arguments. We have prepared, and shall be very glad to submit if desired, a brief going fully into the pronouncements of the various administrations, and to the pertinent material in the congressional proceedings, and outlining all of the various factors which seem to demand corrective legislation.

It is the thought of the Americans in the islands that the situation could be corrected by inserting a proviso at the end of section 251 as is set forth in the amendments offered.

MEMORANDUM TO THE COMMITTEE ON FINANCE, UNITED STATES SENATE

Your attention is respectfully invited to an inadvertent change in the policy of the United States with respect to the Philippine Islands which for a long time has effected substantial discrimination against many hundreds of American citizens in good faith engaged in business—most of them pioneers—in the islands, in the hope that you may see fit to bring before the Senate a clarifying amendment to section 251 of the income-tax law which is now in force.

The discriminatory taxation sought to be remedied by the suggested clarification resulted from a construction of section 262 of the Revenue Act of 1921 (now sec. 251 of the current revenue act) by the Revenue Bureau and a court of the United States, which was contrary as well to the historic American policy toward the Philippines as to the legislative background and clear intent of the Congress in enacting that section. Substantial revenue has been lost to the Philippine treasury by virtue of such construction which surely was not within the intent of the Congress.

Protracted efforts over a long period of years have been made to remedy this situation. Finally, as recently as June 5, 1936, the Senate of the United States adopted a clarifying amendment to the House bill that became the Revenue Act of 1936, in practically the same form which in 1928 was sponsored and urged by the Philippine Government, the Secretary of War, the Secretary of the Treasury of the United States, and the Governor General of the Philippines, whose views are set forth in the accompanying memorial presented to the Congress at that time. The amendment was lost in the conference on the bill between the two Houses of Congress along with all others that did not relate to the immediate purposes for which the 1936 revision of the tax legislation was undertaken.

The purpose of this communication is, therefore, to enlist your interest and your aid in bringing to a successful fruition this well-advanced effort to remove the inequitable interpretation which has so seriously handicapped American businessmen in the Philippines and deprived the Philippine Government of much revenue—a situation which former Governor General Taft, speaking on the same point, described as "a departure from the heretofore consistent policy of the United States in the past of not imposing a tax in the Philippine for the benefit of the Treasury of the United States." (Printed memorial of May 1, 1928, p. 13, accompanying this letter.)

The discrimination under which the American businessmen labor, all of whom, except doctors, lawyers, and individuals in trade, are doing business in corporate form, lies in their enforced competition with long-established import and export houses of British, French, German, Swiss, Chinese, Japanese, and other nationals who are not required to pay income taxes to their home governments. The amendment will put Americans on an equality with their competitors in the islands, and without depriving the United States Government of income taxes on incomes of citizens who have merely invested money in the Philippines. What follows will enable you to act with full knowledge and will make clear the history of income taxation in the islands, the policy of the United States, its frustration down to the present, and the efforts toward remedial legislation.

Please note that that policy, from the time of President McKinley, has been to derive no revenue by way of taxation from business conducted in the Philippine Islands; and the reason underlying the policy is the fact that the United States has always sought to maintain the position of guardian and ward toward the people of the islands, and has never sought to profit by its relations to the islands. The records of the Bureau of Insular Affairs, War Department, fully demonstrate this statement.

The best evidence of this is the first income-tax law passed by the Congress of the United States (act of 1913), which was put into force and effect in the Philippine Islands, but, by special provision of that act, it was to be administered in the Philippines by the officials of the Philippine government, and all revenue derived therefrom by way of income tax was to inure intact to the treasury of the Philippine Islands. This policy was again reiterated by the Congress of the United States in the enactment of the 1916 income-tax law, which contained the same provisions, and by all revenue acts up to the present.

Another concrete evidence of the fixed policy of the United States in this regard is the provision of the act of Congress, or administrative order, which required that cigars or tobacco imported into the United States from the Philippine Islands should bear the revenue stamps, as set forth in the internal-revenue law of the United States, but which declared at the same time that all the revenue collected in the United States under that tax must revert intact to the treasury of the Philippine Islands. During all those years all persons residing in the Philippines, regardless of their nationality, filed income-tax returns in the Philippine Islands, the tax thereon was collected by Philippine officials, and the proceeds turned over to the treasury of the Philippine Islands. No one doing business in the Philippine Islands was required to file any income-tax returns in the United States covering income derived from sources within the islands.

The World War brought on conditions that made it necessary for the Congress of the United States to materially increase income-tax rates in the United States; but, because legislators were not familiar with conditions in the Philippines, they did not consider themselves competent to fix the rates to be enforced therein. Thus the War Revenue Act of 1917 did not alter the rates insofar as the Philippine Islands were concerned, but continued rates and procedure as fixed by the act of 1916 in full force and effect therein. Furthermore, in the same act authority was delegated to the Legislature of the Philippine Islands to change, modify, or repeal the income-tax law insofar as the islands were concerned; and acting thereunder the legislature did by law fix rates, in 1917, which law was legalized and ratified by the Federal Congress in the regular course.

After the United States entered the World War, and in order to prevent draft dodgers and tax dodgers, citizens of the United States, from leaving the United States to avoid their obligations, a rule was put into force requiring every person who sailed from the United States to obtain and file with the steamship company a paper known as the tax clearance. American citizens who were engaged in business in the Philippine Islands and made periodic trips to the United States, either on vacation or business, were confronted by the steamship agent with a demand for Federal tax clearance, and were told that no ticket could be sold to an American citizen without such clearances. The American citizen, on his side, being engaged in business and convinced that he was not liable for any Federal income tax because of his payment of such Federal tax to the Philippine government, would usually appeal to the War Department Bureau of Insular Affairs.

The Bureau would intervene with the result that every American who was honestly and in good faith in business in the islands was enabled to sail with-

out the necessity of such tax clearance. In due course these cases of intervention of the Bureau of Insular Affairs became so numerous and burdensome that the administration in Washington was requested to remedy the situation.

The Philippine authorities were fully aware of the situation with its resulting inequity and burden. The Philippine Legislature therefore adopted a resolution, in February 1920, instructing its Comissioners to the United States as follows:

"*Be it resolved by the Senate (the House of Representatives of the Philippines concurring)*, That the Resident Commissioners be, and they hereby are, instructed to ask Congress for the amendment of the United States Internal Revenue Act of nineteen hundred and nineteen, in the sense that American citizens who are bona fide residents of the Philippine Islands shall not be subject to any income tax greater than that required of other residents of said islands."

On September 5, 1921, the United States Philippine Commission, commonly known as the Woods-Forbes Commission, cabled the Secretary of War as follows:

"All nationals in the Philippines, except Americans, exempt from liability for the United States income tax. No foreigner here required to pay income tax to his home government. Americans here also pay income tax Philippine government. Financial situation very critical, and heavy losses have already been sustained. Attempt collect back taxes under Revenue Act, 1918, would be futile the majority of cases, and would only result in bankrupting many of such Americans as still remain in business, leaving commercial field entirely in the hands of British and other foreigners. We therefore urgently recommend that Americans be placed on the same tax basis here as other nationals; otherwise, they are penalized for being Americans and are unable to successfully compete with those who are exempt, and that the relief granted be made retroactive to include exemption from tax liability under Internal Revenue Act of 1918."

Congress thereupon endeavored to remedy and clarify the situation and, in November 1921, enacted into law, as parts of the Revenue Act of 1921, the following provisions, known as section 262, which have been continued down to this date, but are now known as section 251 in the revenue act:

"SEC. 262 (a). General Rule: The case of citizens of the United States or domestic corporations, satisfying the following conditions, gross income means only gross income from sources within the United States—

"(1) If 80 per centum or more of the gross income of such citizen or domestic corporation (computed without the benefit of this section) for the three-year period immediately preceding the close of the taxable year as may be applicable was derived from sources within a possession of the United States; and

"(2) If, in the case of such corporation, 50 per centum or more of its gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States; or

"(3) If, in case of such citizen, 50 per centum or more of his gross income (computed without the benefit of this section) for such perior or such part thereof was derived from the active conduct of a trade or business within a possession of the United States either on his own account or as an employee or agent of another.

"(b) Amounts received in United States: Notwithstanding the provisions of subsection (a), there shall be included in gross income all amounts received by such citizens of corporations within the United States, whether derived from sources within or without the United States."

It should be remembered that the above section of the 1921 act was incorporated into the income-tax laws for one single purpose only, namely, to show that it was not the intention of the Congress of the United States to require citizens of the United States actually and in good faith engaged in business in the Philippine Islands to pay an income tax to the Federal Government on the income derived by such citizens from insular business. This was not because the Congress desired to favor the American citizen but because the Congress desired such citizen to pay all taxes derived from his Philippine business to the government of the islands, in pursuance of its traditional tutelary policy. The tax relationship of the Philippine Islands to the United States should not be confused with that, for instance, of the State of New York, a distinct sovereignty which, independently of the United States, must, under its own sovereign obligations, levy its own taxes upon its own citizens and business for its own

needs; whereas the Philippines are wholly within and under the Federal sovereignty, its taxes are levied wholly under the authority and obligation of Federal revenue laws, and the proceeds of all taxation on income derived from the conduct of business in the islands should be applied to their needs.

The Philippine authorities and the responsible officials in the United States believed that that section cleared up the situation. For a number of years the Americans continued to pay their taxes to the Philippine Government as usual, secure in the belief that there would be no further difficulties, while the Federal Bureau of Internal Revenue, on its side, was satisfied that the islands could not be used as havens of safety by tax evaders, for Americans in the Philippines were required by the new law to show that they were actually interested out here; that 80 percent of their entire income was derived from the Philippines; and, furthermore, that they were regularly and actively engaged in business in the islands; and that at least 50 percent of their income was derived from the active conduct or management of that business. These American businessmen—most of them pioneers—had always earned their income wholly from the conduct of business enterprises and professions in the islands and apprehended no duplication of Federal taxation.

In 1926, however, the Federal Bureau of Internal Revenue held that, notwithstanding the American taxpayer was actively engaged in the conduct of a business, the segregation from such business of that part of his income which was derived from dividends placed him below the 50 percent and subjected his income from the Philippine Islands to the Federal income-tax law. This ruling was confirmed by the Board of Tax Appeals (Docket No. 23101) and by the Court of Appeals of the District of Columbia (No. 5547) and on certiorari from that court to the United States Supreme Court the writ was denied.

This is in effect an erroneous interpretation of the act of Congress which has resulted in onerous discrimination against American citizens actually engaged in business in the Philippine Islands in corporate form. No question has been raised as to the exemption of any American doing business as an individual in the Philippine Islands, or an American engaged in the profession of law, or of medicine, or a partnership, from Federal income tax, provided 80 percent of his gross income is derived from sources within the Philippine Islands and 50 percent thereof from the active conduct of such business or profession. Needless to repeat, the great bulk of American business that is done in the Philippine Islands by citizens of the United States residing therein is done in corporate capacity.

The unintentional unfairness and injustice of this interpretation by the Bureau, having become apparent, in 1928, administration officials concerned in the matter, including the President of the United States, the Secretary of War, the Secretary of the Treasury, and the Governor General of the Philippine Islands joined in requesting Congress, then engaged in writing a new internal revenue act, to clarify section 262 so as to permit that part of the income which a businessman in the Philippine Islands derived by way of dividends from a company conducted by him to be included in that 50 percent. The views of these officers are set forth in the accompanying reprint of the letter, above referred to.

On May 11, 1936, when the new income-tax law was before the Senate, Mr. John W. Haussermann, acting in the interest of these American residents as well as the citizens of the Philippines, addressed a letter to the Secretary of the Treasury of the United States embodying much of the substance of my present communication, at the suggestion made by Chairman Harrison, of the Senate Committee on Finance, in order to formally pave the way for another attempt to obtain congressional clarification of this legislation. At the Senator's further suggestion the matter was fully discussed with Mr. L. H. Parker, legislative counsel of Congress, then and now assisting the committee. Eventually a clarifying amendment to the "50 percent" paragraph of section 251 was submitted to the Finance Committee and on June 5, 1936, was adopted by the Senate as its amendment (No. 152) to paragraph 3 of section 251 of the Revenue Act of 1936 (H. R. 12395).

In the conference between the two Houses of Congress on H. R. 12395, however, the Senate, in the press for adjournment, receded from more than 50 of its amendments that were not immediately related to the main points in the measure because of lack of time for due consideration of their merit. The above amendment was one of them. But during its brief course in the congressional process no objections were raised against it, and it was the under-

standing that it would be taken up for consideration in the forthcoming Congress when a new income-tax bill was expected to be brought forth.

Respectfully submitted.

H. W. VAN DYKE.
LUCIEN H. MERCIER.

WASHINGTON, D. C.

PROPOSED AMENDMENTS TO H. R. 9862, INTRODUCED MARCH 1, 1938, REVENUE ACT OF 1938

AMENDMENT NO. 1

Amend Supplement J, Section 251, Page 232, by striking out all of sub-section (a) and inserting in lieu thereof the following:

"(a) *General rule.*—In the case of citizens of the United States resident of a possession of the United States for more than five years prior to January 1, 1938, and in the case of citizens of the United States or domestic corporations (other than personal holding companies as defined in Title 1–A, Section 402) engaged in the active conduct of a trade or business in such possession, and satisfying the following conditions, gross income means only gross income from sources within the United States—

(1) If 80 per centum or more of the gross income of such citizens or domestic corporations (computed without the benefit of this section but including salaries and other compensation for personal services rendered in such possession), for the three year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States."

Add a new section at the end of Title V, to be known as Section 812, and to read as follows:

"SECTION 812. Retroactive amendments to Revenue Acts of 1917 and all subsequent revenue acts."

(a) The Revenue Act of 1917, and Section 261 of the Revenue Act of 1918 are hereby retroactively amended by adding at the end thereof the language which appears below; Sections 262 of the Revenue Act of 1921, and of the Revenue Act of 1924, and of the Revenue Act of 1926, and Sections 251 of the Revenue Act of 1928, and the Revenue Act of 1932, and of the Revenue Act of 1934, and of the Revenue Act of 1936, are hereby amended by striking out all of sub-section (a) thereof and inserting in lieu thereof the following:

"(a) *General rule.*—In the case of citizens of the United States who are bona fide residents of a possession of the United States, and in the case of citizens of the United States or domestic corporations (other than personal holding companies as defined in Title 1–A, Section 402) engaged in the active conduct of a trade or business in such possession, and satisfying the following condition, gross income means only gross income from sources within the United States—

"(1) If 80 per centum or more of the gross income of such citizens or domestic corporations (computed without the benefit of this section but including salaries and other compensation for personal services rendered in such possession), for the three year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States."

(b) The amendments made by this Section to the revenue acts amended shall be effective as to each of said acts as of the respective dates of the enactment of such acts.

MEMORANDUM ON THE EFFECT OF AMENDMENTS

AMENDMENT NO. 1

Amendment No. 1 seeks to correct the situation as set forth in the Memorandum covering Amendment No. 2.

This Amendment No. 1 eliminates the 50% clause of Section 251 altogether, retroactively to the year 1917.

In order that no tax dodging haven be created, the amendment, so far as the 1938 Act is concerned, would allow a bona fide resident of a possession of the United States for more than five years prior to January 1, 1938, to pay a Federal tax only on his income from sources within the United States if more than 80% of his gross income was derived from sources within a possession of the United States.

AMENDMENT NO. 2

Insert a new Section at the end of Supplement J, Section 251, Page 235, to be known as sub-section (j) thereof, and to read as follows:

"(j) *Philippine Islands.*—No citizen of the United States who has been a resident of the Philippine Islands for more than five years, and no citizen of the United States or domestic corporation (other than a personal holding company as defined in Title 1–A, Section 402) engaged in the active conduct of a trade or business in the Philippine Islands, shall have any greater tax liability under this Act with respect to income derived from sources within said Islands than is imposed under this Act with respect to such income upon citizens or corporations of such Islands, or upon aliens or foreign corporations in such Islands."

REVENUE ACTS OF 1917 TO 1936

Insert a new section at the end of Title V, giving a retroactive effect to this amendment as if the law beginning with the Revenue Acts of 1917, and reading as follows:

"*Philippine Islands.*—No citizen of the United States who is a bona fide resident of the Philippine Islands, and no citizen of the United States or domestic corporation engaged in the active conduct of a trade or business in the Philippine Islands, shall have any greater tax liability under this Act with respect to income derived from sources within said Islands than is imposed under this act with respect to such income upon citizens or corporations of such Islands, or upon aliens or foreign corporations in such Islands."

MEMORANDUM ON THE EFFECT OF AMENDMENTS

AMENDMENT NO. 2

The net effect of Amendment No. 2 is to put the American in the Philippine Islands on exactly the same tax basis as the foreigners in the Islands with whom they have to compete and who receive exactly the same protection from this Government that the American receives. The sum and substance of the Amendment is that the American in the Philippines will have no greater tax liability under the Revenue Act of 1938 and all prior Revenue Acts since 1917 than is imposed by those Acts on the Filipinos or foreigners living in those Islands.

This amendment is limited to the Philippine Islands and does not effect any other possession of the United States.

AMENDMENT NO. 3

Amendment to Revenue Act of 1938

Amend Supplement J, Section 251, Page 232, by striking out the period after the word "another" appearing on line 2, Page 233; inserting a semicolon, and adding the following words:

"*Provided, however,* That for the purpose of this subsection, the income dividends, salaries and other compensation received from a corporation, partnership, trade, or business being conducted in a possession of the United States, shall be deemed to be gross income derived from the active conduct of a trade or business, when such citizen is actively engaged in the conduct of such corporation, partnership, trade, or business, either as an officer, agent, or employee thereof."

RETROACTIVE FEATURE

Add a new section at the end of Title V, giving Sec. 251 as above amended a retroactive effect as in the law beginning with the 1917 Act.

MEMORANDUM ON THE EFFECT OF AMENDMENT No. 3

Section 251 provides that an American in business in a possession of the United States has to pay a tax only on his income from sources within the United States if 80% or more of his gross income comes from sources within a possession of the United States; and 50% or more of his gross income is derived from the active conduct of a trade or business.

Whenever the interpretation of the 50% clause has come up, it has been construed very strictly, with the result that what Congress wanted to do by Section 251 has been more or less nullified in the case of a great many Americans in the Philippine Islands.

For instance, an American conducting business as an individual or as a partnership, no matter how much capital he has invested in the business, gets the full benefit of Section 251. Another American doing the identical business, with the same amount of invested capital, but doing it in corporate form, is limited to drawing a reasonable salary from this corporation; and the dividends that he gets from the corporation although this corporation is merely his style of doing business, results in depriving him of the benefit of Section 251. Again, an American may own an apartment house with very heavy gross rentals; but with very little net income, or maybe a net loss for the year. In computing his tax liability under the 80 percent clause, the amount of the gross rentals from this apartment house is the amount used, rather than the net, or the loss; and this deprives the American of the benefits of Section 251. Other instances could be cited.

The motive of Congress in passing Section 251 was to exempt the bona fide business man in the Philippines from having to pay any tax to this Government in order that he might get for this country the valuable trade of the Philippines. The percentages and the language used in the section as it has stood since 1921 were to make certain that a tax dodging haven would not be created.

Amendment No. 3 seeks to remedy the situation retroactive to 1917 by including in the computation of the income under the 50-percent clause the dividends or income received by an individual from a corporation or business under his active conduct, provided 80 percent of the income of that corporation or business arises in that possession of the United States.

Mr. MERCIER. Mr. Chairman and gentlemen of the committee, I think probably the chairman was in error in his remark a while ago that the House had in some fashion taken care of this situation.

The CHAIRMAN. As I understand it, the House did this: They took care of, as far as the future was concerned, the tax on incomes derived by American citizens in the Philippines from Philippine sources; they did not exempt Americans living in the Philippines from income derived from sources within the United States.

Mr. MERCIER. May I correct the chairman on that score? There were two proposition submitted to the House; one, the amendment of section 119 (e), and that is on page 161; that is what they corrected. Section 119 (e) provided that if anyone residing in a possession of the United States came to this country to purchase some personal property, the resulting profit from the sale of that property in a possession of the United States could be taxed in the United States. That situation they corrected, and I think they corrected it very well.

It is a situation that should have been corrected, I think, because if it had been allowed to exist (and none of the Americans living in the Philippines knew it was there until the revenue agent came there), it would have stopped Americans from coming to this country to purchase merchandise for sale in the Philippines.

Mr. MERCIER. 1925.

The CHAIRMAN. 1925, yes.

Mr. MERCIER. Yes.

The other matter we brought to the attention of the House, but about which nothing has been done, was an amendment to section 251, to take care of the future on section 251, as well as the past. Section 251 was brought into revenue laws in 1921 and has remained the same ever since 1921. That section provides that with respect to Americans living in possessions of the United States, gross income shall mean only gross income from sources within the United States if 80 percent of their gross income comes from that possession, and if 50 percent of the gross income was derived from the active conduct of a trade or business, either in his own behalf or as agent or employee of another. Now, then, in order to give you the correct picture, a revenue agent was sent there by this Government last year. The full realization of the liability for these taxes did not come on these Americans until 1933. Up until 1933 every American residing in the Philippines thought that section 251, the way it was worded, and particularly the words said about it in Congress, notably by Speaker Longworth, protected them to the extent they did not have to file any returns or pay any taxes here.

Now, here is what happened in 1933: One of the Americans there has always maintained his home in Ohio, despite the fact he had spent nearly all of his time in the Philippines. He is one of these kindly gentlemen who wants to pay everything he thinks he owes, whether he owes it or not——

The CHAIRMAN. That is very rare.

Mr. MERCIER. He has always filed returns, although under the proper interpretation of section 251 he should not have filed any at all.

In 1930 one of the officials in the Bureau said, "So far as this particular income is concerned you do owe us a tax, because in figuring out the 50 percent clause of section 251 you cannot take into consideration the dividends that come to you from the business operated by you, because that is a return on your capital, and so, picking out these dividends, you owe a tax on all of the dividends as well as all of the income from the Philippines, excepting salary."

That case was taken to the courts and was finally decided in 1933 by the Court of Appeals of the District of Columbia, and since that time, as I say, came the full realization these Americans owed taxes, because they did not think, in figuring out their exemption, to see whether they came within the 80-percent and the 50-percent clause they took under the 50-percent clause the dividends they received from the corporation they owned. Most of these Americans in the Philippines do business in a corporate form, and most of the corporations there, I am told, are closely held, except the mining companies, which are widely held; but the rest of those corporations are closely held corporations.

All of the capital in those corporations is capital which these Americans got in the Philippine Islands; they could never get capital in the United States to help them with their business because of the political uncertainty in the Islands. So, from the very earliest of times, in order to get their business to grow, they had to plow back into these corporations nearly all of their earnings, because that is the only way they could get capital.

Now, then, even though that corporation is their alter ego, whatever comes to them by way of dividends, the court has held, and that is contrary to what Mr. Longworth said in 1921, that despite the fact the corporation is nothing but his alter ego, his earnings are considered as dividends and they are not to be considered under the 50-percent clause of section 251.

The CHAIRMAN. Was that a court decision or a decision of the Board of Tax Appeals?

Mr. MERCIER. Both the Board of Tax Appeals and a court.

The CHAIRMAN. What court?

Mr. MERCIER. District of Columbia.

The CHAIRMAN. That was not until 1933?

Mr. MERCIER. Not until 1933.

The CHAIRMAN. And that is when they woke up to the fact they were about to be assessed?

Mr. MERCIER. That is right, Mr. Chairman; that is when they woke up to the fact they were about to be assessed.

Two years ago we came before your committee and asked your committee to amend section 251, and you did, and included it as part of the bill. It went up in conference, and because of lack of time it, together with 50 other committee amendments, was thrown out in a block.

The CHAIRMAN. Had the Government made any effort before 1930 to collect anything from these Americans living in the Philippines?

Mr. MERCIER. No, sir; none until the revenue agent was sent over there in 1937.

The CHAIRMAN. Why do they point out particularly the years 1917, 1918, 1919, and 1920; is that because they made their biggest profits in those years and because of the high taxes in those years?

Mr. MERCIER. No, Senator. When the Income Tax Act of 1913 was passed there was a provision which said in effect:

> So far as Americans in the Philippines and possessions of the United States are concerned, the tax referred to in this act shall be paid by them to the Philippine government and the returns must be filed with the Philippine government and the Philippine government must keep the money.

When the 1916 act came along it provided the same thing, and the 1917 act made no change, and the 1918 act kept it still in force. But despite the fact that the 1918 act kept that provision in force, that the American was to pay his tax and file his return over there, despite that fact, a case came up in California and was decided by the court in May of 1921, which held that the increased rates of the 1918 act should nevertheless have to be paid by an American who was living in the Philippine Islands.

The CHAIRMAN. They did not pay the same rates to the Philippine government that were incorporated in the prior acts?

Mr. MERCIER. Yes, sir; the self-same act, except under the 1918 act. It increased the rate, and in the 1918 act it was said if the Philippine government wanted to increase the rates, the way this Congress had done, they had a right to do so.

The CHAIRMAN. But they did not?

Mr. MERCIER. No. The Government is seeking to collect the increased rates of the 1918 act for 1918, 1919, and 1920.

The CHAIRMAN. Well, under the 1917 act——

Mr. MERCIER. And under the 1917 act as well.

The CHAIRMAN. Did the Philippine government put up the same rates our tax laws put on?

Mr. MERCIER. Yes, sir.

The CHAIRMAN. The only change took place in 1918?

Mr. MERCIER. That is right. All of the Americans in the Philippines in 1917, 1918, 1919, and 1920 thought they owed no taxes because of the provisions I have called to your attention.

The CHAIRMAN. Are you contending if they have to pay this rate, which is higher in the 1918 act than under the 1917 act, it should go to the Philippine Government and not to the United States?

Mr. MERCIER. If the higher rates are going to be applied against everybody in the Philippine Islands on the same basis, it should be paid to that government; but I think it is wrong to single out of those in our own possession the American to tax him as distinguished from everybody else.

The CHAIRMAN. Have you talked to the Treasury Department about this?

Mr. MERCIER. I have talked with Mr. Parker and Mr. Kent in Mr. Magill's office, and the Commissioner of Internal Revenue, and I do not know—I think probably the matter has received favorable consideration everywhere, but I am not certain. But I wanted to finish about the 4 years principally in question.

The CHAIRMAN. Very well.

Mr. MERCIER. When that decision was handed down in May of 1921 the matter was immediately brought to the attention of the Congress, of course, and in November 1921 this section 251 was passed. No effort was ever made by this Government thereafter to collect from these Americans the taxes due——

The CHAIRMAN. That was after the California decision?

Mr. MERCIER. That was after the California decision, when Congress passed section 251, within 4 months. When the Senate passed section 251 they made it retroactive to 1918. When it got into conference, the conferees struck out the retroactive provision. In 1923 the Treasury announced it was going to collect that money from those Americans in the Philippines for those 4 years. As a result, I think Governor General Wood, the Secretary of War, and several others, interested themselves in this thing, and the Treasury just promptly forgot all about collecting them and has never done anything along that line except when the revenue agent came there in 1937.

It is an interesting thing from the standpoint of the trade of this country that when those people first got to the Philippines this country had only about 6 percent of the total trade of the Philippines, or about $5,000,000 a year. At the present day these Americans have procured for this Government the most favorable type of trade we can think of, somewhere between 72 and 80 percent of the Philippine trade. It amounts in money to about $200,000,000 a year. They get from us nearly all of their cotton goods and most of their wheat, and all of the surplus materials we cannot use here and have to sell somewhere, and in return we get from them merchandise which, with the possible exception of sugar, does not in anywise compete with anything we manufacture here in the United States.

We have submitted to the Treasury Department, and I believe Mr. Parker has also seen them, a series of amendments, any one of which would correct the situation we have in mind.

Senator KING. Are there a number of sections to be amended?

Mr. MERCIER. No; only the one section, section 251.

The CHAIRMAN. Some of these taxes have been collected?

Mr. MERCIER. Yes, sir.

The CHAIRMAN. Do you know how much?

Mr. MERCIER. I believe that the collections by Mr. Bercaw from American citizens have totaled about $1,300,000. Of that, $500,000 comes from foreign corporations, and that of course would not be affected by this at all.

The CHAIRMAN. How much is the claim?

Mr. MERCIER. The amount of the claim I could not tell you because it involves from the period 1917 to 1921, about 3,000 people, and for the 1921-37 period about 300.

The CHAIRMAN. If you eliminate interest charges for failure to pay, what would it be?

Mr. MERCIER. I could not tell you. I have not any way of estimating what the claim would be; I do not think anyone could estimate it.

Senator KING. It would be less than a quarter of a million dollars if you eliminate the interest, the amount collected from American citizens?

Mr. MERCIER. You mean what has been collected already?

Senator KING. Yes; that we might be called upon morally, if not legally, to refund.

Mr. MERCIER. No; I would say possibly around $900,000.

Senator KING. I thought you said $500,000.

Mr. MERCIER. The total is $1,500,000, approximately, and if you take $500,000, that would still leave about a million or $900,000.

Senator KING. How much of that is interest; have you any idea?

Mr. MERCIER. Oh; if you collected all of the way back to 1918 it would be 120 percent on one, 114 percent on another——

Senator KING. When you say $1,500,000, do you include the interest?

Mr. MERCIER. Yes, sir.

Senator KING. But eliminating the interest, it would be approximately a quarter of a million dollars that had been collected from American citizens?

Mr. MERCIER. Yes; somewhere between that and half a million.

The CHAIRMAN. Practically all of this income was from sources within the Philippine Islands?

Mr. MERCIER. All of it was; yes, sir.

The CHAIRMAN. You do not contend if an American has investments in this country, that those should not be taxed—the income on those?

Mr. MERCIER. No, sir; and he has to pay a tax on that under the law as it stands now.

The CHAIRMAN. I think the committee understands the proposition, and with the cooperation we have gotten from you and Senator Hawes and Mr. McNutt——

Senator KING. Would not the Chinese situation be analogous?

Mr. MERCIER. Just about the same.

Senator KING. It would be a fair parallel?

Mr. MERCIER. Yes.

The CHAIRMAN. I think, Mr. Mercier, if you could have another conference with these experts—you know we have a lot of "brain-trusters" around here—you had better do it.

Mr. MERCIER. I will see Mr. Parker and Mr. Kent.

Senator KING. And Dr. Magill?

Mr. MERCIER. Dr. Magill, also; yes.

Thank you very much.

The CHAIRMAN. Mr. Bond Geddes, Washington, D. C., representing the Radio Manufacturers' Association.

STATEMENT OF BOND GEDDES, WASHINGTON, D. C., REPRESENTING THE RADIO MANUFACTURERS' ASSOCIATION

Mr. GEDDES. I have a brief and some memoranda for the convenience of the committee, Senator, which will enable them to follow my remarks.

The CHAIRMAN. You are in favor of eliminating the tax on radios?

Mr. GEDDES. I have an if argument. I am only here because the House has embarked on a program of beginning to repeal these so-called nuisance or excise taxes. On this sheet [indicating] you will note the upper part is the repeal and the lower part will give you the House program in brief.

The CHAIRMAN. You may file that.

(The brief referred to is as follows:)

BRIEF OF BOND GEDDES, WASHINGTON, D. C., REPRESENTING THE RADIO MANUFACTURERS' ASSOCIATION

STATEMENT ON 5-PERCENT EXCISE TAX ON RADIO APPARATUS

Mr. Chairman and gentlemen of the committee, my name is Bond Geddes, and I am executive vice president of and appearing for the Radio Manufacturers' Association. This is the national, nonprofit trade organization for the manufacturing portion of the radio industry, including all leading manufacturers and representing about 85 or 90 percent of manufacturing volume.

The pending House revenue bill, H. R. 9682, repeals excise taxes of about $30,000,000, announced as beginning a program to remove the selective and temporary nuisance taxes under existing law. Except for a few excise taxes yielding small revenue, it is surprising that the Treasury recommended and the House bill provides tax repeal principally of over $20,000,000 for unquestionable luxuries, including furs, sporting goods, cameras, and chewing gum.

The House bill failed to include radio in this initiation of repeal of some of the nuisance taxes, and would continue the 5-percent tax on radio apparatus.

Radio, we earnestly submit, should be accorded first and foremost consideration because of its present universal necessity, public service, and general use. Radio should have priority in any excise-tax repeal, over all of the outright luxuries as provided in the House bill. We do not contend that radio manufacturers or broadcasters should be entirely tax free, but this special nuisance tax on radio should be removed and ahead of any of the undeniable luxuries named in the House bill.

Radio, in its present-day service and widespread use, is not a luxury or semiluxury, not under the conditions now prevailing. What might have been termed a luxury or semiluxury 10 years ago, or when this temporary excise tax was imposed in 1932, is today in general use; a general necessity of modern life. The poorest American family now enjoys the all-embracing service of radio today, as our industry has brought down the cost to a fraction of former years, the average radio selling price in 1937 being less than $40.

Radio today is one of the most necessary, most used, most influential adjuncts of everyday family and business life. Because of its service and general public use it should be, like the press, absolutely free of special taxation because it is an even wider means of public communication than the press. We ask that radio be accorded tax relief—either complete repeal or substantial reduction—before any and all of the obvious luxuries for which repeal is provided in the House bill.

Our plea for prior repeal of the radio tax is supported by the entire industry, including thousands of distributors and dealers, by broadcasters, and also the American Federation of Labor, the latter because of the increased employment involved.

Radio and the press are the two great mediums of mass communication. Radio reaches the greater number of people, many of them exclusively, and is a larger and growing influence, with facsimile, television, and other new developments approaching rapidly from our laboratories. There is a postal subsidy, enjoyed by a portion of the press and referred to recently by President Roosevelt, while the greater public service of radio communication bears the burden of this selective excise tax.

Radio now in the American scheme of life is a prime necessity, more necessary than 10 or 5 years ago, and still more necessary in the future. Radio is as characteristically American as the automobile, the moving picture, or the telephone, and reaches a larger audience. There are 7,000,000 more radios in the United States than passenger automobiles. There are more than twice as many homes in the United States with radios than with telephones. In some foreign countries radio is even supplied by the government at cost, to make it more available to the poorer citizen.

In times of peace or war, and especially of national crisis or disaster, radio performs outstanding and exclusive service. This occurred during the last few days when the flood-stricken community of Los Angeles was entirely cut off from all telegraph, telephone, highway, and other communication except radio. During the Ohio and Mississippi floods last year, radio functioned for stricken communities, aided the American Red Cross, and saved lives and property.

Because of the universal service and usage of radio—with 36,800,000 now in use—we earnestly urge entire removal—the complete repeal—of the radio excise tax, a selective and extra tax on this modern and greatest means of mass communication.

Repeal of the radio tax would cause less revenue loss to the Government than any of the major excise taxes repealed under the House bill. If your committee should find, unfortunately, that because of revenue necessities of the Government, it is not practicable at present to entirely abolish the radio tax, we are submitting an alternative request—to which the previous facts and considerations apply with equal force—for reduction immediately of the present 5-percent tax rate.

Our alternative proposal is embodied in the proposed recommendations of our association for immediate revision of section 607, title IV, of the act, to read as follows:

"SECTION 607. TAX ON RADIO AND PHONOGRAPH APPARATUS, ETC.

"There is hereby imposed upon the following articles, sold by the manufacturer, producer, or importer, a tax equivalent to 2½ (or 3) percent of the price for which so sold: Chassis, cabinets, tubes, reproducing units, power packs, and phonograph mechanisms sold for use as part of radio receiving sets or combination radio and phonograph sets (including in each case such as are sold as accessories therefor) except such as are sold for use as part of police, marine, aircraft, address, intercommunicating apparatus, equipment, and devices, or other commercial applications of radio. A sale of any two or more of the above articles shall, for the purposes of this section, be considered as a sale of each separately."

Our recommended revision of section 607 comprises three major subjects: First, reduction of the present 5-percent rate to 2½ or 3 percent, depending upon the tax-repeal limitations and possibilities of the Government as may be determined by the Treasury and Congress; second, exemption from taxation of the radio taxable units incorporated in police, marine, aircraft, address, intercommunicating apparatus, equipment, and devices or other commercial radio; and third (also without material revenue reduction), an administrative amendment of the law's language which would be most constructive from the standpoint of the Government as well as our industry.

Entire repeal of the radio tax would cost the Government this fiscal year about $5,000,000 or possibly $5,250,000 although the Treasury estimates fiscal-year receipts of $6,454,000, excluding $300,000 repealed on phonograph records. We know positively that the Treasury's expectations cannot materialize. Already for the 7 months ending January 31, the latest official figures available show a decrease of 8½ percent compared with the last fiscal year, January radio-tax collections (largely on December 1937 operations) being down 46 percent. Most of our factories since have been and are now practically idle, with widespread unemployment, and business prospects hold no hope for the Treasury's estimates of radio revenue.

Compared with a reasonable estimate of around $5,000,000 from radio, the House bill provides, according to the Ways and Means Committee report (pp. 10 and 11) for the following "nuisance" tax repeals:

Repeal of excise taxes, H. R. 9682

Item	Amount
Tooth paste, toilet soap, etc	$6,600,000
Furs	5,920,000
Phonograph records	300,000
Sporting goods	6,802,000
Cameras and lenses	980,000
Chewing gum	929,000
Matches	6,900,000
Oil processing	894,000
Total	29,325,000

The Ways and Means Committee cited reasons for beginning repeal of the "nuisance" taxes (quoting from the House committee report) as those "having a low revenue yield and which are administratively troublesome, or causing serious inequities, or are imposed on necessities." The "nuisance" tax on radio is entirely in this category. It has a low revenue field—below all of the principal taxes repealed in the House bill. Also there are serious administrative troubles with the radio tax, and certainly it is imposed on a modern-day necessity, of common and general public use and service. We again emphasize that because of its function as the largest and greatest agency of communication it should be entirely free of any extra tax burden, similarly to the press. Persons owning radio-receiving sets are in a similar position to subscribers of newspapers. Receiving-set owners are the "circulation" of radio broadcasting. They should be free of special and burdensome taxation.

That there are serious administrative difficulties in the fur tax is contended by the Treasury, but our information is that the Internal Revenue Bureau has developed a formula on furs which operates satisfactorily. Fur, yielding $5,920,000 in revenue, and more than radio, are definitely in the luxury class. It cannot be argued reasonably that the fur tax should be repealed prior to that on the public's radio-receiving set, considering the comparative costs, general use, and public service. Certainly radio is entitled to tax relief ahead of furs. To repeal the fur tax, exempting sable and ermine coats, etc., while the radio tax is continued cannot be justified or sustained in anyone's mind or conscience.

Another "luxury" tax which the House bill would repeal is that on sporting goods. This involves a revenue loss of $6,802,000, which also is far more than radio revenue. There are minor administrative troubles relating to sports apparel and toys and games, but to exempt polo, golf, baseball, football, and other sports apparatus and retain the tax on radio is illogical and indefensible. The House bill states that the sports tax "bears heavily on the youth of the country" and also that the tax on chewing gum is a "burden" on children. We submit that millions more of the youth and children of America constantly use, enjoy, and require radio than sporting goods or chewing gum.

The House bill also, while omitting radio from tax relief, would repeal the tax on cameras. A comparison between snapshots, the enjoyment of photography, and the great public service of radio leaves its own conclusion. While the camera tax brings small but increasing revenue, it certainly should not be repealed prior to removal or reduction of the special tax on the public's radio.

The excise tax on matches also is repealed under the House bill, with a revenue loss of $6,900,000, and that on toilet soap, tooth paste, etc., bringing in $6,600,000, both groups returning far more than radio, which at least is on an equal plane of general public use, service, and necessity.

On every basis cited by the Treasury and the House Ways and Means Committee for beginning repeal of these special, burdensome "nuisance" taxes—low revenue, administrative difficulties, and modern-day general use and necessity—we respectfully submit that the radio tax should be first to be repealed or reduced, and prior to any and all of the articles carried in the House bill.

The excise rate on automobile trucks is 2 percent and on other automobiles 3 percent. In view of the parallel and general use of automobiles and radio, we think it consistent, logical, and reasonable to ask your committee to at least reduce the radio rate to the 3-percent rate on automobiles.

Our recommendations for exemption of police, marine, aircraft, and other commercial radio involve no substantial loss in Federal revenue. We doubt if Congress ever intended application of the radio excise tax to reach strictly commercial radio apparatus, although Treasury rulings on the complex radio law, as now based on component units, has brought that result. A large part of these administrative difficulties has occurred in the application of the radio-parts tax to commercial radio and also to nonradio apparatus. The tax now applies on the widely developed and necessary use of commercial radio for police administration and public safety, for aviation, shipping, signaling devices for the Army and Navy, railroads, etc., schools, colleges, offices, hospitals, industry, and innumerable other commercial applications or usages of radio.

Many of these commercial devices and apparatus—not ordinary receiving sets—contain few radio units, but inclusion in much nonradio apparatus of a few taxable radio units technically subjects the entire apparatus to the radio tax. There exist innumerable cases of administrative difficulty, causing extensive and costly audits and reports of manufacturers, interpretations from Internal Revenue Bureau, and also inequities between competing manufacturers because of varying and even conflicting rulings in different revenue collection districts. We earnestly urge that the imperatively necessary administrative changes in the language of section 607, as we have recommended, be made in your revision of the law. At least this clarification and workable amendment of section 607 should be made now.

In conclusion, we repeat that radio, because of its general and universal service and usage, like the press, should be free from special taxation, this selective "nuisance" tax. It should have first and preferred consideration in tax relief, ahead of any of the excises repealed in the House bill. In beginning the program of elimination of these "nuisance" taxes, it has a preferential position of public use and service and should be accorded prior action. If any elimination or reduction of excise taxes whatever is possible, the radio tax should be removed or at least the 5-percent rate reduced to 2½ or 3 percent, with exemption for police, aircraft, marine, and other commercial radio. In all events, the present law should be amended to include the minor and technical administrative changes we have recommended, to clarify, simplify, and make it more equitable.

[Submitted by Radio Manufacturers Association, Washington, D. C.]

REPEAL—TITLE IV, SECTION 607—5-PERCENT TAX ON RADIO RECEIVING SETS, ETC.

(Estimated, $5,000,000)

ALTERNATIVE AMENDMENT

(Estimated, $2,500,000 to $3,000,000)

SEC. 607. TAX ON RADIO AND PHONOGRAPH APPARATUS, ETC.

There is hereby imposed upon the following articles, sold by the manufacturer, producer, or importer, a tax equivalent to 2½ (or 3) percent of the price for which so sold: Chassis, cabinets, tubes, reproducing units, power packs, and phonograph mechanisms sold for use as part of radio-receiving sets or combination radio and phonograph sets (including in each case such as are sold as accessories therefor), except such as are sold for use as part of police, marine, aircraft, address, intercommunicating apparatus, equipment, and devices or

other commercial applications of radio. A sale of any two or more of the above articles shall, for the purposes of this section, be considered as a sale of each separately.

Repeal of excise taxes provided in H. R. 9682

Tooth paste, toilet soap, etc	$6,600,000
Furs	5,920,000
Phonograph records	300,000
Sporting goods	6,802,000
Cameras and lenses	980,000
Chewing gum	920,000
Matches	6,900,000
Oil processing	894,000
Total	29,325,000

Mr. GEDDES. Mr. Chairman and gentlemen of the committee, this radio tax has been in effect since 1932 as a temporary tax. We have gone along and paid the tax, and we have not been before Congress for 5 years, and are here now only because the House has begun a program of eliminating temporary excise taxes. The radio tax is small; it is one of the minor taxes; in fact, it is smaller than any of the major excise taxes which would be repealed under the House bill.

Senator TOWNSEND. That is, such as tooth paste, matches, and chewing gum?

Mr. GEDDES. It is smaller than any of them, Senator.

It is surprising that in the initiation of the program of the repeal of excise taxes the Treasury began with unquestionable luxuries, such as furs, sporting goods, chewing gum, and one or two other luxuries, and they have omitted radios, and we are here because we think the radio should have preference over any of these taxes now in the program.

The CHAIRMAN. You think radio is a necessity now?

Mr. GEDDES. It is not a luxury; regardless of what its classification might have been 10 years ago, when radios were very expensive, the cost has been tremendously brought down since then, and they are now in general use. There are 36,800,000 sets in use today, and that is 7,000,000 more than automobiles and twice as many as telephones. The radio is a matter of general common use.

Senator TOWNSEND. Do you think they have reached the saturation point?

Mr. GEDDES. No, Senator; although it would seem that way at this moment.

This is a special tax. We pay all other taxes, but this is a special tax on what we consider the greatest and most-powerful form of mass communication. We think radio should be on a basis comparable with the press. The press, at least part of it, enjoys a subsidy. Now, we have this extra 5-percent tax on radio facilities, and I think it is unnecessary to tell the committee the service, national and international, performed by radio—civic, educational, music, religious, political, and all of the other services enjoyed by radio. On that basis we feel, if Congress is going to start on any program of repealing excise taxes, radio should be considered in a preferential class ahead of any of these other excise taxes on luxuries.

On the fur tax the Treasury makes what I regard as a specious argument in saying that the receipts do not justify the administrative difficulties. The furriers have done a fine job by prevailing on

the Treasury to recommend a change in the fur tax. There has been the question of sample fur on the sleeve or the collar, and so forth, but it is our information the Treasury Department has worked out a formula on furs that is very satisfactory to the furriers.

The CHAIRMAN. You are not advocating that the tax be put back on furs?

Mr. GEDDES. No, Senator; we advocate if it is possible for Congress to begin a program of removing excise taxes, radio should be considered as a most important means of communication, comparable to the press.

The CHAIRMAN. Have you any estimate as to the loss of revenue that would result by this proposed change?

Mr. GEDDES. The Treasury estimates that the loss of revenue this year will be $6,400,000. We know absolutely and positively from the latest returns on excise taxes for last January—that is, for the month of December—that if the Treasury gets $5,000,000 or $5,250,000 this year it will be doing fine. The Treasury records show that taxes collected on radios in January were down 46 percent—our taxes are virtually at a standstill; we have from forty to fifty thousand unemployed at this moment.

Senator KING. Where are most of the factories?

Mr. GEDDES. In Chicago and the Middle West; Chicago, Cleveland, and also in the eastern cities, New England, and the Philadelphia-Camden district.

Senator KING. Some in Ohio?

Mr. GEDDES. Yes, sir.

We feel that the Treasury—they gave three arguments for eliminating excise taxes and one of them was because of administrative difficulties. We have them in our tax; it is a tax not on the radio set but on the several component units. It has a phraseology that where an article is suitable for radio use, even in a nonradio application, it subjects the entire mechanism to the radio tax. That language is clumsy and it causes lots of administrative difficulties. If nothing is done about the tax we would like to have the tdministrative amendment changed.

The CHAIRMAN. What percent of automobiles have radios in them?

Mr. GEDDES. Senator, there are now about 7,000,000 radio sets in automobiles, or about one-fourth in automobile sets.

Senator KING. One-fourth in automobiles?

Mr. GEDDES. Yes.

The CHAIRMAN. And the life of the radio in an automobile is what percentage of the life of the automobile, generally?

Senator HERRING. About 200 percent.

Mr. GEDDES. They last entirely too long; they will at least last as long as the automobile.

The CHAIRMAN. From the standpoint of the radio seller they last too long.

Mr. GEDDES. Yes, sir.

Senator KING. The trouble is you make so many little gadgets and amendments that you have to get a new set every few months.

Mr. GEDDES. That simply marks progress of science in the art.

Senator KING. I think the science should be more static.

Mr. GEDDES. It is static in television.

Senator TOWNSEND. Why is that?

Mr. GEDDES. It is largely financial, and there are also transmission difficulties that cannot be solved. For instance, they can cover England with eight television stations, whereas we estimate it would take at least 600 stations in this country.

Senator KING. Are you developing the television mechanism?

Senator HERRING. It is already developed, but they do not want to spring it.

Mr. GEDDES. No, sir; it is simply an impossible engineering problem. A television set now will not transmit more than 25 miles as a service range and the engineers have found no reasonably cheap facility to get beyond the 25-mile limit and connect stations like you do the networks; in other words, you have to have a separate television station in every large community in the United States and there is a tremendous capital investment involved.

Senator HERRING. Is that true of facsimile?

Mr. GEDDES. No, sir; it is not true of facsimile, because that is approaching very rapidly. It is being experimented on in 16 broadcast stations and also by a number of manufacturers; in my opinion it is imminent for adoption.

We recognize the constructive action in the House in eliminating the 1 (b) basket clause, and it makes it uncertain whether any of these excise taxes may be retained in the bill——

Senator KING. Why do you say that?

The CHAIRMAN. That has been rumored by someone.

Senator KING. You mean the reduction of the revenue may necessitate restoring——

Mr. GEDDES. Restoring all of the excise taxes. Our request is based on the possibility of the committee carrying out the Treasury program as contained in the House bill, or taking off some excise taxes, and if any are taken off, we believe radios should be first.

The CHAIRMAN. The press ought not carry that because that causes more visitors to come before the committee.

Senator KING. I think the members of the press have been very fair.

The CHAIRMAN. You want to eliminate the 5-percent tax on radios?

Mr. GEDDES. If any excise taxes are going to be omitted, we ask that that be omitted.

The CHAIRMAN. You would like to get that done?

Mr. GEDDES. That is the first and foremost.

The CHAIRMAN. Your alternative is to make it about 3 percent and include it in the general provision?

Mr. GEDDES. If it is not possible to repeal it, then we would like to have it reduced.

The CHAIRMAN. If we make it 3 percent, you claim under section 607 we would get how much revenue?

Mr. GEDDES. If you repeal it, you will lose from $5,000,000 to $5,250,000 this year, although the Treasury estimates $6,400,000, but they have not a chance to get it.

The CHAIRMAN. The Treasury does not go too high often.

Senator KING. But they are not infallible.

The CHAIRMAN. On this other proposition, if we reduce it to 3 percent, we would get from two and a half to three million?

Mr. GEDDES. Yes, sir.

The CHAIRMAN. Anything else?

Mr. GEDDES. We feel Congress never intended to levy this tax except on those things which were regarded as luxuries. We do not think Congress intended to levy it on such organizations as the police, public safety, schools, and things like that.

Senator KING. And ships on the high seas.

Mr. GEDDES. Yes, sir. We do not think it was intended in the policy of Congress.

The CHAIRMAN. You get a refund if you sell it to a municipal organization such as to the police, or State organizations?

Mr. GEDDES. If it is a State institution, then it is not taxable.

The CHAIRMAN. But we use it on the police force and they get a refund, do they not?

Mr. GEDDES. The tax does not apply; but if we sell direct to schools, gymnasiums, theaters, the Union Station, and things like that, we pay the tax. We do not think Congress intended that should apply to strictly commercial radio

The CHAIRMAN. Is there anything else you wanted to say?

Mr. GEDDES. Nothing.

Senator KING. Did you leave a memorandum, Mr. Geddes?

Mr. GEDDES. Yes, sir.

The CHAIRMAN. Mr. Donald Kane, representing the National Cooperative Milk Producers Federation.

Do you have a brief, Mr. Kane?

Mr. KANE. Yes, sir; a supplemental statement and also a list of our member organizations which I would like to put in the record.

The CHAIRMAN. Very well.

STATEMENT OF DONALD KANE, WASHINGTON, D. C., COUNSEL, NATIONAL COOPERATIVE MILK PRODUCERS' FEDERATION, WASHINGTON, D. C.

Mr. KANE. I am counsel of the National Cooperative Milk Producers' Federation, a dairy federation of 59 farmer-owned and farmer-controlled cooperative associations representing more than 350,000 dairy farmers. The Filled Cheese Act was passed by Congress in 1896. At that time many cheese manufacturers were taking the butterfat out of cheese and replacing it with melted lard and other vegetable or animal oils and selling it for genuine cheese.

Senator KING. Did they not have to state, like oleomargarine, that part of the cheese was the component part you have indicated?

Mr. KANE. Not at that time; they do now. But at that time they were selling it for and as cheese, particularly abroad in our export markets, and at that time we had quite a substantial export market. The result of the sale of this spurious product was that we lost those markets.

The CHAIRMAN. Tell us what filled cheese is.

Mr. KANE. Filled cheese is cheese from which the butterfat has been removed and replaced by oil or a fat other than butterfat. The Kraft Cheese Co. is making a product called Okey-Doke in which the cheese is ground up and mixed with either coconut oil or some other vegetable oil. They make cheese-covered popcorn and also use it for spreading on potato chips and crackers and things of that kind.

The CHAIRMAN. It is pretty good, is it not?

Mr. KANE. Yes; as far as their product is concerned, and we have no objection to that. I represent the dairy farmers here, and we are afraid the amendment put into the act by the House, although it will take care of the Kraft Co.'s difficulty, will make it possible for open bootlegging of filled cheese again.

Senator TOWNSEND. They would not bootleg cheese, would they?

Mr. KANE. We are afraid of that.

The CHAIRMAN. You suggest the elimination of the amendment as put in by the House?

Mr. KANE. Yes, sir.

The CHAIRMAN. Is there some modification of that amendment you might suggest?

Mr. KANE. No, sir. That amendment was put in by Congressman Thompson of Illinois, a member of the Ways and Means Committee, and there was no hearing held on it. The committee took the word of Chester Thompson, who has been a good friend of agriculture, and I do not think he realized that by offering this amendment to take care of the one company he was opening up the whole filled-cheese law so that there could be bootlegging of this spurious product.

The CHAIRMAN. Has he changed his mind about that?

Mr. KANE. He feels this amendment would not permit that, but the Secretary of Agriculture wrote a letter to Congressman Boileau of Wisconsin, in which the Secretary points out how absolutely impossible it would be to police the filled-cheese law if the exemption is put in to take care of this one particular product. I am filing that letter with the committee.

Our position is if any interested company, such as the Kraft Co., desires a modification of the filled-cheese law to take care of an honest product, which will not permit any bootlegging of spurious cheese and deprive our dairy farmers of the market for cheese, we will go with them and develop an amendment, first of all, with the consultation of other people in the cheese industry besides the Kraft Co., because we have a lot of cooperatives and other private people who are interested.

The CHAIRMAN. But you have no suggestion now to take care if it?

Mr. KANE. No, sir. I have tried to work out some language which would cover the product of the Kraft Co. and still not open up the way for violation through the sale of this stuff for making Welsh rarebit, cheese omeletts, toasted cheese sandwiches, and other uses now filled by genuine cheese.

The CHAIRMAN. Welsh rarebits are pretty good sometimes.

Mr. KANE. They are if made with genuine cheese, but not when they are made with lard.

Senator KING. They are helping the growers of pigs in using lard.

Mr. KANE. And the Kraft Co. is helping the cocoanut growers in the Philippines in using cocoanut oil.

The CHAIRMAN. You say you have a letter from Secretary Wallace in your brief?

Mr. KANE. Yes.

The CHAIRMAN. And you have filed the whole discussion?

Mr. KANE. Yes, sir.

The CHAIRMAN. Thank you very much.

SUPPLEMENTAL STATEMENT OF DONALD KANE, COUNSEL, THE NATIONAL COOPERATIVE MILK PRODUCERS' FEDERATION

The Federal filled cheese law was enacted by Congress in 1896. This legislation was occasioned by the fraudulent and deceptive sale, both in American markets and in our export trade, of a so-called cheese made from skimmed milk to which was added lard and other animal and vegetable oils and fats.

Because of the widespread sale of this spurious article, American cheese producers practically lost their foreign markets. At the same time, American consumers were becoming disgusted with this so-called American cheese and dairy farmers throughout the United States were feeling the consequent effects.

The law as passed imposes a 1 cent per pound tax on filled cheese and provides stringent regulations with reference to its packaging and sale.

Since 1896, so far as we know, there have been no attempts to modify or nullify in any way the Federal filled cheese law. The proposed amendment contained in section 707 of the Revenue Act of 1938 was included in the bill by the House Ways and Means Committee on the petition of Congressman Chester Thompson of Illinois, a member of said committee.

No hearings were held on this subject. No opportunity was given to any interested parties to appear and give testimony. No request was made of any department of the Federal Government or of any of the State governments for their opinions as to the effect of this amendment upon the Federal filled cheese law, or upon other related food and drug laws.

The first opportunity that anyone had to study the amendment came when the bill was reported out to the House of Representatives. At that time our federation consulted not only the farmer-owned and farmer-controlled cheese cooperatives in our federation but also others in the private cheese industry and officials of the United States Department of Agriculture.

The answer obtained from each of these groups was the same, namely, that the proposed amendment, no matter how praiseworthy its object, would have the effect of making the Federal filled cheese law unenforceable.

Congressman Boileau addressed a letter to Secretary Wallace asking the opinion of the United States Department of Agriculture with reference to this legislation.

He received the following letter from Secretary Wallace in response to his request:

MARCH 9, 1938.

Hon. GERALD J. BOILEAU,
House of Representatives.

DEAR MR. BOILEAU: I am acknowledging your letter of March 7, 1938, requesting the Department's comment on the desirability of a proposed amendment to the act of June 6, 1896, defining filled cheese. Our comment is offered largely on the basis of our experience in the enforcement of the Federal Food and Drugs Act in the interest of consumer protection.

Ostensibly this amendment will permit the substitution of edible oils other than butterfat for the natural butterfat of cheese in foods purported to be of restricted use. By the original filled cheese law certain combinations of foods made in imitation or semblance of cheese are held to be "filled cheese."

To need exemption the products, provision for which is made in the amendment, must be of the nature of cheese, in which case they will be readily mistaken for cheese by the purchaser. Although by the amendment the exemption rests on the manner of sale and objective use, these restrictions are not, in our opinion, so binding as to preclude the possibility of many combinations of cheese and oils supplanting cheese in its ordinary uses. The ostensible sale may be claimed to be for flavoring, but actually and practically the articles may be used in place of cheese. There are many "spreads" now on the market consisting mainly of whole milk cheese with added substances, other than edible oils, which are used to impart cheese flavor to other foods. In fact, the preparation of a sandwich can be interpreted as an imparting of cheese flavor to the bread or roll. This legislation may result in the replacement of the butterfat of the cheese component of such product by edible oil.

It is recognized that this reply does not furnish an adequate answer to your question but as the subject involves the activities of three bureaus of the Department, and requires careful study of the various factors concerned, it is impossible in the limited time available to present a more comprehensive statement.

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Upon reference of the matter to the Bureau of the Budget, as required by Budget Circular 344, the Acting Director thereof advised the Department of Agriculture under date of March 9, 1938, as follows:

"I am returning herewith a copy of your proposed report in which no recommendation is made either for or against the enactment of the proposed legislation, and you are advised that there would be no objection by this office to its submission to Congressman Boileau.

"Sincerely,

"H. A. WALLACE, *Secretary*."

It is obvious, therefore, that everyone who has a legitimate interest in the protection of the American dairy farmers and in the protection of domestic consumers, and our export markets for cheese, is opposed to the amendment. On the other hand, the only persons seeking its enactment so far as we are able to determine is the Kraft Cheese Co.

Their interest in this matter arises out of the fact that they are manufacturing a compound consisting of dried cheese and coconut oil, which compound is being used for the purpose of spraying popcorn, potato chips, and other like articles to impart a cheese flavor.

The Bureau of Internal Revenue has held that this compound should be classified as filled cheese under the act of 1896 and it was to get around this ruling of the Bureau of Internal Revenue that the Kraft Co. induced Congressman Thompson to introduce this amendment.

We have no criticism of the Kraft Co. They are an entirely reliable and high-class corporation engaged in the cheese business not only in the United States but also in foreign countries. We are sure that it is not their intention to weaken the filled-cheese law but their purpose is solely to protect the compound which they are now selling.

However, in the desire to take care of their present problem, we are afraid that they did not consider the dangers inherent in their proposal.

While the amendment provided that the substances and compounds which are to be exempted are not to be sold in imitation of cheese but only for cheese flavor, the difficulties of enforcement would appear to be insurmountable.

Once the product has been sold by the manufacturer, there is no control whatsoever over the wholesaler or the retailer. While the manufacturer may sell it in good faith, to be used as cheese flavoring, there is nothing which would prevent the retailer from selling or using it as a cheese spread for use in cheese omelets, for use in Welsh rarebit and toasted cheese sandwiches and numerous other uses where it would be substituted for genuine cheese.

In addition, unscrupulous manufacturers could unquestionably manufacture a product under this amendment which would be sold in direct competition with cheese out of grocery stores and other sales outlets. It would be very easy for an unscrupulous manufacturer to do this and at the same time meet the requirements of section 707 by stating in small letters on the glass or can that the product was a cheese flavoring and not a genuine cheese.

Representing as we do, the dairy farmers of the United States, we are obviously interested in developing further outlets for cheese. We do not, however, desire to open these outlets through the use of compounds and substances which would take away the market for pure whole American-produced cheese.

We are willing to cooperate in any investigation which this committee or any other committee of Congress might undertake to develop a modification of the existing law which might permit the legitimate use of a cheese spray, provided this can be done in a manner which will not leave the road open for bootlegging and for the practice of fraud and deception of consumers.

Such an investigation would require the study, not only of persons engaged in the cheese industry but also of State and Federal food and drug authorities.

We do, however, strenuously object to any change in a statute which has been effective for 42 years made without hearings and without consultation with any interested parties, including dairy farmers and Federal and State pure food and drug authorities.

MEMBER ORGANIZATIONS

Berrien County (Mich.) Milk Producers' Association, Benton Harbor, Mich.

California Milk Producers' Association, 6022 South Gramercy Place, Los Angeles, Calif.

Cedar Rapids Cooperative Dairy Co., 560 Tenth Street SW., Cedar Rapids, Iowa.

Challenge Cream and Butter Association, 925 East Second Street, Los Angeles, Calif.
Champaign County Milk Producers, 201 North Walnut Street, Champaign, Ill.
Chattanooga Area Milk Producers Association, Chattanooga, Tenn.
Connecticut Milk Producers' Association, 130 Washington Street, Hartford, Conn.
Consolidated Badger Cooperative, Shawano, Wis.
Consolidated Milk Producers for San Francisco, 593 Market Street, San Francisco, Calif.
Cooperative Pure Milk Association of Cincinnati, Plum and Central Parkway, Cincinnati, Ohio.
Coos Bay Mutual Creamery Co., Marshfield, Oreg.
Dairy and Poultry Cooperatives, Inc., 110 North Franklin Street, Chicago, Ill.
Dairymen's Cooperative Sales Association, 451 Century Building, Pittsburgh, Pa.
Dairymen's League Cooperative Association, Inc., 11 West Forty-second Street, New York, N. Y.
Des Moines Cooperative Dairy Marketing Association, 1935 Des Moines Street, Des Moines, Iowa.
Dubuque Cooperative Dairy Marketing Association, Inc., 1020 Central Avenue, Dubuque, Iowa.
Evansville Milk Producers' Association, Inc., 305 Boehne Building, Evansville, Ind.
Falls Cities Cooperative Milk Producers' Association, 229 Bourbon Stock Yards Building, Louisville, Ky.
Georgia Milk Producers' Confederation, 661 Whitehall Street, SW., Atlanta, Ga.
Indiana Dairy Marketing Association, Muncie, Ind.
Indianapolis Dairymen's Cooperative, Inc., 729 Lemcke Building, Indianapolis, Ind.
Inland Empire Dairy Association, 1803 West Third Avenue, Spokane, Wash.
Interstate Associated Creameries, 1319 Southeast Twelfth Avenue, Portland, Oreg.
Inter-State Milk Producers' Cooperative, Inc., 401 North Broad Street, Philadelphia, Pa.
Knoxville Milk Producers' Association, Knoxville, Tenn.
Land O'Lakes Creameries, Inc., 2201 Kennedy Street NE., Minneapolis, Minn.
McLean County Milk Producers' Association, 411–413 North Center Street, Bloomington, Ill.
Madison Milk Producers' Cooperative Association, 29 Coyne Court, Madison, Wis.
Maryland & Virginia Milk Producers' Association, 1731 I Street NW., Washington, D. C.
Maryland Cooperative Milk Producers, Inc., 810 Fidelity Building, Baltimore, Md.
Miami Valley Cooperative Milk Producers' Association, 136–138 West Maple Street, Dayton, Ohio.
Michigan Milk Producers' Association, 406 Stephenson Building, Detroit Mich.
Mid-west Producers' Creameries, Inc., 224 West Jefferson Street, South Bend, Ind.
Milk Producers' Association of San Diego County, 354 Eleventh Avenue, San Diego, Calif.
Milk Producers' Association of Summit County and Vicinity, 145 Beaver Street, Akron, Ohio.
Milwaukee Cooperative Milk Producers, 1633 North Thirteenth Street, Milwaukee, Wis.
Nebraska-Iowa Non-Stock Cooperative Milk Association, 2506 Dodge Street, Omaha, Nebr.
New England Milk Producers' Association, 142 Cambridge Street, Charlestown, Mass.
Northwestern (Ohio) Cooperative Sales Co., 2221½ Detroit Avenue, Toledo, Ohio.
O. K. Cooperative Milk Association, Inc., Oklahoma City, Okla.
Peoria Milk Producers, Inc., 208–210 East State Street, Peoria, Ill.
Pure Milk Association, 608 South Dearborn Street, Chicago, Ill.

Pure Milk Producers' Association, 853 Live Stock Exchange Building, Kansas City, Mo.
Pure Milk Products Cooperative, 111 King Street, Madison, Wis.
Richmond Cooperative Milk Producers' Association, 516 Lyric Building, Richmond, Va.
St. Joseph, Mo., Milk Producers' Association, Inc. 403 Ballinger Building, St. Joseph, Mo.
Salt Lake Milk Producers' Association, 1069 South State Street, Salt Lake City, Utah.
Sanitary Milk Producers, Room 609 Chamber of Commerce Building, 511 Locust Street, St. Louis, Mo.
Scioto Valley Cooperative Milk Producers' Association, 79 East State Street, Columbus, Ohio.
Sioux City Milk Producers' Association, Inc., 413-414 Warnock Building, Sioux City, Iowa.
South Texas Producers Association, Inc., 912 Bankers' Mortgage Building, Houston, Tex.
Stark County Milk Producers' Association, Inc., Canton, Ohio.
Tillamook County Creamery Association, Tillamook, Oreg.
Tulsa Milk Producers' Cooperative Association, 1120 North Boston Street, Tulsa, Okla.
Twin City Milk Producers' Association, 2402 University Avenue, St. Paul, Minn.
Twin Ports Cooperative Dairy Association, 6128 Tower Avenue, Superior, Wis.
United Dairymen's Association, 635 Elliott Avenue West, Seattle, Wash.
Valley of Virginia Cooperative Milk Producers' Association, Harrisonburg, Va.
Wisconsin Cheese Producers' Federation Cooperative, Plymouth, Wis.

The CHAIRMAN. Mr. Dewey F. Fagerburg or Mr. E. P. Snyder, of Chicago, Ill., representing the Kraft-Phenix Cheese Corporation.

STATEMENT OF DEWEY F. FAGERBURG, CHICAGO, ILL., REPRESENTING KRAFT-PHENIX CHEESE CORPORATION

Mr. FAGERBURG. Mr. Chairman and gentlemen, the firm which I represent, the Kraft-Phenix Cheese Corporation—

The CHAIRMAN. Have you talked to Mr. Kane?

Mr. FAGERBURG. Yes, sir.

The CHAIRMAN. You did not agree?

Mr. FAGERBURG. No; I do not see why anyone interested in the dairy industry should object to this amendment, because our viewpoint is one entirely of one interested in the dairy industry and I do not think there is a concern in the country that would do any more to prevent the situation which existed in filled cheese that has been referred to, if we thought it would bring that back——

Senator KING. You are one of the largest users of cheese?

Mr. FAGERBURG. Yes; I think we buy a large portion of the production of Mr. Kane's plants.

The CHAIRMAN. So you do not agree with the organization composed of dairy farmers on this proposition?

Mr. FAGERBURG. No; for this reason: We do not feel that the amendment in its present phraseology would permit the substitution of this flavoring for any legitimate cheese purpose. Our company, as well as every other company in the cheese industry, has been working for a number of years to try to develop a way of spraying cheese on food products so they can enlarge the market for natural cheese. During the last few years they have developed this product. They do it by almost dehydrating the natural cheese and get the moisture down to about 1 percent, which gives them a powdered

cheese. They combine with that powdered cheese an edible oil, and they are then enabled to spray the product on foods, and we hope it will ultimately become a good filler for crackers and be sprayed on crackers and potato chips.

During the last year our client used 600,000 pounds of natural cheese in this product. Mr. Thompson testified before the Ways and Means Committee there were over a million pounds of cheese used for this purpose last year; so I assume he had information indicating what our competitors used for that purpose.

The reason we do not have any fear of this amendment opening up the door to violations of the Filled Cheese Act is that the amendment eliminates from the application of the old Filled Cheese Act, only substances and compounds consisting principally of cheese with added edible oils. Cheese is defined in section 1 as being made from milk or cream; in other words, whole milk or cream. So it is a new way of utilizing whole-milk cheese, rather than a substitution for whole-milk cheese and it has no importance as a revenue factor, because I think Mr. Thompson put into the record—and he did testify before the Ways and Means Committee, so there was a hearing on this—that over the 42 years that this Filled Cheese Act had been on the books there had only been collected by the Government approximately $127,000.

The CHAIRMAN. Was this amendment recommended by the subcommittee of the Ways and Means Committee?

Mr. FAGERBURG. No, sir; it was offered in the committee——

Senator TOWNSEND. Have you read the letter of the Secretary of Agriculture?

Mr. FAGERBURG. Yes, sir.

Senator TOWNSEND. You do not entertain the same fears that he does?

Mr. FAGERBURG. No, sir. He has stated he has not had a great deal of time to examine into the question, and he says this legislation may result in the replacement of the butterfat of the cheese component of such product by edible oil. He is referring to cheese, but this amendment says that this product has to be cheese, which cheese is defined in section 1 of the act as being made from whole milk. So that that statement is in error; it could not result in the replacement of butterfat, and it would be easy from analysis for the Department to find out whether it did.

One reason why we have to have this exemption is that under the interpretation of the Department of Internal Revenue as put upon this act it will require the stoppage of this entire business of manufacturing and use of cheese flavoring on farinaceous food products, because it is impossible to stamp a package of this type of flavor as required in the Filled Cheese Act. You have a stamp on the side, top, and bottom of the cheese, in letters 2 inches in height, I believe it is, the words "Filled cheese." This cheese flavor is put up in a tin container and you could not possibly stamp anything on a pasty product of this type.

The CHAIRMAN. Is there any other similar cheese made by companies other than the Kraft people?

Mr. FAGERBURG. Yes; it is made by the Borden Co. and a number of other smaller——

The CHAIRMAN. You say other small?

Mr. FAGERBURG. I should take the word "other" out, because Borden is quite a competitor.

As I said, we expect that the outlet during the next few years will run into several millions of pounds of natural cheese, and we think it is to the interest of the dairy industry in its entirety that this amendment be passed, because this outlet will be stopped unless——

Senator TOWNSEND. You want it as in this bill?

Mr. FAGERBURG. Yes, sir.

Here is another factor to consider in determining whether or not this product is going to be substituted for natural cheese: The wholesale price, as sold by our client, was 35 cents a pound. That results from the fact you have to use the best well-aged cheddar cheese in order to impart the cheese flavor to the product.

The CHAIRMAN. What would be the price of the cheddar cheese?

Mr. FAGERBURG. On January 12, 1938, the wholesale price of well-aged cheddars in Chicago was 23½ cents and the retail price in the Fair Store of well-aged cheddars was 33 cents or 2 cents less than the wholesale price of the cheese flavoring.

Senator HERRING. What percent of cheese to oil do you use?

Mr. FAGERBURG. Forty-five percent cheese and 55 percent oil. You have to have sufficient oil so that you can readily spray it on these food products.

Senator LA FOLLETTE. Have you given any consideration to the problem that the Secretary points out in his letter of policing enforcement of this amendment?

Mr. FAGERBURG. Yes; I think so. We do not think there will be any difficulty in policing it, because from a practical point of view the expense of the product prevents its competition with natural cheese, and in the second place it can be very readily determined whether or not this product has the oil in it; and if there was any other type of cheese that had the oil combined with it, when you heat it the oil will run off; for example, if you leave cheese flavoring in much more than ordinary room temperature, the oil separates out; so it is readily ascertainable whether it is cheese or cheese flavoring. Furthermore, we feel the branding provisions of the act, aside from the Filled Cheese Act, would be sufficient to protect the product.

Senator KING. Would the ordinary inspector who visits cheese factories detect the difference?

Mr. FAGERBURG. Yes, sir.

Senator KING. The oil would be manifest?

Mr. FAGERBURG. Yes, sir.

Senator TOWNSEND. Is it of advantage to the manufacturer to increase the oil content?

Mr. FAGERBURG. That is a matter of experimentation, Senator. They experimented with the relative quantities that had to be used to get the cheese to dry well on the food product, and at the same time you have to use an optimum of cheese in order to impart the cheese flavor. You cannot sell the product unless it has a good flavor and is a good cheese product. So they use as much cheese as necessary to give the sharp cheese flavor and still have it carried by oil.

Senator KING. It has never been contended by anyone it is deleterious in any way?

Mr. FAGERBURG. No; as Mr. Kane has said, there can be no objection to our product or that of our competitors.

Senator La Follette. The only apprehension is, as I understood Mr. Kane's statement, this amendment, while authorized to cover this particular product, may open up and loosen the enforcement of the Filled Cheese Act, which would be a great blow to the industry in this country.

Mr. Fagerburg. If we thought that would be the result, we would be just as much opposed to it as he, but the language providing that the product has to be made of cheese will prevent that, because cheese is defined as being made of whole milk, in the first section of the act; and filled cheese, as the Department of Agriculture defined it in its bulletin in 1918, is the name applied to cheese from which the butterfat has been removed and foreign fat added. It further states, "the foreign fat is added by stirring it violently in the milk and setting with sufficient rennet to coagulate quickly. The rest of the manufacture is the same as for Cheddar cheese."

That refers to section 707, and in this copy that I have it is page 307.

Thank you very much.

(The following letter was offered by Mr. Fagerburg:)

Washington, D. C., *March 16, 1938.*

Hon. Pat Harrison,
Chairman, Finance Committee, United States Senate,
Washington, D. C.

Dear Sir: Acting upon your suggestion, we are briefly outlining herein the reasons why section 707 of the proposed Revenue Act of 1938 should be enacted into law. This section provides for the amendment of section 2 of the Filled Cheese Act of 1896. The Honorable Chester Thompson of Illinois, who introduced this measure in the House, made a statement before the Ways and Means Committee, which gives a comprehensive explanation of the reasons for his introduction of the amendment. We attach hereto, a copy of his statement as it appears on pages 848 to 854 of the Report of Hearings before the Committee on Ways and Means of the House of Representatives, on Revenue Revision 1938.

At the time the proposed Revenue Act of 1938 was considered in the House of Representatives, certain objections were raised to section 707, on the ground that its enactment might open the door to violations of the Filled Cheese Act and make that act difficult of enforcement. As we stated to you, we represent Kraft-Phenix Cheese Corporation, which, perhaps more than any other single concern in the dairy industry of the United States, is interested in the strict enforcement of the Filled Cheese Act. We would not favor any amendment to that act that would result in the reintroduction of filled cheese on the American market. However, we do not believe that the amendment to the Filled Cheese Act proposed by Congressman Thompson would result in a revival of the manufacture of filled cheese. The amendment merely permits the combination of natural whole-milk cheese with edible oils, thus permitting the adaptation of natural cheese to uses which otherwise would not be possible.

At the present time, cheese flavoring made by the combination of dehydrated natural cheese and an oil carrier is being widely used for spraying on popcorn and it is anticipated that the use of this product will be extended to crackers, potato chips, and other farinaceous products and thus develop a new market for several millions of pounds of natural cheese per year. The Filled Cheese Act as presently construed by the Department of Internal Revenue, will require the discontinuance of the sale of this product, and it is to prevent the loss of this market, that the amendment is proposed.

We do not understand that the amendment is being criticized on account of its authorization of the use of a product such as the cheese flavoring, which is now being used for the coating of popcorn. The objectors have merely expressed a fear that the language of the amendment may permit a revival of the manufacture of filled cheese. They have not pointed out wherein the language of the amendment is capable of such construction. That the amendment may not be so construed is evidenced by the fact that it only permits the combination of "cheese" with edible oils and "cheese" is defined in the first section of the

act as a product made from whole milk or cream. Filled cheese, on the other hand, is made from milk which has had substituted for the natural butterfat of the milk, a fat foreign to milk. (See the excerpts from the Congressional Record of April 9, 10, and 11, 1896, referred to in the Honorable Chester Thompson's attached statement.)

It is our opinion that a product made from whole-milk cheese and edible oil used for the purpose of cheese flavoring is not a filled cheese, but as above noted, the Department of Internal Revenue has ruled otherwise, and in view of the fact that the Filled Cheese Act of 1896 has certain specific requirements with respect to the marking and packaging of filled cheese which cannot be complied with in handling a pasty product such as the cheese flavor which is used for coating popcorn, the result of the enforcement of the present Filled Cheese Act, as interpreted by the Department of Internal Revenue, would be to deprive the industry of this additional outlet for high-grade natural cheese, an outlet which it is anticipated will run to several millions of pounds per year within the next 2 years. It should be noted also that the cheese used in this product is the very highest type of well-aged American Cheddar. This type of cheese is required to produce the strong cheese flavor necessary for the intended uses.

The manufacture of filled cheese was detrimental to the cheese industry because it substituted for natural cheese an inferior cheaper product which was easily pawned off as natural cheese on an unsuspecting public. In contrast, the cheese flavor which is used for the coating of popcorn is, on account of the expensive process of manufacture and the high grade of cheese and oils used therein, sold at wholesale prices which are higher than the retail prices of well-aged American Cheddar cheese.

By way of illustration, on January 17, 1938, the wholesale price of cheese flavoring sold by Kraft-Phenix Cheese Corporation was 35 cents per pound. On the same day well-aged American Cheddar cheese was being wholesaled in Chicago at 23½ cents per pound, and retailed at The Fair store (a typical large Chicago retail outlet) at 33 cents per pound. From the foregoing it is evident that this product would not be a competitive substitute for cheese even if such substitution were feasible. Its use, therefore, must necessarily be restricted to instances where natural cheese could not be used. As a matter of fact, the only present outlet for this cheese flavor are to manufacturers of food products who spray it on their products to impart thereto a natural cheese flavor heretofore impossible of accomplishment.

In the event there is a request from anyone to appear before the Senate Finance Committee to testify with respect to this amendment, we would appreciate it if you would accord to us like opportunity. The writer could be called, collect, in Chicago, telephone Randolph 8161, or by collect telegram at 135 South La Salle Street, Chicago.

Respectfully yours,

NICHOLSON, SNYDER, CHADWELL & FAGERBURG,
By D. F. FAGERBURG.

(The following statement was also offered for the record by Mr. Fagerburg:)

STATEMENT OF HON. CHESTER THOMPSON

Mr. Chairman, I wish to outline briefly the present effect upon the cheese industry and the enlargement of the use of cheese in food products of certain provisions of the Filled Cheese Act of 1896. During the period from approximately 1875 to 1895, the creameries of this country in an apparently ever-increasing number, after extracting the butterfat from milk for the manufacture of butter, used the skim-milk residue for manufacturing a product which, upon completion, bore a semblance to cheese, had a fat content practically the same or the same as cheese but contained little or no butterfat. It was made by heating the skim milk and agitating it while injecting into it lard or animal fats. Rennet was added to coagulate the compound and the process of manufacture thereafter was similar to that of the manufacture of Cheddar cheese.

Certain of these creameries would label the product "filled cheese"; others would label it merely "cheese"; but the Congressional Record indicates that at the time this act was under consideration interested Congressmen's investigations disclosed that, whether the product was originally marked "filled cheese" by the

manufacturer or not, when it was sold throughout the United States or foreign countries, the markings were changed to indicate that it was, i. e., Wisconsin full cream cheese or other cheeses connoting a high quality of American Cheddar cheese. The practice grew to such proportions that, in the early part of the nineties, it was credited with the ruination of the American cheese-export business.

The Filled Cheese Act of 1896 was, therefore, passed to tax the manufacturers of filled cheese, to place a tax upon the product sold, and to impose certain restrictions upon the manufacturers, wholesalers, and dealers of the product including regulation of the method of marking the containers in which the product was sold, specifying the type of containers to be used and providing for penalties in cases of violation.

I am including certain extracts from the Congressional Record which will serve to illustrate the members' concept of the product which Congress was proposing to regulate by the adoption of the act of 1896; and, from an examination of the complete record of the debates on the filled cheese bill, particularly in the House of Representatives where it was most thoroughly discussed, it is obvious that the thing Congress was trying to control was the manufacture of a product made of skim milk and animal fats which was being sold in imitation of cheese and thereby destroying the market for cheese. There certainly seemed to be no intent that the act apply to a product which is not sold as cheese but which is manufactured to enlarge the uses of cheese and to make it possible to use cheese where it had never been possible to use it before.

From the reference by the Members of Congress, it will be noted that the products being discussed for taxation or control as filled cheese were made of milk from which the butterfat content had been extracted. The Department of Agriculture in its Bulletin No. 608, issued March 6, 1918, also defines filled cheese as follows:

Filled cheese is the name applied to cheese from which the butterfat has been removed and foreign fats added. The foreign fat is added by stirring it violently in the milk and setting with sufficient rennet to coagulate quickly. The rest of the manufacture is the same as for Cheddar cheese.

The Commissioner of Internal Revenue has recently interpreted the definition of "filled cheese" in the act to cover a product manufactured which is not made of a milk or skim milk from which the butterfat has been extracted. It is made of well-aged Cheddar cheese from which the moisture has been extracted by a special spray-drying process which reduces it to a cheese powder with a moisture content less than 3 percent and generally around 1 percent. This cheese powder is then combined with a combination of vegetable oils normally solid at room temperature in such a way as to cause the cheese particles to be uniformly suspended in the fat globules. The end product, while solid at room temperature, will separate into cheese and oil if left standing at higher temperatures. It is, therefore, impossible to pack it in wooden boxes as required by the Filled Cheese Act. In my opinion, this characteristic also renders the product dissimilar to cheese in the accepted concept of that term and takes it out of the act, but the Commissioner of Internal Revenue holds otherwise. The product is not sold as a cheese but as a cheese flavor. It was developed to broaden the uses of natural cheese, not to curtail its uses.

The cheese industry of America had for a number of years been endeavoring to develop a method of spraying cheese upon various food products. Cheese when melted by itself will not spray satisfactorily because of its heavy body and texture. Even if it could be sprayed, the moisture in natural cheese would cause any product upon which it was sprayed to become rancid when exposed to the atmosphere for any length of time. Since 1932, however, the above-described method of reducing cheese to a powdered form which is almost moisture-free has been developed. Through this medium cheese may be sprayed upon farinaceous food products such as popcorn, and a large business has been developed in the United States in the coating of popcorn with cheese flavor which will be wiped out if this product is held to be filled cheese within the meaning of the present act. This business is conducted by relatively small operators scattered throughout the country who buy the cheese flavor and use it for coating popcorn. They have invested in especially built equipment, all of which will be rendered worthless if this product is construed to be filled cheese, because it is impossible to pack it in wooden boxes or to mark it as required by the Filled Cheese Act. The product is of such texture that if heated slightly above normal room temperature it will settle out into cheese and vegetable oils.

Under these circumstances I feel that Congress will be disposed to amend the Filled Cheese Act to clarify any ambiguity in the definition of filled cheese that may exist under its present phraseology, and to definitely read out of the act a product of this type.

It is my view, both from a careful consideration of the words of the Filled Cheese Act and from a review of the debates in Congress at the time of the adoption of the act, that it was not intended to and does not apply to a product of this character. The Commissioner of Internal Revenue, however, has taken the position that it does so apply, and I recognize that there is perhaps an ambiguity in the language which may properly serve as a basis for the argument that it does.

Having in mind the apparent intent of Congress in the adoption of this act, I would, therefore, suggest for your consideration the amendment of the act to clarify its terms. Section 2 of the act of 1896 (29 Stat. 253 et seq.) provides as follows:

"That for the purposes of this act certain substances and compounds shall be known and designated as 'filled cheese,' namely: All substances made of milk or skimmed milk, with the admixture of butter, animal fats or oils, vegetable or any other oils, or compounds foreign to such milk, and made in imitation or semblance of cheese."

My proposal would be that this section of the act be amended by adding thereto the following proviso:

"*Provided*, That substances and compounds consisting principally of cheese with added vegetable oils which are not sold as substitutes for cheese but are primarily useful for imparting a cheese flavor to other foods shall not be considered 'filled cheese' within the meaning of this act."

The manufacturers who purchase this cheese flavor understand that they are not buying cheese. They buy it for a specific purpose and pay more for it than the regular prices for American Cheddar cheese.

Under the proposed amendment, if cheese flavor should at any time be sold as cheese, the proviso would not be applicable and the guilty party could be prosecuted under the statute. I may say that the provisions of the food and drug law with respect to misbranding would also serve to protect the public against any such misrepresentation.

Mr. Chairman, I feel that the cheese industry (which includes every farmer and dairyman producing milk for the cheese market and every person whose welfare is in any way dependent upon its prosperity) is interested in this corrective legislation, because if the act is enforced according to the interpretation thereof by the Commission of Internal Revenue, a very useful and broad field for the development of the use of cheese in food products will have been withdrawn from the cheese industry.

[From Congressional Record, House, vol. 28, pt. 4]

FILLED CHEESE

April 9, 1896

(P. 3702:)

Mr. COOK of Wisconsin. "Filled cheese" is an imitation cheese and is sold to the people by means of deception which disguises the facts as to what the article really is. Such deception is a fraud and should be publicly branded as a fraud.

Filled cheese is made at butter factories, where they have centrifugal machinery to take all the cream or butterfat out of the milk. The cream is made into butter and sold for "finest creamery," and then they take the skimmed milk that is left and put lard and neutral oils into it. This is done by "heating the milk and injecting the neutral into the milk," and this is made into what is known to the trade as filled cheese.

(P. 3703:)

Mr. COOK of Wisconsin. Filled cheese is made from skimmed milk, rennet, neutral oils, salt, and coloring.

Mr. OTEY. What part is taken out of the milk that is supplied or filled in in the making of filled cheese?

Mr. NORTHWAY. The butter.

April 10, 1896

(P. 3829:)

Mr. GROSVENOR. Filled cheese is a food product manufactured from milk and neutral oil. The process is that of taking the milk of the cow and by a modern process extracting from the milk all butterfat, leaving the milk simply skimmed milk—nothing else. Seventy percent of this milk and 30 percent of neutral oil constitute the product known as filled cheese. The neutral oil is manufactured from the leaf lard of the hog. The process of rendering and preparing for use is by the application of heat. There was some dispute in the testimony before the committee as to the degree of heat that has been applied to the commodity. In the beginning of our investigation it was stated that about 120 degrees of heat were applied and that this was not sufficient to render the article digestible. The weight of the evidence, however, places the degree of heat at a point very considerably higher.

(P. 3838:)

Mr. TAWNEY. Mr. Chairman, what is filled cheese and what methods are employed in its manufacture and sale? Filled cheese is a compound or counterfeit cheese, the constituent parts of which are skimmed milk and uncooked animal fat, known to the trade as neutral oil. This neutral oil is substituted or put into the skimmed milk to take the place of the butterfat extracted by the use of the centrifugal separator. This substituted fat is not made by those who manufacture filled cheese, but is bought by them from the manufacturers of neutral oil or pork-packing establishments. It is claimed by the manufacturers of filled cheese that nothing but pure hog leaf is used in making this oil. They admit, however, that it may be, and doubtless is in many instances made from the fat of diseased animals or from impure refuse or putrid fats, and that when they receive it they do not know and have no means of knowing whether it is pure or filled with the germs of disease.

The percentage of skimmed milk and neutral oil used in making filled cheese is about 70 percent of the former and about 30 percent of the latter. To this is added a certain amount of rennet, with the necessary coloring and flavoring matter. It is made in the form and semblance of pure cheese, with absolutely no mark or brand of any kind to identify it as filled cheese.

(P. 3842:)

Mr. RAY. The only milk used in the manufacture of filled cheese is that from which the cream has been removed by the separator. In other words, filled cheese is the result of mixing refuse lard with skim milk and so combining the two as to produce an article that is sold to the laboring masses of this country as the product of the dairy, when, in fact, it is not cheese and does not contain the life-sustaining powers found in cheese. Filled cheese is a fraud and an imposition upon those who would purchase and use cheese as a food. Filled cheese is an imposition upon the farmers of the United States for it substitutes in our city markets an article that is not cheese for cheese—substitutes a fraudulent article that is sold as cheese. Filled cheese is an indigestible mass of lard or other animal oils flavored with skim milk.

(P. 3843:)

Mr. EVANS: Filled cheese is unquestionably a meritorious food product. It is a product of skimmed milk in which rennet, pure lard, and other harmless substances take the place of the butter or cream, and the milk being filled in this way, the product is called "filled cheese" in contradistinction to cream cheese made without skimming the milk.

(P. 3864:)

Letter from Secretary of Agriculture, J. Sterling Morton, to the Committee on Ways and Means, Fifty-fourth Congress.

"What is known as filled cheese was formerly called margarin cheese and oleo cheese, and is designated as imitation cheese in the laws of several States. It is apparently a perfectly legitimate food product and properly called cheese. It has the characteristics of cheese, although not of high grade, and is similar in chemical composition. The only essential difference between filled cheese and that made from whole milk is in the substitution of the fat of the hog for that of the cow. The neutral fat of the milk being extracted, or separated, is replaced by a good quality of lard, at the rate of 2 or 3 pounds of the latter to 100 pounds of skim milk.

"At different stages in the development of this industry various fats and oils have been used, including oleo oil, margarin, cotton oil, and unmerchant-

able butter, as well as others still cheaper and of doubtful origin. But objectionable results have led to the rejection of all except neutral lard. At the present time the only fat not natural to milk which is used in making 95 percent or more of the filled cheese produced is neutral lard, and this of a superior quality, tasteless, odorless, and usually selling at about 1 cent per pound more than the best family lard. The wholesale price of "neutral" has been for some months in the vicinity of 7 cents per pound.

"In view of these facts the most correct and significant legal designation of this article would be 'lard cheese.'

"In the process of manufacture the bulk of the milk is raised to the same temperature as in making ordinary cheese, while part of the milk and all of the neutral lard is raised to a temperature of at least 200° F. This is about as high a temperature as pork fat is subject to in cooking, and much higher than the fat of milk is heated in ordinary cheese making. The places and processes of manufacture of lard cheese, or filled cheese, and the same where whole-milk or full-cream cheese are made are practically equal, so far as care and cleanliness are concerned."

(P. 3847:)

Mr. SAUERHERING. The process of manufacture is quite simple and inexpensive. By the use of a modern cream separator the butterfat is extracted from the milk and manufactured into good creamery butter; then the skimmed milk is taken, and, by a peculiar process known to the trade, lard neutral oils are forced into it to take the place of the butterfat which has been extracted. From this skimmed milk, so "filled" with lard and neutral oils, "filled cheese" is made.

April 11, 1896

(P. 3871:)

Now, what is filled cheese It is the result of the new method of separating the fatty substance from new milk. By the centrifugal force that is used milk can have the fattly substance taken from it and made into butter, and that milk thus relieved of its fatty substance, which is perfectly fresh and wholesome, is, under the new method, manufactured into cheese. How? By taking leaf lard and subjecting it to certain heat, so that it becomes oil, and mixing a certain number of pounds of that with a hundred pounds of this milk, and then the process of manufacture is the same as the manufacture of other cheese. The leaf lard is as pure and clean a product as the fatty substance in the milk itself. The only difference between a full-cream cheese and this filled cheese is the fact, as I have just indicated, that in the one case it is the fatty substance that comes from the cow and in the filled cheese it is the fatty substance that is taken from the leaf lard of the hog.

[From Congressional Record, Senate, vol. 28, pt. 7]

June 4, 1896

(P. 6090:)

Mr. SHERMAN: Now, it is complained recently that in order to get a cheaper form of cheese they take the skimmed milk only. So far as the milk is concerned, they take the cream and convert it into butter and sell the butter. They then take the skimmed milk, which my friend from Missouri says is so wholesome—although I suppose we have drunk a good deal of it in our lifetime without being very dangerously injured—and add to it not cream, or the product of cream, but they add to it lard—the lard of the hog—and they take this lard, reduced, or rendered, as they call it, melted by a heat of probably 120, 130, or 140 degrees, and they mix that lard with the milk and make what is called filled cheese. That is, it is skimmed-milk cheese, filled with lard instead of with butter or butterine or cream, which is the foundation of butter. That is all there is in this case.

The manufacture and sale of filled cheese have grown to be an abuse so great as to destroy a large industry in many of the agricultural States of the Union—North, South, East, and West. It has become so great an evil that the farmers in their meetings and conferences have denounced it, and they claim that it is injurious to their business.

This filled cheese, which is manufactured, not of cream and milk but manufactured of skimmed milk, the cream which is taken out of it and made into butter being superseded by lard, is believed by many to be unhealthy. Certainly, it is not what is called cheese, which is a product always of the cow, and not of the hog. The distinction there is marked.

The business amounts to a fraud. It is true that a person who did not have some mode of testing this cheese might not distinguish it from ordinary cheese, but most persons could tell the difference between it and the genuine cheese; but still it is colored precisely like the genuine cheese. (P. 6092:) Letter from H. W. Wiley, Chief of Chemical Division, Department of Agriculture, to Hon. John H. Gear, United States Senator from Missouri:

"SIR: 'Filled cheese' is a trade term given to cheese which is made from skim milk. The deficiency in fat is usually supplied by the addition of lard. In all the samples which have been examined in this laboratory the added fat has been found to be lard. It is said that only the purest leaf lard of a neutral reaction is used for filling, but this, of course, cannot be confirmed by our own investigations, which have extended to only a few samples. The lard found in the samples examined by us has apparently been of a high grade of purity.

"The casein, or cheese-making property, of filled cheese and full cream cheese does not differ greatly in amount, and from an ordinary analysis the two kinds of cheese might be easily confounded, as they may have the same quantities of water, of casein, and of fat. If, however, the fat be examined, the difference between the two cheeses is readily appreciated; in the full milk cheese the fat present being butterfat, while in the filled cheese nearly the whole of the fat present is lard or some fat foreign to milk. I enclose a table giving some data of analyses which have lately been made in this Division.

"The fraud which is practiced in the case of filled cheese is in abstraction of a more valuable and the insertion of a less valuable fat, the price of lard being, as a rule, much less than the price of good butter. Thus, the skim milk which is left after the separation of the cream, by setting or by mechanical appliances, and which is of very little value, can be turned into a cheese which in appearance and general properties resembles very nearly that made from full milk. It is not difficult to discriminate, however, between the taste of a full-milk cheese and that of filled cheese, and especially for cooking purposes. When the cheese is to be cooked as a whole, or where it enters as an ingredient in other goods, the difference is most marked. As an illustration of this, it may be said that it is quite impossible to make a presentable Welsh rabbit from a filled cheese.

"The fraud in filled cheese cannot properly be said to be a nutritive one, inasmuch as the nutritive value of the lard which is added is probably nearly the same as the fat which is abstracted."

The CHAIRMAN. The next witness is Mr. Claude W. Dudley, representing the Millers National Federation, and I understand he desires to discuss the undistributed-profits tax.

Have you a brief there, Mr. Dudley?

STATEMENT OF CLAUDE W. DUDLEY, WASHINGTON, D. C., REPRESENTING THE MILLERS NATIONAL FEDERATION

Mr. DUDLEY. I have, Mr. Chairman, and I should like to have each of you have one, because there are two tables in there to which I want to refer.

The CHAIRMAN. Very well.

(The brief referred to is as follows:)

I represent the Millers' National Federation of Chicago, Ill., the members of which are engaged in the milling of wheat and rye flour and also in some cases in other lines of business. The federation has 560 members, who produce approximately 81 percent of the wheat flour commercially produced in the United States. The federation has sent to its members a questionnaire for the purpose of securing a cross-section of their views with respect to the undistributed-profits tax. Our members are unqualifiedly in favor of the repeal of that tax, even though it may be necessary for revenue purposes to increase substantially the rates of normal income tax on corporations. They believe that this tax has retarded business recovery, that it works a hardship on every

small- and medium-sized business, and that it is basically unsound in principle in that it penalizes thrift and conservatism in management of corporate affairs. I ask that permission be granted to place in the record an analysis of this questionnaire.

The revenue bill as passed by the House of Representatives retains the principle of the undistributed-profits tax. It is drastically modified, but the principle is still there. This tax is so generally condemned that it should be abandoned entirely. The reduction in rate does not remove the inequities; it merely lightens their burden. It is well recognized that it is impossible for corporations to pay out all their profits as dividends, yet this proposed law provides for a higher rate of tax if any part of the profits is retained for expansion or rehabilitation of plant, retirement of debt, or other legitimate corporate purposes. It is well known that corporations cannot accurately compute their profits of the taxable year until after the year is closed, yet this proposed law imposes a penalty tax upon any part of the profits which are not actually distributed before the end of the year.

I urge the complete repeal of the undistributed-profits tax, first, because of the inequalities which are inherent in it and which cannot easily be removed, second, because of its complexities, and third, because it encourages dissipation of business resources at a time when every encouragement should be given to employment of capital in business enterprise.

The inequalities inherent in the undistributed-profits tax have been loudly proclaimed. It is directly contrary to the basic principle that taxes should be levied in accordance with ability to pay. The debt-ridden corporation which is financially unable to pay a dividend pays the highest rate of tax; the affluent corporation with ample cash resources from which it can currently distribute its profits pays the highest rate of tax; the affluent corporation with ample cash resources from which it can currently distribute its profits pays the least tax. The small corporation seeking to finance its development out of its own savings pays for that privilege. It has no other source of capital upon which to draw. The large corporation which has already attained an outstanding position in its field has no need to retain its earnings for further expansion and pays only the minimum tax.

The provision exempting corporations having not more than $25,000 of net income from the undistributed-profits tax is helpful so far as it goes. It carries with it an implication that growth beyond that point is not to be encouraged. With that policy I disagree emphatically. Growth and development of industries, whether owned by corporations or individuals, is a vital factor in the job of rehabilitation now before us. No tax policy should be adopted which discourages the growth of a business beyond the point of $25,000 of net income. No barrier should be set up to discourage the development of business beyond any stated size.

Now let us consider the complexities that are inherent in the undistributed-profits tax. I think we all agree that simplicity in a tax law is a desirable objective. We have not in recent years made any progress in that direction. The 1918 act, including its very elaborate scheme of war-profits and excess-profits taxes, was 106 pages long; the Revenue Act of 1936 is 121 pages. The game of hide and seek of tax avoidance and loophole plugging and the efforts of Congress to correct this, that and the other inequality, have combined to make the determination of net income a difficult matter under the present laws. Add to that the necessity of determining adjusted net income, first division net income, second division net income, special class net income, tentative tax, alternative tax, dividends paid credit, basic surtax credit, bank affiliate credit, dividend carry-over, consent stock, consent dividends credit, consent dividends day, preferential dividends, et cetera, and you increase tremendously the difficulties encountered by the businessman in making a return. The expense involved in the preparation and audit of the returns will be disproportionate in comparison with the revenue collected from an undistributed-profits tax which is limited to a maximum of 4 percent.

It would be much simpler to increase the basic rate from 16 percent to 17 percent and have this increase of 1 percent apply to all corporations. And since approximately 80 percent of all corporate profits are distributed in dividends, it is obvious that as large an amount of revenue would be collected in this manner.

Finally, I am opposed to the undistributed-profits tax because it encourages dissipation of business resources at a time when every encouragement should be given to employment of capital in business enterprise. The need for this is apparent from an examination of the data with respect to new capital issues of recent years. During the past 6 years, 1932-37, the total new capital issues of domestic corporations is $3,451,615,000. The comparable figure for the corresponding 6 years of the previous decade is $16,891,170,000. Take the year 1937 alone. During the first 8 months of last year business was at a higher level than at any previous time with the single exception of the year 1929. Yet the new capital invested in domestic corporations was only $1,191,891,000 in comparison with $4,656,801,000 in 1927.

It is not my contention that the undistributed-profits tax is the principal cause of the failure of new capital to be attracted to business enterprise. The timidity of capital was evident before the undistributed-profits-tax law was passed. I do contend, however, that it is one of the important contributing factors and it is one which can be inexpensively removed.

There is no need for an undistributed-profits tax to prevent the unwarranted accumulation of surplus by corporations. Section 102 of the act provides that a special tax of 25 percent to 35 percent shall be levied on the net income of every corporation which is formed or availed of for the purpose of preventing the imposition of the surtax on its stockholders by permitting its gains or profits to accumulate instead of being distributed. The real measure of effectiveness of this statute is not in the amount of revenue which it produces directly but the amount which it produces indirectly by forcing distributions by corporations who fear the imposition of the special tax imposed by section 102.

The effectiveness of this provision and section 351 of the present law, relating to personal holding companies, is clearly shown by the fact that in 1935 the cash dividends paid by all corporations, large and small, amounted to 78.2 percent of their adjusted net income, compared with distributions amounting to 47.4 percent of the adjusted net income in 1923. For the 6-year period, 1930 to 1935, the cash dividends paid by all corporations amounted to 86.9 percent of their aggregate adjusted net income.

The Government has lost in the lower courts two outstanding cases in which they have brought proceedings under section 102. These are the *DeMille case* and the *National Grocery case*. The Supreme Court has denied the Government's petition for certiorari in the former case and has granted it in the latter case. In its present form, section 102 requires that there be a manifest purpose to avoid surtaxes, otherwise the penalty tax does not apply. In the *DeMille case*, the Board of Tax Appeals held that even though the effect of the corporation's activities may be the prevention of the imposition of surtaxes upon the stockholders, nevertheless the penalty tax does not apply unless there be a purpose to avoid such taxes. This committee should consider the possibility of amendments to section 102 of the act so as to bring within its scope those cases where the obvious effect of a corporation's activities is to prevent the imposition of surtaxes on its stockholders, even though it cannot be proved that there exists a positive purpose and intent to avoid such taxes. No amendment should be adopted, however, which subjects a corporation to the penalty tax because of accumulation of surplus to provide for expansion of the corporate business or the accumulation of adequate reserves for the preservation of the business.

Of far greater importance as a deterrent to employment of capital in business enterprise are the extremely high rates of tax on the net income of individuals. The maximum rate of tax is now 79 percent. This applies to net income in excess of $5,000,000. A rate of 76 percent or more applies to all income in excess of $1,000,000. A rate of 62 percent or more applies to all income in excess of $100,000.

These rates are too high, and in my opinion do not produce as large a revenue as would be produced by lower rates. It must be remembered that the Federal income tax is not the only tax that has to be paid by the individual taxpayer. In addition there is the State income tax which is often imposed by two or more States. And there are numerous other State taxes, including those on real estate and personal property. What possible incentive can there be to an individual to invest his money in business enterprise when the Government—State and Federal—takes more than 80 percent of the profits from such investment and bears none of the losses?

The following table shows for each of the years 1917-36, the maximum rate of individual income tax, the number of individuals reporting net income of $300,000 or more, the total individual income taxes as reported, and the Federal Reserve Board's index of industrial production.

	Maximum rate of individual income tax	Number of individuals reporting net income of $300,000 or more	Individual income taxes as returned	Federal Reserve Board index of industrial production
	Percent			
1917	54	1,015	$795,381,000	
1918	77	627	1,127,722,000	
1919	73	679	1,269,630,000	83
1920	73	395	1,075,054,000	87
1921	73	246	719,387,000	67
1922	58	537	861,057,000	85
1923	43½	542	661,665,000	101
1924	46	774	704,265,000	95
1925	25	1,578	734,516,000	104
1926	25	1,591	732,475,000	108
1927	25	1,938	830,639,000	106
1928	25	3,250	1,164,254,000	111
1929	25	3,130	1,001,938,000	119
1930	25	1,020	476,715,000	96
1931	25	494	246,127,000	81
1932	63	246	329,962,000	64
1933	63	272	374,120,000	76
1934	63	235	511,400,000	79
1935	63	354	[1] 853,990,000	90
1936	79	568	[1] 1,210,157,000	105

[1] Preliminary estimates.

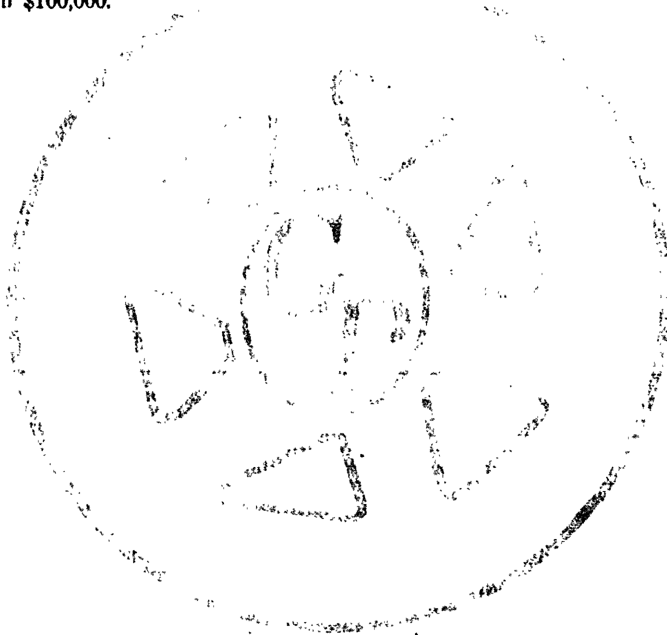
It is significant to note that practically every time the tax rates are increased the number of persons reporting net income of $300,000 or more decreases and that when tax rates are reduced, the number of people reporting these large incomes increases. For example, during the period 1917-21, a period of increasing rates, the number of people reporting net income of more than $300,000 declined from 1,015 to 246. From 1921 to 1925, during which period maximum rates were reduced from 73 to 25 percent, the number of people reporting net income of $300,000 or more incerased from 246 to 1,578. By 1928, when the maximum rate was still 25 percent, this number had increased to 3,250. By 1932, a depression year in which the maximum rate was increased to 63 percent, the number of people reporting net income of $300,000 or more had again declined to 246. In 1936, a year of substantial recovery, when the Federal Reserve Board's index of industrial production reached 105, the number of persons reporting net income of $300,000 or more was only 568. The maximum rate of tax in that year was 79 percent. The number reporting net income of over $300,000 is less than one third of the number reporting such income in 1927, when the index of industrial production stood at 106, but the maximum rate of tax was 25 percent. It is obvious that when very high rates of tax are in effect, the taxpayers with the largest income shift their funds into tax-exempt securities. When tax rates are reduced, such funds are again attracted to business enterprise.

The highest rate of tax do not necessarily produce the greatest amounts of revenue. During the first 5 years of the last decade, 1920-24, when the maximum-tax rate varied from 46 to 73 percent, the total individual-income taxes were $4,021,428,000. During the next 5 years, 1925-29, when the maximum rate of tax was 25 percent, the total individual-income taxes were $4,463,822,000. It is true that business conditions were better during the second half of the decade but it is also unquestionably true that the lower tax rates were contributing factors in the improvement of business conditions.

We should be careful not to accept the estimate of $1,210,157,000 of individual-income tax receipts for 1936 as proving the productiveness of high rates of tax. In the first place, this is only a preliminary estimate and subject to correction on final compilation of all the returns. In the next place, we all know that corporate distributions were artificially stimulated in that year by the undistributed-profits tax. Many extra dividends were paid near the close of the taxable year. A great deal of the windfall of revenue in that

year will undoubtedly be lost in 1937 and 1938, for it is axiomatic that abnormally large distributions of corporate earnings in 1 year must be followed by abnormally small distributions in later years.

The theory of high surtaxes is that it places the heaviest tax burden on the wealthier class. This theory has not worked out in practice. The facts are exactly contrary to this theory. During the 20-year period, 1917–36, individuals having net income of more than $100,000 paid 44 percent of the total taxes and individuals having net income of less than $100,000 paid 56 percent of the total taxes. During 11 out of the 20 years, the maximum-tax rate on individuals was in excess of 50 percent. In those 11 years individuals having net income of more than $100,000 paid only 38.1 percent of the total taxes and individuals having net income of less than $100,000 paid 61.9 percent of the total. During 9 out of the 20 years, the maximum-tax rate on individuals was less than 50 percent. In those 9 years individuals having net income of more than $100,000 paid 52.1 percent of the total taxes and individuals having net income of less than $100,000 paid 47.9 percent of the total. The following table shows for each year of the 20 years' period the maximum rate of tax on the net income of individuals, the amount of tax and the percentage of the total tax paid by persons having net incomes of more than $100,000, and the amount and percentage of the total tax paid by persons having net income of less than $100,000.



Individual income taxes, 1917–36

	Maximum rate of tax	Total tax paid by individuals	Tax paid by persons having net income of less than $100,000
	Percent		
1917	54	$691,492,000	$330,006,000
1918	77	1,127,723,000	658,003,000
1919	73	1,269,630,000	726,544,000
1920	73	1,075,053,000	753,992,000
1921	73	719,388,000	517,170,000
1922	58	861,057,000	559,345,000
1932	63	329,962,000	219,535,000
1933	63	374,120,000	236,449,000
1934	63	511,399,000	331,428,000
1935	63	653,990,000	410,512,000
1936	79	1,210,157,000	721,038,000
Total for years in which maximum rate of tax was above 50 percent		8,823,971,000	5,464,022,000
1923	[1] 43½	661,666,000	450,888,000
1924	46	704,265,000	400,543,000
1925	25	734,555,000	375,761,000
1926	25	732,471,000	359,760,000
1927	25	830,639,000	382,793,000
1928	25	1,164,254,000	450,071,000
1929	25	1,001,939,000	348,549,000
1930	25	476,716,000	237,064,000
1931	25	246,127,000	136,445,000
Total for years in which maximum rate of tax was under 50 percent		6,552,632,000	3,141,874,000
Grand total		15,376,603,000	8,605,896,000

	Tax paid by persons having net income of more than $100,000	Percent of total tax paid by persons having net income of less than $100,000	Percent of total tax paid by persons having net income of more than $100,000
1917	$361,486	47.7	52.3
1918	469,720	58.3	41.7
1919	543,086	57.2	42.8
1920	321,061	70.1	29.9
1921	202,218	71.9	28.1
1922	301,712	65.0	35.0
1932	110,427	66.5	33.5
1933	137,671	63.2	36.8
1934	179,971	64.8	35.2
1935	243,478	62.8	37.2
1936	489,119	59.6	40.4
Total for years in which maximum rate of tax was above 50 percent	3,359,949	61.9	38.1
1923	210,778	68.1	[2] 31.9
1924	303,722	56.9	43.1
1925	358,794	51.2	48.8
1926	372,711	49.1	50.9
1927	447,846	46.1	53.9
1928	714,183	38.7	61.3
1929	653,390	34.8	65.2
1930	239,652	49.7	50.3
1931	109,682	55.4	44.6
Total for years in which maximum rate of tax was under 50 percent	3,410,758	47.9	52.1
Grand total	6,770,707	56.0	44.0

[1] After applying retroactive reduction of 25 percent under the provisions of the Revenue Act of 1924, enacted June 2, 1924. Throughout 1923 investors thought they were subject to a maximum tax of 58 percent.
[2] After applying retroactive reduction of 25 percent under the provisions of the Revenue Act of 1924, enacted June 2, 1924. Throughout 1923 investors thought they were subject to a maximum tax of 58 percent.

This table proves conclusively that the burden on those having the lower incomes is proportionately greater when the highest tax rates are in effect. This is because of the fact that when rates are raised or reduced, the adjustment is made all along the line, affecting those with small and large incomes. The wealthier class find it advantageous to shift their capital into the tax-exempt field as the rates are increased. The smaller taxpayers, most of whose income is from personal services rather than investments, have no such refuge and must pay the tax. For this and other reasons it is invariably true that as tax rates are reduced the portion of the tax burden borne by the wealthier class increases and as tax rates are increased, the portion of the burden borne by this group constantly decreases.

We are now in the midst of a period of declining business. The most important thing to be done is to start business on the upgrade, to stop the increase in unemployment, and to start reemployment. I urge upon the committee a moderate reduction in individual surtaxes, say, to a maximum of 50 percent, as a means to that end. I also urge that the committee, subsequent to the passage of the Revenue Act of 1938, undertake an exhaustive investigation of the whole subject for the purpose of ascertaining the rates of tax applicable to the net income of individuals which will be most advantageous from two points of view: First, the revenue to be collected, and, second, the Government expenditure which can be saved from a general improvement in business.

I also urge upon the committee the necessity of broadening the tax base by reducing the specific exemptions. Too few people pay income taxes. The estimate for 1936 is that there were 2,888,990 taxable returns filed. This is in comparison with 41,487,000 people gainfully employed in that year. Less than 7 percent of the people gainfully employed contribute anything to the Federal Government by way of a direct tax. I believe that it would be a good thing for this number to be trebled or quadrupled. Nothing stimulates the interest in governmental activities so much as a direct obligation to pay taxes for its support.

My final recommendation is that a constitutional amendment should be adopted which will permit the Federal Government to tax the income from the future issues of State and municipal bonds and which will give the State governments the power to tax the income from future issues of obligations of the Federal Government. The adoption of such an amendment, coupled with a gradual reduction of the surtaxes, will, in my opinion, do much to direct the investment of private capital into business enterprise, reduce unemployment, and redound generally to the benefit of the country.

EXHIBIT A—ANALYSIS OF QUESTIONNAIRES ON EFFECTS OF THE UNDISTRIBUTED-PROFITS TAX RECEIVED FROM MEMBERS OF MILLERS' NATIONAL FEDERATION

1. What is the capacity of your mill or mills? Under 1,000 barrels, 71; 1,000 to 2,500 barrels, 32; over 2,500 barrels, 16.

2. (*a*) Have you in the past had the policy of accumulating reserves in periods of prosperity, Yes, 116; no, 2.

(*b*) If so, have these reserves been used to increase the payments that could otherwise be made during periods of depression: (1) To your employees, Yes, 98; no, 9.

(2) To your stockholders? Yes, 96; no, 20.

3. (*a*) Do you think that the effect of the undistributed-profits tax is to accentuate depressions or decrease the severity of depressions? Accentuate, 108; decrease, 2; neither, 2.

4. Is it your belief that the undistributed-profits tax has been a business stimulant in that it has forced distribution to stockholders and placed them in funds for additional purchases of goods? No, 76; yes, 22; qualified, 20.

5. Do you believe that the undistributed-profits tax has retarded business by discouraging businessmen from undertaking additions and improvements to plant facilities? Yes, 119.

6. If your answer to question 4 and 5 are both "yes," do you believe that the net effect has been to stimulate or retard business? Retard, 76; stimulate, 1; qualified, 3.

7. (*a*) Have you abandoned any contemplated improvement or addition to your plant facilities because of the tax on earnings which would be required to be retained for such purposes? No, 62; yes, 49.

(*b*) If so, state the estimated cost of the contemplated expenditure.

Forty-seven of the responding members reported the abandonment of contemplated improvements and additions estimated to cost $1,970,500.

(*c*) State the approximate number of man-hours of labor in the improvement or addition abandoned.

Thirty-one of the responding members attempted an approximation of the man-hours of labor involved in the improvement or addition abandoned. The total man-hours involved in these 31 cases are 553,270.

8. Do you have difficulty in estimating accurately before the close of the taxable year the amount of your net income for the year so that you are required to base your decision as to distribution of dividends to some extent on guesswork? Yes, 104; no, 10; qualified, 1.

9. Do you think it necessary that a reasonable time after the close of the taxable year be allowed for the payment of dividends, credit for which is to be taken in the tax return? Yes, 121; no, 1.

10. Is it a fact that in a year of increasing business a part of your profits are tied up in inventories and accounts receivable and are not available for distribution in the year in which earned? Yes, 114; no, 5; qualified, 1.

11. Approximately what period of time elapses between the date of realization of profits in a bookkeeping sense and the date on which the profits are available in distributable form? 1 to 3 months, 67; 3 to 6 months, 35; 6 to 12 months, 3.

12. (*a*) Has the operation of the undistributed-profits tax law caused you to pay dividends in excess of the amount which sound, prudent judgment would otherwise dictate? Yes, 57; no, 54.

13. Have you had, during the past year, adequate working capital? Yes, 56; no, 46; qualified, 12.

14. Have you, because of the undistributed-profits tax, paid as dividends amounts which should have been in use as working capital? Yes, 58; no, 53; qualified, 1.

15. (*a*) Has it been your practice to pay dividends less than your net income in periods of prosperity? Yes, 105; no, 7; qualified, 1.

(*b*) Did your dividends paid exceed your net income in the aggregate for the taxable years 1931, 1932, and 1933 combined? No, 78; yes, 30.

16. Do you now have debts outstanding which should be retired in due course from net profits? Yes, 72; no, 45.

17. Does the undistributed-profits tax tend to retard the growth of your business? Yes, 91; no, 11; qualified, 3.

18. (*a*) Do you think that the general effect of the undistributed-profits tax law is more favorable to the large or to the small corporations? Yes, 112; no, 0.

22. (*b*) If so, what percentage of the profits do you think should be permitted to be retained tax free? 3 percent to 25 percent, 26; 25.01 percent to 50 percent, 47; 50.01 percent to 100 percent, 24.

(*c*) Would you favor the exemption of such part of the profits even though it would be necessary for revenue purposes to increase substantially the rates on the remaining taxable profits? Yes, 80; no, 15.

23. (*a*) Do you favor the repeal of the undistributed-profits tax? Yes, 109; no, 4; qualified, 3.

(*b*) Would you favor the repeal of the undistributed tax even though it would be necessary for revenue purposes to increase substantially the rates of normal income tax on corporations? Yes, 81; no, 16; qualified, 4.

24. Do you favor a substantial increase in the rates on undistributed profits and the elimination of the normal income tax on corporations, the capital-stock tax, and the excess-profits tax? No, 79; yes, 14; qualified, 3.

Mr. DUDLEY. I represent the Millers National Federation, which is a trade association of the flour-milling industry. We have four recommendations to make——

Senator KING. Is that a large organization in the sense it covers the United States pretty generally?

Mr. DUDLEY. Our members produce about 81 percent of the wheat flour commercially produced in the United States.

Senator KING. That would cover bran, shorts, and grits?

Mr. DUDLEY. That is correct.

We have four specific recommendations to make, the first of which is the absolute repeal of the undistributed-profits tax.

Senator TOWNSEND. If that were done, you would have no other recommendation?

Mr. DUDLEY. We do, Senator.

Senator KING. When you eat the whole apple you want something else?

Mr. DUDLEY. Second, a reduction of the surtaxes on individuals, substantially, but not more than 50 percent, and, third, a broadening of the tax base so that the number of persons filing income-tax returns shall be substantially increased.

The CHAIRMAN. Do you want to reduce the surtaxes 50 percent?

Mr. DUDLEY. So that the maximum is not more than 50 percent.

Senator KING. Then you are addressing yourself to something more than the undistributed-profits tax?

Mr. DUDLEY. I am, Senator.

Finally, the adoption of a constitutional amendment which will permit the Federal Government to tax the income from State issues——

Senator CONNALLY. How about the State taxing the Federal Government?

Senator KING. You want the Federal Government to have power to tax the States if it wants to, through taxation?

Mr. DUDLEY. No, sir.

Senator CONNALLY. We have no jurisdiction of constitutional amendments; I think we are wasting time.

The CHAIRMAN. He is stating briefly his recommendations, as I understand.

Mr. DUDLEY. That is correct, Senator.

I should like to summarize very briefly those four points and the reasons for them.

First, with respect to the undistributed-profits tax, you will find in our brief a résumé of a questionnaire which the federation sent to all of its members relating to the undistributed-profits tax——

The CHAIRMAN. What does your organization consist of; what kind of millers?

Mr. DUDLEY. Flour millers.

The CHAIRMAN. Eighty-five percent of all in the country belong to the federation?

Mr. DUDLEY. Not in number, but in volume.

The CHAIRMAN. How much in number?

Mr. DUDLEY. There are 600 members in number. I could not say exactly what percentage of the total number of persons engaged in the manufacture of flour are members of the federation.

The CHAIRMAN. You speak the views of that organization?

Mr. DUDLEY. I think I do, Senator.

Senator KING. Of course, the number of persons having stock in those various plants would be much greater than 600, would it not?

Mr. DUDLEY. Yes; but not so much as you might think, Senator. For instance, we think probably 95 percent of the members would be in what was called the third basket. The flour-mill industry, especially, is an industry of incorporated members which are very closely

held corporations, and there are a great many individuals and partnerships.

Senator CONNALLY. Is it peculiar to the flour-milling business they have more closely held corporations, or not?

Mr. DUDLEY. Of course, there are other industries in which that is also true, but it is true of the flour-milling industry. I have heard it said that every corporation in the State of Kansas producing flour would be a title 1B corporation if it were enacted into law. I do not know whether that is true or not.

Our members are unqualifiedly against the undistributed-profits tax and are for its complete repeal because of the inequalities which are inherent in it and which cannot get out. In response to the questionnaire they say, both the large and small members, that this tax falls more heavily on the small manufacturer than on the large; they are against it also because of its complexities. You gentlemen know our tax laws are becoming constantly more complex——

Senator KING. You have not read this bill to see how simple it is?

Mr. DUDLEY. I have studied the bill, Senator, and regard the determination of net income itself a difficult matter, but when you have to determine unadjusted net income and undistributed net income and special class net income and first division net income and second division net income and all of the other types of income and credits which are involved in the undistributed-profits tax, it is a nightmare.

Senator KING. I agree with you.

Mr. DUDLEY. Finally, we think the most important thing immediately is to get capital redirected into business enterprise. We think the repeal of the undistributed-profits tax would be one step in that direction. We would much prefer an increase in the basic rate, and I should think 1 percent increase in rate would bring in as much revenue, applied to all corporations, as the 16–20-percent plan. The basic rate of 17 percent on all corporations having a net income of more than $25,000, I should think would produce as much revenue as the 16–20-percent plan.

The CHAIRMAN. If the 17 percent did not, at a flat rate, do you think your organization would prefer to go to a higher flat rate than retain the 16–20?

Mr. DUDLEY. I do not only think so, but there are answers in my brief which show they would.

Now, the drying up of capital which is going into industry is serious. In 6 years of the present decade the total new capital put into domestic corporations is only $3,000,000,000——

The CHAIRMAN. How many years?

Mr. DUDLEY. The 6 years from 1932 to 1937, $3,000,000,000.

The CHAIRMAN. Does that include profits plowed back?

Mr. DUDLEY. No, sir; that is new capital, what are called flotations of new capital.

The CHAIRMAN. I did not know there had been that much.

Mr. DUDLEY. In the previous comparable 6 years of the previous decade it was $19,000,000,000; in other words, we are having only $1 in almost seven in comparison with what it has been in the past.

Furthermore, unemployment of labor goes right along with unemployment of capital; that is axiomatic.

Senator KING. You do not call reflotations new capital?

Mr. DUDLEY. No, sir; that leaves out the refunding issues. Now, it is very sessential that capital——

The CHAIRMAN. How much is involved in new issues for the last year or the last 2 years; have you those figures?

Mr. DUDLEY. For 1937, Senator?

Senator KING. The calendar year?

Mr. DUDLEY. For the calendar year 1937, and that, by the way, was a year in which business, for the first 8 months of 1937, was at the highest level we ever had except 1929 alone. In that year, despite that splendid business situation, the total new capital was only $1,195,000,000 in comparison with $4,600,000,000 in 1927, 10 years before.

I do not contend the undistributed-profits tax is the principal cause of the failure of capital to go into business enterprise, but I think it is a contributing factor. I think the high surtaxes are one of the principal causes for the failure of capital to be attracted to business enterprise. The maximum rate is now 79 percent. At $1,000,000 it is 76 percent and at $100,000 it is 62 percent. All of those rates are sufficiently high so that the gamble is not good. Whenever the Government takes more than two-thirds of the gain and bears none of the losses, and so long as we have billions and billions of State and municipal and Federal issues which are tax-exempt and available to the wealthy taxpayers, we cannot expect capital to be redirected into business enterprise until those rates are reduced.

Senator KING. You understand, do you not, that the Federal issues of tax-exempt securities have been largely held by insurance companies?

Mr. DUDLEY. Banks and insurance companies.

Senator KING. And they buttress the credit of the bank and at the same time protect the hundreds of thousands of poor people as well as wealthy people who have life-insurance policies.

Mr. DUDLEY. The table on page 8 of my prepared statement and the table on page 11, also, show clearly what happens as surtax rates are increased and reduced. For instance, the table on page 8 shows as the rates are increased the number of persons reporting incomes of $300,000 or more drastically declines; as the rates are reduced the number of persons reporting incomes of $300,000 or more is very substantially increased.

The CHAIRMAN. What are these figures based on?

Mr. DUDLEY. These are figures from 1917 to 1936, taken from the statistics of income as published by the Bureau of Internal Revenue; they are the Bureau of Internal Revenue statistics.

Now, the table on page 12 shows a startling result. The theory is the highest surtaxes hit the wealthiest classes; but as a matter of fact, during the past 20 years, the lower the tax rates the greater proportion of tax has been paid by people in the higher income groups, whereas the higher the tax rate the smaller proportion of tax paid by those wealthy people.

For the 20-year period there are 11 years in which the maximum tax rate on individuals is above 50 percent——

Senator KING. You are reading from page 12?

Mr. DUDLEY. Yes. In those two groups of years, 1917 to 1922 and 1932 to 1936, the maximum tax rate on individuals was above 50 percent, and during that period only 38 percent of the total tax paid was paid by persons having more than $100,000 income, whereas 62 percent was paid by persons having income of less than $100,000.

On the other hand, take the nine relatively low tax-rate years, which are the years from 1923 to 1929 and 1930 and 1931; in all of those years the maximum tax rate was up 50 percent, and at that time, during those 9 years as a whole, persons having an income of more than $100,000 paid 52 percent of the total taxes, and persons having an income of less than $100,000 paid 48 percent of the taxes——

Senator KING. Is that 44 or 48?

Mr. DUDLEY. 47.9 percent, to be exact.

Senator KING. I have the wrong one—I see.

Mr. DUDLEY. Of course, the reason for that is obvious. During these years, when the rates were put up very high, of course, they were increased all along the line, starting at the bottom. People with moderate incomes, most of them, the majority of their income is earned and they cannot escape into the tax-exempt field, whereas the people with the larger incomes, the greater part of their income being from investments, they can escape into the tax-exempt field and do.

It is my belief that with a reduction to a maximum of not more than 50 percent tax rate on individuals, that a very substantial amount of capital will be redirected into business enterprise, which we urgently need there, and a greater proportion, rather than a smaller proportion of our total tax burden will fall upon the wealthier groups that are able to pay it.

I will be through in just a moment. My final suggestion is that the tax base be broadened by lowering the exemption——

The CHAIRMAN. You have said nothing about capital gains.

Mr. DUDLEY. I have not, Senator.

The CHAIRMAN. Do you discuss that in your brief?

Mr. DUDLEY. I have not, Senator. Of course, in a way the reduction of the surtax to some extent takes care of the capital gains, so long as a table such as that used in the House bill is used. If that is discarded and a flat rate is placed upon capital gains, that rate should have some reasonable relationship to the maximum surtax. Under the House bill the maximum rate of tax which can apply to a capital gain on an asset held more than 5 years is 16 percent.

The CHAIRMAN. Without going into it fully, because you have filed your brief, do you believe it would help to unfreeze some money to put it into industry if with these other suggestions you have made that the capital gains should be put at a reasonable figure, on a flat rate, and put in a classification by itself?

Mr. DUDLEY. I think it would help, Senator, but I think there is one objection, if I may state it.

The CHAIRMAN. Yes.

Mr. DUDLEY. I think that the small taxpayer and the taxpayer with a small income is entitled to relief with respect to capital gains in the same proportion as a wealthy taxpayer. Under our old 12½-percent maximum tax which was in effect so long, 10 or 12 years, no one got any benefit unless he had an income of $50,000 or more.

The CHAIRMAN. Your maximum surtax at that time was pretty low.

Mr. DUDLEY. That is correct, it was relatively low. I do feel that some consideration should be given to capital gains all of the way along the line, in all income groups because of the fact when a man does sell an asset which he has held for 5 or 6 years and realizes in 1 year the increase in value, theoretically it should be taxed just as though he had earned it over the 5-year period. Of course, the same is true of lawyers' fees and that sort of thing, but unfortunately we cannot do that because they come in in the year they collect it. Now, as to broadening the base, there were only 2,800,000 returns filed last year, as compared with 48,000,000 people employed; that is less than 1 out of 14.

I would like to see that number trebled or even quadrupled. I think it would be a splendid thing if we had 10,000,000 filing tax returns and paying tax to the Government. In that case I think it would be possible to eliminate some of the taxes those people are now paying indirectly.

Senator KING. Would you approach that objective by lowering the amount of deductions or by increasing the income tax upon the lower brackets—which?

Mr. DUDLEY. My thought would be to lower the exemptions.

Senator KING. Lower the exemptions?

Mr. DUDLEY. Yes, sir.

Senator KING. Thank you very much.

Mr. DUDLEY. Thank you, Senator.

Senator KING. Mr. J. C. Wilkes, Operative Builders' Association of the District of Columbia. Is Mr. Wilkes here?

(No response.)

Senator KING. Mr. Donald Marks, representing H. Hentz & Co.

STATEMENT OF DONALD MARKS, NEW YORK CITY, REPRESENTING H. HENTZ & CO.

Mr. MARKS. I have a brief, Senator King, which I will file.

Senator KING. Proceed, Mr. Marks.

Mr. MARKS. I am here to make a plea for a rather narrow amendment to title 8, schedule A, of the tax law of 1926, as it now stands, relating to transfer taxes on securities. I appeared before the House Ways and Means Committee and presented my plea there, after having vainly taken up with the Bureau of Internal Revenue and the Treasury Department the situation presented by a ruling of the Bureau which was made in March 1937 and reaffirmed, after some discussion with the Bureau, in February of this year.

My plea is against a double taxation which has resulted from the ruling of the Bureau, and I am basing my plea not only on the ground it is an obvious inequity which plainly was not intended by Congress but also because I feel that the amendment which I have to suggest will actually result in an increase in revenue through added income taxes because I am speaking for what may be called a depressed industry.

H. Hentz & Co. is a member of the stock exchange and of various other security and commodity exchanges in this country, and has offices in some of the principal cities abroad. They have offices in Amsterdam and Rotterdam in Holland, and this particular problem relates only to purchases of American securities by Dutchmen.

Senator KING. You want us to take Holland, do you?

Mr. MARKS. Not quite; I want you to do something for Holland, and incidentally for ourselves.

Senator KING. Just give us a concrete illustration.

Mr. MARKS. The problem arises because in the very large investment business in American securities that has been carried on by the Dutch, in various American securities purchased by the Dutch and taken to Holland have been put in what are known as Dutch administration offices, which are stock corporations—there are about 300 of them, organized for the sole purpose of becoming depositaries for American securities. The Dutch administration offices issue their certificates against American securities and they are traded in on the Dutch exchanges. That is the practice and has been the practice for many years in Holland.

The Dutch administration offices are organized under the statutes of the Netherlands and have no power to buy or sell securities themselves, but only the power to hold securities for deposit and retender the American certificate upon surrender of their own.

Now, what has happened is this: The Bureau of Internal Revenue has ruled that there are two transfer taxes to be paid upon American securities bought by Dutchmen and put into the name of a Dutch administration office, and the reason they have ruled it is because they have said the Dutchman who purchases the security must pay a tax on the purchase and by transferring the certificate into the name of the Dutch administration office he must pay a second transfer tax on the right to receive the certificate because title 8 taxes not only purchases and sales but also transfers of the right to receive.

I argued at length with the Bureau that the transfer of the right to receive, if any occurred, took place outside of the country, but they turned me down on that——

The CHAIRMAN. If a party puts it in the bank here and it is transferred the bank being the beneficiary, is it not true it has to pay the tax?

Mr. MARKS. No; there are now in title 8 exemptions which are to avoid double taxation where securities are put in the hands of nominees or custodians in this country, and I say the intent of Congress plainly was not to have two taxes on any single purchase.

Senator KING. Your contention is if I purchased stock here, as a Dutchman, and pursuant to the plan in Holland, transferred it to this organization, there would be just the one tax?

Mr. MARKS. There should be.

Senator KING. That is scarcely a transfer but merely a custodianship.

Mr. MARKS. Yes, sir. I might say this, gentlemen, that the result of this ruling—the original ruling came down in March 1937, and from then until the reaffirmation in February of this year there was great confusion in the application of this provision, but since this affirmation of the ruling there has been a tremendous falling off of the business of American brokers who have Dutch offices because the Dutchmen say they are not going to buy securities and have two taxes of 4 cents a hundred each imposed on every purchase.

The CHAIRMAN. I was under the impression the same rule applied here; how about that?

Mr. L. H. PARKER (Joint Committee on Internal Revenue Taxation). If a man wants to go to Europe and he puts his securities in

the name of a nominee, for instance a bank, he has to pay a tax; even if the beneficial title has not changed he still has to pay another tax.

The CHAIRMAN. If a gentleman was traveling abroad to be gone a year, he would go to a bank in Washington and say, "Here are my securities; you may sell them"; he has to pay two taxes?

Mr. PARKER. The way he would get around it would be to give a power of attorney. If he acted as agent it would not be. But the ordinary way, years ago, they would put them in the hands of a nominee.

Senator KING. Suppose I was going abroad and I deposited a stock with my banker and told him, "If I draw a draft and I do not have sufficient funds to cover, you sell that stock"?

The CHAIRMAN. You would have to pay two transfer taxes.

Mr. PARKER. If you do it by putting it in the hands of a bank.

Senator KING. Suppose I borrow money and put up the stocks as security and go abroad and I do not pay my note on time and they sell the stock; do I have to pay two transfer taxes there?

Mr. PARKER. No; I think not.

Mr. MARKS. If I endorse a certificate in blank and put it in the hands of a bank with power to sell it, then there is no second transfer tax on that deposit of my certificate.

Mr. PARKER. With power of attorney.

Mr. MARKS. Yes. The method suggested would not be followed here. If I leave my stock in the hands of a broker, in street name, or endorsed in blank, there is no transfer tax. I say clearly that a method which has been followed in regard to American securities and which has made a good market for American securities abroad should not be submitted to a penal tax which will freeze that market. We cannot afford to lose any revenue, I know, but what they have derived from revenue on these double-transfer taxes will be lost by reason of reduction of income taxes as a result of loss of this Dutch business.

Senator KING. Suppose, as a Dutchman, I went to that organization, the depositary, and I would say, "In order to avoid an unjust tax, you order for me 100 shares of stock and take it in your name, although it is mine, and then give me the certificate; you are doing that for me so I will escape the tax."

Mr. MARKS. I would not be here if that simple method of evasion could be followed, because the Dutch administration offices cannot buy; they are not permitted to do so.

The CHAIRMAN. Have you filed your brief?

Mr. MARKS. Yes, sir.

The CHAIRMAN. This matter was brought to my attention by some American bankers, that is, a certain feature of it. There may be certain aspects of it that I do not recall, but the committee will consider it.

(The brief above referred to is as follows:)

MEMORANDUM IN RE PROPOSED AMENDMENT OF SCHEDULE A8 OF TITLE VIII OF THE REVENUE ACT OF 1926, AS AMENDED BY SECTION 723 (a) OF THE REVENUE ACT OF 1932

This memorandum is submitted on behalf of H. Hentz & Co., of New York City, members of the New York Stock Exchange and other American and foreign securities and commodity exchanges, and who have branch offices and agents in many European centers. These brokers, and other similarly situated,

have been affected by a ruling of the Commissioner of Internal Revenue relating to the transfer of stock purchased in this country by Dutch owners to the several Dutch administration offices. The pertinent facts are as follows:

The Dutch administration offices are corporations organized under the laws of Holland to act as depositaries for American securities which are traded in on Dutch securities exchanges. Dutch owners may deposit such securities with the appropriate administration office and receive in exchange therefor certificates which are deliverable on the Dutch exchanges.

Dividends which accrue on stock deposited with a Dutch administration office are payable to said office; and the holder of the Dutch certificate issued against the deposited shares may receive such dividend upon presentation of the certificate, which is then stamped to show the payment of such dividend.

There are about 300 Dutch administrative offices. They are organized under Statutes of The Netherlands, and they are quite uniform in their "Statuten" and bylaws. We are informed that they may act only as depositaries and may not engage in the purchase or sale of securities. There are elaborate safeguards established in their bylaws for the protection of the owners of deposited securities. A fee is charged for the making of such deposit and the issuance of the administration-office certificate.

All certificates deposited with an administration office must be issued in the name of said administration office. They will not accept certificates in negotiable condition or in common parlance, in "street name."

The maintenance of proper arbitrage facilities between the Dutch and American securities markets necessarily involves the minimizing of expenses in connection therewith so that the limits of price disparity between such markets may not run to extremes. Both investors and arbitrageurs in Holland necessarily use the administration offices. It is quite usual for Dutch purchasers of American securities to instruct the broker, either at the time the order for purchase is given or at some time thereafter before the new certificate has been issued in the name of the purchaser, to have the stock certificate issued in the name of a particular administration office.

The Commissioner of Internal Revenue has ruled that in such cases a second transfer tax is payable on the theory that there has been a transfer of the right to receive from the owner to the administration office.

The ruling of the Commissioner is contained in a letter dated March 24, 1937, addressed to H. Hentz & Co.

Reconsideration of said ruling has been requested on the ground that such transfer of the right to receive, if any there be, takes place wholly outside this country and is, therefore, without the taxing jurisdiction of the United States.

However, in anticipation of a possible adverse decision upon said application, this memorandum is submitted to request favorable consideration of an amendment of the law so as to avoid the disruption of Dutch business which has followed the ruling of the Commissioner.

A similar disruption of business with Switzerland has been experienced since the method of handling American securities in Switzerland is similar to that in Holland, except that the Swiss Banking Corporation acts as the depositary, and the American certificates must be issued in its name.

It is suggested that the law be amended so as to enlarge the exemption from transfer tax to include deliveries or transfers by a broker to a depositary, custodian, nominee, or agent for a customer under certain limited conditions which will not unduly broaden such exemption.

It seems obvious from the present wording of the proviso in schedule A3 of title VIII, exempting deliveries or transfers to a broker for sale or by a broker to a customer for whom and upon whose order he has purchased securities, that it was the intent of Congress to avoid double transfer taxation in the purchase and sale of securities. It is quite natural that where special facilities or methods exist in the handling of such securities, as in the case of the Dutch administration offices, such cases might have been overlooked in the drafting of the proviso above referred to.

However, there is no more occasion to impose a double transfer tax upon the purchase of American securities by Dutch owners than in any other case, where the purchase by reason of such special methods, requires issuance of the new certificate in the name of a custodian, nominee, or agent. That fact should not result in double taxation. Such double taxation imposes an undue burden on the purchase of American securities by foreigners and tends to impair their value in international markets.

The revenue derived or to be derived from the imposition of such second tax is trivial at best, and it is readily apparent that the indirect loss of revenue through the business which is lost to this country will far outweigh the small returns from such transfer taxes.

American brokerage houses with offices in Holland, or with Dutch connections, and those with similar connections in Switzerland, have complained that since the ruling of the Commissioner above referred to, their business from Holland and Switzerland has been materially affected.

On principle, it is submitted that when securities are purchased and the purchaser directs his broker to have the new certificate issued in the name of a custodian, nominee, or agent, there is not the substantial change of ownership or interest therein which is or should be taxable. A custodian, nominee, or agent holds the security for the benefit of the purchaser thereof, and therefore no additional tax burden should be laid upon the issuance of the certificate in the name of such custodian, nominee, or agent.

It is to be noted that if the American certificates were transported abroad in street name, and merely delivered from hand to hand in Holland or Switzerland, there would be no tax on such transfers. The fact that the Dutch or Swiss owner, in order to meet the requirements of a special method which exists in those countries, has the American certificate issued in the name of a custodian, should not alter the taxable status of the transaction. The mere issuance of the new certificate here in the name of the custodian should not be made the occasion of a transfer tax.

An amendment to accomplish this narrow objective is simple. It is requested that the third proviso of schedule A3 of title VIII be amended to read as follows (italicized portions are new):

"*Provided further*, That the tax shall not be imposed upon deliveries or transfers to a broker or his registered nominee for sale, nor upon deliveries or transfers by a broker or his registered nominee to a customer for whom and upon whose order the broker has purchased same, nor upon deliveries or transfers by a purchasing broker (*a*) to his registered nominee if the shares or certificates so delivered or transferred are to be held by such nominee for the same purpose as if held by the broker, or (*b*) *to a depositary, custodian, nominee, or agent for the customer if the instructions to make such delivery or transfer shall have been given by the customer to the broker at or before the completion of the purchase*, but such deliveries or transfers shall be accompanied by a certificate setting forth the facts."

The foregoing changes will not provide an unduly broad exemption, but will correct an obvious inequity which is at the present time seriously harming our securities business with Holland and Switzerland.

Respectfully submitted.

BAER & MARKS,

No. 20 Exchange Place, Borough of Manhattan, City of New York, Attorneys for H. Hentz & Co.

Dated, NEW YORK, *March 16, 1938.*

The CHAIRMAN. There is one other witness, I think. Is Mr. Camp here?

Mr. CAMP. Yes, sir.

The CHAIRMAN. We will hear you now, Mr. Camp.

Mr. CAMP. Mr. Chairman, if you wish to adjourn I could appear in the morning.

The CHAIRMAN. We will not have any time in the morning as we have quite a number of witnesses scheduled to be here tomorrow.

Mr. CAMP. It will only take me a few minutes.

Senator KING. Do you have a brief?

Mr. CAMP. Yes.

The CHAIRMAN. Are there any other witnesses who desire to speak who were not on this calendar?

Senator KING. One or two witnesses did not show up.

The CHAIRMAN. They will not be heard tomorrow then because we have a full calendar.

All right, Mr. Camp, you may proceed.

STATEMENT OF FRANK B. CAMP, CHICAGO, Ill.

Mr. CAMP. I represent the 100 Percent Endorsement Association of Chicago, Ill. I am the executive secretary of that association, Mr. Chairman.

A year ago it was incorporated to secure the 100 percent endorsement of the toilet preparations industries of the United States.

On January 22 I appeared before the Ways and Means Committee for all the associations in the United States except the Toilet Goods Association of New York. That association prior to March 5 had not endorsed the bill we are sponsoring which was introduced in the House. Today we have the Toilet Goods Association's endorsement.

The purpose for my being here is to ask you gentlemen to allow me to put this amendment into the House bill, which reads, "That the tax imposed"——

The CHAIRMAN (interposing). Let me find that provision. That is on cosmetics and toilet articles?

Mr. CAMP. That is the House bill. That is on page 299, line 36.

The CHAIRMAN. All right.

Mr. CAMP. Our House bill H. R. 8484 asks for the repeal of the entire section. This amendment also asks for the repeal of the entire section.

Now, I have one other thing to ask.

The CHAIRMAN. You are satisfied with certain provisions of the House bill, but you do not think it goes far enough?

Mr. CAMP. It does not go far enough, Mr. Chairman, and there is no reason for segregating any one of those things from the other.

Now, I was told by the Ways and Means Committee it was a matter of revenue. The Finance Committee naturally thinks they must have revenue. There is no question about that.

I have an offer to make Congress whereas the Government can secure enough revenue to take care of the entire repeal of section 603, and also the excise tax collected from the radio industry, which was mentioned by Mr. Geddes who preceded me here.

The CHAIRMAN. What is that tax?

Mr. CAMP. This is a tax on international and express-money orders of the United States of America.

Now, Mr. Chairman, I am only going to be brief.

On January 8, 1937, a member of your committee, Senator Arthur Capper, wrote to me that he was very much interested in my letter in which I said I would like to see a plan worked out by which aliens would pay a tax of 25 percent on the money which they send to their relatives in foreign countries.

I have been trying to get a bill through Congress for 4 years.

I have a letter from the Assistant Postmaster General, and some from seven or eight Congressmen, and from several Senators.

Prior to 1927 I had the Bonners Ferry News in Northern Idaho, and I had occasion to contact the Great Northern and the Southern Pacific and many others with employees approximating 10,000. And there was a Greek section hand at Bonners Ferry, who was an alien, and who had lived 10 years in the United States, and who every month went to the post office in Bonners Ferry and bought a $100 money order for $1 and sent it to Athens, Greece.

I have been told the Greek Government is taking 40 percent of every dollar sent out by alien Greeks in this country.

It seems to me, gentlemen, you are seeking revenue. And as one Congressman wrote me, he says, "You ask why Congress does not enact a tax of 50 percent on international money orders. So far as I know such a tax has never before been suggested." Why? Is it because we are afraid of antagonizing our foreign voters that we do not tax them for more than 1 percent to send money out when they fail to become citizens of the country they have lived in for years?

We are the only Nation left in the world, Mr. Chairman, where its citizens send money out for any percent. Why should we?

And if I understand correctly—I may be misinformed, but I think not—there were $32,000,000 sent out last year from this country to 72 other countries by aliens and immigrants.

Now, why not 25 percent instead of 1 percent? It brings you back tax which you eliminate from the excise taxes and the balance helps Mr. Farley with the deficit in the Post Office Department. It can be worked out. It is simple. It does not require any more employees and it does not require the appointment of any commission. The postmaster in each post office simply charges 25 percent instead of 1 percent—1 percent, you understand, Mr. Chairman, to send our money that is earned here by alien citizens to their own countries, when now an alien can send for $1 the sum of $100.

I am offering you that as a bill, and if it could be introduced and argued by your committee before the Senate I believe that you would have the cooperation of 100 percent of the Senate behind such a bill. Perhaps you would not have 100 percent, but you would have a majority that would enable you to stop considering piecemeal measures as to these various excise taxes.

I am not trying, you understand, to have a tax removed from an industry just for the sake of having the tax removed, I have made a study of this industry for 2 years inside and out. I worked for the Internal Revenue Department in Chicago, Ill., in the Excise Tax Division with warrants for distraint on taxes that were assessed 22 months back after a certain new ruling was made.

But what I am trying to get at is this: Today we have in Chicago alone so many unemployed, worse than, I believe, it has ever been, staggering help in the department stores and in the offices everywhere. And we have in the cosmetic industry a necessity for taking $500, $1,000, or $2,000 to the window of the Collector of Internal Revenue in cash every month, instead of being able to take and advertise a new name on a new face powder or other products.

And there is not a gentleman on this committee, Mr. Chairman, who has a wife and daughters, who can conscientiously say that toilet preparations today are a luxury. They are an absolute necessity, unless you pay $50 an ounce for perfume, or unless you pay $40 a box for an imported talcum powder. But the man with a wife and daughters in any home will find everything that is taxed in that list on the shelf and it is used.

But I have this thought—and I know positively that it is not a question of just taking and wiping out excise taxes. But I do know this—that my contacts with both cosmetic and with radio people will enable Congress not only to eliminate soaps and tooth-

pastes but everything in that section 603. And that is all I am asking. I am here in this city today for the purpose of asking your committee to repeal this tax; also for the purpose of asking you to let me file this amendment and a brief on Saturday with these remarks.

The CHAIRMAN. I would suggest you get it in promptly.

Mr. CAMP. It will be here Saturday morning.

I thank you.

(Subsequently Mr. Camp submitted the following brief:)

[H. R. 8484, 75th Cong., 2d sess.]

A BILL To terminate the tax on toilet preparations, etc.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 603 of the Revenue Act of 1932, as amended (imposing a tax on toilet preparations, and so forth), is hereby repealed.

BRIEF OF 100 PERCENT ENDORSEMENT ASSOCIATION

(An association to terminate the tax on toilet preparations, etc., sponsoring bill H. R. 8484, Chicago, Ill.)

BRIEF FOR REPEAL OF MANUFACTURERS' EXCISE TAX ON TOILET PREPARATIONS AS PROVIDED FOR IN THE REVENUE ACT OF 1932 AND AMENDMENTS THERETO, BY FRANK B. CAMP, EXECUTIVE SECRETARY, 100 PERCENT ENDORSEMENT ASSOCIATION

Your petitioner respectfully represents that the membership of the 100 Percent Endorsement Association consists of members of the toilet-preparation industry located in every section of the United States and likewise members of affiliated groups buying from and selling to the toilet-preparations industry.

The toilet-preparation industry, due to the imposition of the excise tax, has suffered directly in four principal ways, as follows: (1) Loss of immediate working capital, (2) creation of competitive restrictions, (3) governmental discrimination, (4) bankruptcies and failures.

The reference to loss of immediate working capital means, in substance, (a) the loss of cash paid to the Government in taxes which should, in view of conditions existing within the industry, be available for reinvestment in current business; (b) the loss of reserve capital wherewith to offset general or local business recessions as are being experienced at the present time.

Unequaled taxation has imposed severe restrictions upon the toilet-preparation industry. Business competition today is between all industries that compete with each other for a share of the public's dollar. The most successful industry is one that intensively applies all of its resources to creating a greater volume of sales, higher turnover, and lower cost of operating expenses. Such an industry can operate at a profit.

The toilet-preparation industry has been denied, through taxation, its rightful opportunities to conduct this competition. It is obvious that such an industry, when taxed, cannot devote its financial resources to compete with other industries which are not taxed. Industries which have a higher rate of turnover, higher rate of sales, have a greater degree of profit—industries which, by the conservation of their moneys, can, under normal conditions, devote their full energies to stimulating their production and distribution, and in subnormal periods can better withstand business recessions.

The toilet-preparation industry of the United States has been forced to meet all adverse economic situations, and by reason of discriminatory taxation has lost its place in American business life until it has reached a point where it no longer represents its industrial capabilities or possibilities. It is being rapidly taxed out of existence—its bankruptcies and failures adding to the burdens of the Nation.

It is conscientiously believed that the toilet-preparation industry has been and is being severely discriminated against by reason of its classification for purposes of taxation—as an industry that deals in luxuries, and especially in view of the fact that other industries have long ago been freed of excise tax; which action places the toilet-preparations industry in an underbalanced competitive position.

It is further believed that it is erroneous to construe the toilet-preparation industry as a source of taxation, justified on the assumption that it is able to pay its taxes and yet remain in existence. It is respectfully submitted that this discrimination on the part of the Government has done more to retard the growth of this industry than any other given element and that this discrimination has caused such reverses in the past 5 years as the industry will never be able to overcome so long as this discrimination continues. It is contended that such conditions are economically unsound, unjust, and unequal. It is not believed that it is the intent of the Government to contribute toward their continuance.

Practically every toilet-preparation manufacturer during the last several years has been involved in serious tax litigation with the Bureau of Internal Revenue regarding interpretations and application of the tax on toilet preparations, and particularly the small manufacturers of toilet preparations who made monthly returns and paid taxes as provided for under the section relating to tax on toilet preparations as interpreted by the former administration.

In 1935 different interpretations and applications of the section were invoked and immediately thereafter deputy collectors called on all toilet-preparation manufacturers in the entire United States and set up additional taxes. It was not a case wherein the present administration indicated that from a date a certain new policy would be invoked and that interpretations and application of the tax would be thus and so, but, on the contrary, set up retroactive taxes which the small manufacturers in the toilet-preparation industry cannot possibly pay, and consequently will result in the closing of their doors or the filing of bankrupty proceedings. The larger manufacturers of toilet preparations, although likewise assessed additional taxes, due to their reserve, etc., and their method of passing the tax on to distributors, will be the only ones able to ride the storm.

Your petitioner further respectfully represents that there has been an enormous increase in selling prices on toilet preparations, yet said increases all had to be absorbed by the manufacturers engaged in the toilet-preparation industry. Selling costs have materially increased, this being due to decreased prices, and general business conditions having caused a decrease in sales, while salesmen's salaries and expenses have not decreased, and expenses in many cases, due to hotel and railroad rates, have shown an increase.

The greatest demand for toilet preparations is through the chain-store channels of distribution, sold to the consuming housewives at a set price of 10 cents. Likewise there has been a material increase during the past several years in the cost of raw materials, packaging, labor, overhead expense, other expenses, etc. Manufacturers generally have been obliged during the past 6 months of this year, on account of underproduction, to carry an enormous loss in labor and overhead, which had to be deducted from any net profit which they contemplated making, because in cost accounting it is necessary to figure cost of labor and overhead upon costs arrived at on the basis of capacity on normal production, and this is equally true as to figuring the expense factor and costs.

There has been a material decline in sales of manufacturers selling to the wholesale trade and retail channels of distribution for the past 6 months. The returns on excise tax themselves, as paid to the Treasury Department, show the percent of the falling off of said sales.

Your petitioner further represents that there has been a noticeable feature in analysis of present-day conditions in which there is a marked tendency toward localization of business. Local and near-by territories have shown in some instances a falling off of sales, which can be attributed, first, to higher freight rates; and, secondly, the policy of hand-to-mouth buying, and low stocks, which cause jobbers and retailers to buy where they can get the quickest service, as said wholesale and retail channels of distribution have refused to carry any large amount of stock on hand.

There are certain sources using toilet preparations, such as beauty shops, barber shops, etc., who compound and mix their own preparations in conjunction with services rendered in said establishments. No records are kept, no taxes are paid, and yet they are in direct competition with manufacturers who are compelled to make required returns and pay said taxes monthly.

Another bad competitive development exists wherein certain channels of distribution have toilet preparations manufactured and produced for them, which are produced in bulk, the tax being paid on the manufacturer's selling price to said channels of distribution. The distributor does not pay any tax on his sales to the retail channels of distribution, yet there are certain small toilet-preparation manufacturers who manufacture and produce toilet preparations and then sell

direct to the wholesale or retail channels of distribution. It is necessary, in the sale of said toilet preparations by small manufacturers to the wholesale and retail channels of distribution, to account for the sales made by them to the retail channels of distribution, which nominally carry with the selling price manufacturing costs, raw materials, packaging, labor, overhead expense, commissions paid salesmen, advertising, etc.

It is also worth considering that 75 percent of the sales of toilet preparations are direct to the housewives, and particularly to the farmers and residents of small towns. The housewife cannot understand why it is necessary that she should be compelled to pay a tax of 10 percent on toilet preparations when same are a necessity and not a luxury, while at the same time there is no further tax on jewelry, candy, etc., which might properly be classified as luxuries.

Your petitioner further represents that a tabulation is now being prepared relating to failures in the toilet-preparation industry and likewise pending additional assessment matters against small and large manufacturers, which will plainly indicate the dire need for relief for the small manufacturers.

In presenting these facts, it is especially urged that the toilet-preparation industry be considered as entitled to a complete elimination of excise tax, as an industry deprived of its competitive rights to such an extent that its economic condition does not warrant a classification as a source of revenue. If freed from taxation, the toilet-preparation industry can recover a part of its lost advantages, and by a utilization of its saved profits, recognize its ensuing possibility for stability and permanency. Through this means the payment of taxes under other provisions of the Revenue Act will more than make up for any deficiency by the elimination of the present tax on toilet preparations. Unquestionably the revenue will be used for increased pay rolls, increased use of raw materials, increase in production, etc.

The repeal of the 10-percent excise tax on toilet preparations and 5-percent tax on toothpaste, soaps, etc., should be made effective immediately, as the stocks of this merchandise, both in the hands of the wholesale and retail channels of distribution, are lower at the present time than at any other time in the history of the industry. Accordingly the elimination of the tax effective on some date in the near future would cause minimum inconveniences and financial loss.

The appeal is endorsed by every large and small manufacturer of toilet preparations in the United States and by the following associations representing this industry: The Chicago Perfumery, Soap and Extract Association, the California Cosmetics Association, the Allied Drug and Cosmetic Association of Michigan, and the Toilet Goods Association, Inc., of New York, also by approximately all associations representing industries which buy from and sell to this industry.

The entire approximate revenue collected from this industry yearly does not exceed $18,000,000. The 100 Percent Endorsement Association realizes that your committee cannot erase this amount from the actual revenue needed by the Treasury Department, and because it so realizes it is offering a substitute tax, which, if enacted into law by the Congress, will produce a very substantial amount above the $18,000,000 now collected in excise taxes from the toilet preparations industry.

(Following is an outline of the proposed Federal tax:)

"PROPOSED FEDERAL TAX ON ALL MONEY ORDERS SENT OUTSIDE ALL BOUNDARIES OF THE UNITED STATES

"[An Act]

"UNITED STATES POSTAL DEPARTMENT—OFFICE OF THE POSTMASTER GENERAL

"By virtue of the authority vested in the Postmaster General, I, James A. Farley, Postmaster General, do make, prescribe, publish, and give public notice of these regulations, with the force and effect of law, to be in force and effect on and after June 1, 1938, and until amended or superseded by regulations thereafter made by Congress with the approval of the President under said act.

"I. *Definition*

"The following terms as used in this regulation shall have the meaning hereby assigned to it:

"All money orders, secured or purchased, by any individual person, partnership, firm, estate, or corporation, of any amount whatsoever, which said in-

dividual person, partnership, firm, estate, or corporation, has secured or purchased from any post office in the United States of America for the purpose of sending to any individual person or persons, business houses, firms, or corporations, in any foreign country, shall be subject to a tax of not less than 25 percent of the face value of said money order and this tax of not less than 25 percent shall be payable to the postmaster of the post office from which said money order is purchased, prior to the issuing of said money order.

"2. There shall be one exception to the above ruling, to wit: If a sworn statement accompanies the request for international money orders, showing that money being paid to an individual, partnership, firm, estate, or corporation outside of the boundaries of the United States of America, is a payment for merchandise purchased by sender, it shall not be subject to the tax. There shall be no other exceptions.

"In witness whereof I have hereunto set my hand and caused the official seal of the Department of postal affairs to be affixed in the city of Washington, this 1st day of June 1938.

"JAMES A. FARLEY,
"*Postmaster General.*

"Approved:
"FRANKLIN D. ROOSEVELT,
"*The President of the United States.*

Your petitioner also wishes to incorporate in this brief the following copy of a proposed bill to be later introduced in Congress:

"AMENDMENT Intended to be proposed by Mr. ——— to the bill (H. R. 9682) to provide revenue, equalize taxation, and for other purposes

"On page 229, lines 3-6, insert the following:

"'(a) Toilet preparations. The tax imposed by section 603 of the Revenue Act of 1932 shall not apply to articles sold after June 30, 1938.'"

This act must be legislated by Congress. Your petitioner is under the impression that possibly such legislation must be inaugurated in the House of Representatives because of its being a new revenue measure, but regardless of where inaugurated, such a tax is justifiable and when enacted into law will produce twice the revenue now collected by the Treasury Department in excise taxes from the toilet preparations industry. One of your committee members, the Honorable Arthur Capper has expressed himself as being in favor of a plan by which aliens would pay a tax of at least 25 percent on the money which they send to foreign countries. Your petitioner further feels that the absolute repeal of the excise tax on all toilet preparations (section 603) will enable this certain industry to do its share toward taking up the slack of unemployment.

We therefore respectfully, urgently, and earnestly petition the Congress of the United States to grant to the toilet-preparation industry the much-needed relief by entirely repealing, at the earliest possible moment, section 603 of the Revenue Act of 1932, as amended, and all provisions pertinent thereto or in connection therewith during this, the Seventy-fifth Congress.

Respectfully submitted.

FRANK B. CAMP,
Executive Secretary.

The CHAIRMAN. The committee will recess until tomorrow morning at 9:30.

(Whereupon, at 5:05 p. m., the hearing was adjourned until Friday, March 18, 1938, at 9:30 a. m.)

REVENUE ACT OF 1938

FRIDAY, MARCH 18, 1938

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

The committee met, pursuant to recess, at 9:30 a. m. in the Finance Committee room, Senate Office Building, Senator Pat Harrison (chairman) presiding.

The CHAIRMAN The committee will be in order. Mr. Iglauer, of Cleveland, Ohio.

STATEMENT OF JAY IGLAUER, CLEVELAND, OHIO, TAXATION COMMITTEE, NATIONAL RETAIL DRY GOODS ASSOCIATION

The CHAIRMAN. Mr. Iglauer, we have been forced to limit these discussions if we are ever going to get a tax bill out of the committee. Do you have a brief, so we can refresh our minds when we go into the executive session?

Mr. IGLAUER. I have that brief, and I shall also time myself so I will not exceed my time.

The CHAIRMAN. You represent the taxation committee, National Retail Dry Goods Association?

Mr. IGLAUER. Yes; and 40,000 retail stores of other associations, whose telegrams I shall submit for the record.

Senator TOWNSEND. In other sections of the country?

Mr. IGLAUER. All over the country. I represent 5,900 retail stores, as chairman of the taxation committee of the National Retail Dry Goods Association. In addition to that, I have telegrams authorizing representation from four or five national associations not affiliated with the National Retail Dry Goods Association, representing some 40,000 retail stores throughout the country.

(The telegrams referred to are as follows:)

WASHINGTON, D. C., *March 17, 1938.*

Mr. HAROLD R. YOUNG,
3525 Davis Street NW., Washington, D. C.:

Will you ask Jay Iglauer to represent the opinion of our group of 5,000 member stores in his appearance tomorrow before Senate Finance Committee. We are strongly and basically opposed to the principle of this undistributed-profits tax, as testified before the same committee 2 years ago by our representative. We favor no cut in revenue but substitution of flat corporation income tax of slightly higher percentage to offset the possible loss of proceeds. Will you seek, however, some relief for smaller firms. Please ask in our behalf repeal of salary publicity. A return to flat rate capital-gains levy in place of present graduated tax and some strengthening of section 102 to stop under-accumulation of surplus for tax avoidance.

NATIONAL RETAIL FURNITURE ASSOCIATION,
WM. J. CHEYNEY, *Vice President.*

NEW YORK, N. Y., *March 17, 1938.*

JAY IGLAUER,
National Retail Dry Goods Association, Munsey Building,
Washington, D. C.:

In your presentation to the Senate Finance Committee of the views of your association on pending legislation we understand that you plan to oppose the undistributed-profits tax in any form and also to oppose further publicity for income-tax returns in any form. We should like to have you know that this association, representing 3,500 shoe stores in all sections of the country, is in thorough agreement with this position. Our members strongly hope that the committee will endorse the principles of no publicity for income-tax returns and no tax on undistributed profits in any form.

NATIONAL COUNCIL OF SHOE RETAILERS, INC.

INDIANAPOLIS, IND., *March 17, 1938.*

HAROLD R. YOUNG,
Munsey Building, Washington, D. C.:

Iglauer authorized to voice our objection to continuance undivided-profits tax, insist on reduction capital-gains tax, elimination salary publicity, and strengthening of act prohibiting accumulation of unreasonable corporation surpluses. In our judgment everything possible should be done to simplify our entire tax structure.

HERBERT P. SHEETS.

CHICAGO, ILL., *March 16, 1938.*

HAROLD YOUNG,
Washington, D. C.:

N. A. R. C. H. approves Iglauer recommendations. Authorized to speak for us as outlined.

NATIONAL ASSOCIATION RETAIL CLOTHIERS.

NEW YORK, N. Y., *March 16, 1938.*

JAY IGLAUER,
Care Harold Young, Washington, D. C.:

Understand you are to appear before Senate Finance Committee Friday in opposition to capital-gains and undistributed-profits taxes, including publicity of salaries of executives. The Limited Price Variety Stores Association, representing 2,000 independent variety stores as well as claims in this field, agree fully with the National Retail Dry Goods Association in conviction that these provisions are not merely unsound but actually harmful to the development of American business. You may, if you so wish, state your views represent those of our association as well as your association.

PAUL H. NYSTROM,
President, Limited Price Variety Stores Association.

I shall go right to the heart of this thing at once.

I am of the Halle Bros. Co., of Cleveland, Ohio, and chairman of the taxation committee of the National Retail Dry Goods Association, representing 5,900 individual retail store members located in every State. The personnel of our committee includes several members who have been in the service of the association since 1917 or 1918 and continuously through the subsequent periods of business depression, of great financial and political change. The committee has worked with the Treasury Department, the Bureau of Internal Revenue and with the successive congressional committees; it has consistently viewed Government activity, both legislative and administrative, as a sincere effort by you to solve pressing national problems and not to create them.

We realize that extraordinary conditions have existed which have made extraordinary expenditures necessary; there are still problems which may require continuing aid from State and Federal Government. Looking to the future we are concerned with the preservation and further development of our economic system. We believe this can be best accomplished by encouraging the prosperity and expansion of our industrial life.

Taxes are an essential part of the governmental and economic picture; we are not here to ask you to reduce the total tax dollars needed for essential and reasonably economical operation; we hope you gentlemen will give attention very soon to reducing the cost of government. Our suggestions will attempt to clarify the function of taxation; to point out the instability of yield under the present law and to suggest means of relieving industry and distribution of those psychological factors that breed uncertainty and hesitation; that lead corporations to make unwise distributions of working capital and then to make retrenchment of physical expansion and reemployment.

The function of taxation it seems to us, must always be primarily that of obtaining revenue. When weaknesses in our tax structure develop and loopholes for some of our taxpayers appear, it is not illogical for government to attempt to close them. As a result there has been a trend toward the use of the taxing power for regulation or for punishment. With this resort to abuse of the taxing power, we take issue.

Regulation and punishment are functions of government, but it would be well to keep them as distinct as possible from the function of revenue production. The reasons underlying this principle are so numerous and so well understood that the time of your committee will not be taken to outline them.

Section 102 is one of the remedies of the present law. It imposes a penalty upon unreasonable accumulations of reserves to avoid tax. When it has been invoked by the Government, it has been effective, we are informed, in 9 out of 16 cases. Whether it is amended to strengthen it, or left in its present form, it is unlikely to present any problems for the ordinary operating company. By the intelligent and vigorous use of section 102, the proper regulation, of those corporations especially created, or availed of to evade tax, will be accomplished.

If you will strengthen section 102, and eliminate the tax on plowed-in profits, you will remove one of the major causes of irritation on the part of the multitude of corporations whose history belies any appearance of an attempt to evade taxes.

The revenue from income taxation is sensitive to the total volume of business profits; government income from this source fluctuates widely with the changing cycles of business.

Under a system of taxing corporations at fixed rates your Treasury experts could use the cumulative data on trends of current business as a fair measure of the expected income. Under the present system of taxing "plowed in" earnings, corporations, in one year, following a number of years of good operation, may declare large dividends—in the next year, they may have the same earnings but requirements for working capital may force corporations to retain their earnings, and pay the penalty.

Thus in 1 year the yield from undistributed profits will be small but the yield from surtaxes very large—the next year quite the reverse. It is unreasonable to expect Treasury experts to foretell the return from either source or from both sources, because of unpredictable changes in corporate policy, bred of necessity or uncertainty.

I submit that there is no reliable proportion between the amount of tax saved to corporations who distribute their earnings, and the amounts paid by the individual stockholders, as the result of such distribution. If 150 million was the yield from the undistributed-profits tax for 1936, the only year for which this information is available, no one can say accurately that the return to the Treasury from individual surtaxes would have increased by 150 millions if corporations had distributed all their earnings for that year, with no yield from the undistributed-profits tax.

Business fluctuations are sufficiently severe to cause the Treasury ample concern without retaining factors of unpredictable character inherent in the law itself.

It seems inevitable that the same total of corporate income will yield entirely different tax revenues in different years, both as to revenues from corporation taxes and that of individuals. In short, the effect of the tax on earnings plowed into business is to make it difficult in the extreme for the Treasury to budget Federal receipts with any practical certainty.

Of the uncertainties and hesitation on the part of business we can speak with first-hand knowledge insofar as it applies to the retail craft. Certainly one of the important factors which has contributed to this feeling on the part of business has been the imposition of the tax on undistributed profits. In the opinion of our taxation committee, it strikes at the very heart of one of the basic principles of American business—the plowing in of profits. This is particularly true of retail stores.

In every urban community, stores have grown from small beginnings with few employees to moderate, and large, specialty and department stores, each employing hundreds, and often thousands of people. The stores we are thinking of are a part of the very lifeblood of the communities you gentlemen represent. They have grown as their communities have grown and in accordance with the requirements of the consumers in their neighborhoods. This growth was possible only through the willingness of the proprietors to defer, for many years, the personal enjoyment of the annual profits, while they built up the business and created increasing employment for hundreds of their fellow townsmen.

Under the present law, they must choose between two horns of a dilemma: If they retain their profits for working capital, for the retirement of debt, for the expansion of facilities and added employment, for the replacement of worn-out or obsolete equipment, they must pay a penalty for such retention; if they distribute their earnings to avoid the penalty, to that extent they limit the capital available for any of the purposes just mentioned. The very fact that such an alternative exists makes for division of opinion in the management of corporations as to which course is the more prudent, or desirable, and tends to discourage the purchase of new equipment as well as expansion of facilities and employment.

The amount of the tax is actually of less importance to the businessman than the method of its imposition. We agree wholeheartedly with the public statement attributed to the chairman of the Finance Committee, and with the attitude of his colleagues to which the statement referred, reflecting a disposition to simplify the tax structure. I am confident that business in general, and retailing in particular, will be deeply grateful for any action this committee may take to make our tax laws simpler and more understandable.

Under the urge of the undistributed-profits tax in 1936, corporations distributed in dividends a much larger share of their earnings than formerly. Many of them, in the years from 1930 to 1936, used up substantial portions of working capital as the result of the depression, but particularly because they continued to pay dividends out of accumulated surpluses to aid the restoration of business. As a consequence, they do not now possess the protective cushion of accumulated surplus which was available in 1929 and 1930. More than ever it is necessary for corporations to plow in their reduced profits to maintain employment, to provide a cushion against losses during periods of low net income, and to provide capital for the expansion of merchandise stocks, of accounts receivable, and for reemployment.

Actually, taking the bill as it is now before you, the amount which the Treasury suggests is necessary to make up for the loss of revenue as the result of the elimination of the tax on undistributed profits, is approximately 1.8 percent of the total estimated yield from corporate-income taxes alone, or less than $22,000,000 at the outside. I am taking $22,000,000 as the figure. If we take $40,000,00 as the amount then it is only 3.7 percent of the total estimated yield from corporate income taxes, but I am told that $22,000,000 is the accurate figure, which is 1.8 percent. Now, so much for the undistributed-profits tax.

The CHAIRMAN. Have you about finished your statement?

Mr. IGLAUER. Yes; on that point. I want to talk about capital gains and losses.

In the bill before you we are confronted with a new and extremely complicated system of taxing capital gains.

The taxpayer is confronted with the necessity first of segregating his gains and losses into the numerous categories of the bill. He must check every individual transaction to see in which of the 49 categories it belongs. He must test whether he is to add the net long-term capital gains to his ordinary income and apply the usual normal and surtaxes, or to compute the tax on the ordinary net income and add thereto 40 percent of the net long-term capital gain to see which method produces the lesser tax, and so on and so on.

We are informed that in 1936 this section of the revenue bill yielded less than $25,000,000 and further decreases are expected by the Treasury in 1937 and 1938. This contrasts with the testimony of Mr. Magill, that the average yield of the years 1927 to 1936 inclusive was approximately $141,533,000. Mr. Magill failed to state at that point what was the yield for 1936 alone.

It is common knowledge that the revenue yield has been substantially reduced as a result of even the existing provisions of this law and it seems obvious these new complications will further discourage sales and purchases productive of tax revenue.

Our taxation committee had earnestly hoped that the proposed bill would move in the direction of simplification—we are disappointed that the contrary has occurred.

The new definition of capital assets which will permit the taxpayer to take losses against ordinary income from the sale of property used in the taxpayer's trade, or business, and subject to depreciation allowances, constitutes some relief. There is however a situation which arises frequently in the retail business and in that of building contractors, and perhaps others of which we may not have knowledge, in which sales in substantial amount made to a large corporation are paid for with the stock, or other securities of the corporation. The taxpayer receiving such stock, or security, in payment of his bill puts the security in his portfolio and closes the accounts receivable. Thereafter the stock, or security, becomes worthless, or suffers substantial depreciation in value when sold. The taxpayer cannot charge the full loss against ordinary income under the proposed statute. If he was fortunate enough to have taken the stocks or bonds as security for a note or mortgage, it is true he would probably be able to charge off the full amount of his loss if the stocks or bonds become worthless, but not otherwise. However, in the case of a taxpayer known to us who accepted $100,000 in second mortgage bonds issued by an hotel company in exchange for merchandise consisting of furnishings supplied to the hotel, the pending reorganization of the hotel company will wipe out these bonds.

If the proposed change in the revenue act is retained limiting bond and stock losses on corporation transactions to $2,000, there will be a denial of a rightful loss deduction not involving an investment or speculative transaction, but which is in fact a merchandising transaction in the ordinary course of business. This is an inequity which should be cured in any revision of the capital gains and losses section. Corporations which of necessity must accept securities in payment of merchandise and services should be permitted to deduct such losses, if any, in full, just as they charge off bad debts.

I think that is a new element that has not been studied before.

Finally as to gains and losses, we say to you with the greatest earnestness--simplify the tax structure, please do not complicate it. Encourage the purchase and sale of securities by adopting a single, flat rate similar to the 12½ percent rate in the earlier statute.

Now, may I say just a word about publicity?

The taxation committee of our association strongly recommended the elimination of that clause, known as 148-D in the existing statute which requires the publication of salaries.

The very astute proposal of a member of the House Ways and Means Committee to increase the limit to $75,000 for the purpose of harmonizing the differences of opinion which existed among House Members on this provision, has probably had the effect of satisfying a great number of those whose names will not now be published under the changed provision, but seriously gentlemen, I direct your attention to the principle presented in this provision and its unfairness in the higher brackets of which unfortunately not I, nor the majority of our Members are victims.

There may be some justification for the disclosure to stockholders only of the salaries paid to the officers of a company, whose stock is widely held, but the public disclosure of salaries both under the Securities and Exchange Commission Act and the bill before you serves two principal harmful purposes: First, it tends materially to accept class consciousness; the workman at the bench, the salesperson,

or the floor manager, fails to appreciate the knowledge, the experience and the skill and personal qualifications of leadership, modern business requires of executives. Even if the salary of the executive is only $15,000 per year the rank and file may regard such compensation as excessive. Second, the individual is seldom an impartial judge of his own value. When he learns through the newspapers of salaries paid to one or more of his associates which may be in excess of his own compensation he is made unhappy, and it may result in irritations and lack of cooperation between the executives in an organization. The disclosure of salaries in large organizations, which would be the ones affected by the new provision, would in our opinion seriously impair the individual usefulness of persons who might think they had been rated unfairly by the management. This is a serious handicap to the successful operation of a business and might often result in injury to the interests of the stockholders.

The publication of salaries provides a convenient list for sucker-seekers and criminals. I think this statement needs no elaboration.

The CHAIRMAN. Well, you do not object to a shareholder in a corporation knowing what the salaries of the officers and executives in that particular corporation are?

Mr. IGLAUER. Not in the least. I believe the S. E. C. should reveal to individual stockholders who have shares in the corporation anything that they may want to know about the operation of the company, concerning its financial soundness, that will give them an opportunity to judge whether the organization is stable and whether it is spending its money wisely, but the public disclosure does not do anything but satisfy curiosity seekers.

Senator BULKLEY. What is your comment on the way the bill passed the House in regard to this disclosure?

Mr. IGLAUER. I just said I believe it would make no difference because their names would be no longer on the list, but as to the larger corporations like General Motors, for example, where someone in management has to determine the value of the individuals who are the executives, and they themselves would hardly be fair judges of their own value, when they see the disclosure of the salaries paid to other men of the organization and they feel that that compensation is in excess of their own, it makes for lack of cooperation between the individuals and the management, and to that extent I think it is a bad thing, and it might go so far, with a man of great capability, as to affect the actual interests of the stockholders. I think nothing is served except it provides a convenient list for sucker-seekers and criminals.

Now, Mr. Chairman, I have finished. I have here a supplemental statement. I want to offer it for the record.

(The supplement referred to is as follows:)

I have not included in my formal statement any reference to the so-called 1B provision originally in the House bill because of its elimination in the bill now before you and because of the further fact that based on apparently dependable information, the attitude of the Senate is not favorable to restoration of this title. However, Under Secretary Roswell Magill appeared before you urging restoration of this provision. With no desire to consume unnecessarily the time of your committee, in the event there is sufficient interest in it, I have what may be some illuminating observations with reference to Mr. Magill's initial statement before the House Ways and Means Committee urging the imposition of this tax. In the printed hearings before the Committee on Ways and Means, page 105, the statement of Mr. Magill is: "During 1936 the dividends

paid credit for all corporations reporting prior to August 31, 1937, amounted to an average of 80.66 percent of the adjusted net income. In the 10 years from 1926 to 1935, when no undistributed-profits tax was in effect, the ratio of cash dividends paid to adjusted net income ranged from 57.1 percent in 1926 to 100.7 percent in 1932. In only 2 years, 1926 (57.1 percent) and 1928 (59.7 percent), was the ratio less than 60 percent. The average distribution of American corporations of all sizes during this 10-year period, taking into account both good years and bad, was 76.9 percent of net income."

I call your attention to the fact that the 10-year period used by the Secretary includes the beginning of the depression in 1930 and the subsequent disastrous years, 1931, 1932, 1933, and 1934. It is a well known fact that many corporations, during the period of the depression, paid out substantially more than their entire income in dividends in the hope of maintaining buying power in the consumer, and many of these suffered severe losses in their effort to maintain employment in the earlier years of the depression when they did not fully realize how long it would last. They were able to do both of these things because of surplus accumulated in prior years when there was no undistributed-profits tax.

I believe it will impress you gentlemen as somewhat unfair to use a 10-year-period basis, of which 5 years out of the 10 were the years of the depression.

Your attention is directed to the fact that in the years 1923 to 1929 the figure ranged from 47.4 in 1923 to 62.0 in 1929. Percentages, however, do not tell the whole story. We call your attention to the fact that in the year 1932 when cash dividends were 100.7 of the adjusted net income, the adjusted net income was only $2,305,000,000, compared with $12,019,000,000 in 1929, when 62 percent was the ratio, or $8,055,000,000 in 1923, when the ratio was only 47.4.

Standard Statistics has compiled some figures which may be of interest in this connection: 403 industrial companies, 22 utilities, 25 railroads, earned, in the 5-year period, 1930 to 1934 inclusive, a total of $8,008,000,000 and disbursed in dividends $15,800,000,000.

It will be apparent to you I am sure that the record for the years used in Mr. Magill's statement can hardly be regarded as an argument for the retention of the tax on undistributed earnings.

Taking the figures from the Treasury reports of all corporations used by Mr. Vinson and Mr. Magill, the total dividends of all companies for the same years, 1930 to 1934 inclusive, were 19 billion 272 millions, compared with earnings of 21 billion 551 millions, or a ratio of 89.4 percent. Would you say that that represented retention of earnings when no undistributed-profits tax existed? Would the undistributed-profits tax have increased the dividend distribution? Is there evidence of unreasonable retention in the 10-year period selected by Mr. Vinson?

Under the original House bill the "Vinson" report shows net loss in revenue of 23 million in a total of 5 billion 300 million expected tax revenue. "That certainly is substantially a balance", he said.

It would be interesting to learn from the Under Secretary what would have been the return from the undistributed-profits tax for the year 1933 or the year 1932 when the total tax received from all corporations was only 423 million in 1933 and 286 million in 1932.[1]

In those two years all corporations in total reporting income showed a combined deficit of 2 billion 547 million and 5 billion 644 million respectively. Would the undistributed-profits tax have been a burden in those years of great stress? Would it have been fair to tax those few profitable corporations for retaining their profits when the banks were closing and fear gripped every business man? Would you gentlemen like to have such a tax on the statute books if we should have another debacle in the coming years?

Senator Townsend. Mr. Chairman, I desire to insert in the record a table worked out by the tax commission of my State, showing the effect of this tax on estates. I do this so that the experts and the Treasury Department may see it and work out an answer to it.

The Chairman. Without objection that will be ordered, and I hope the representatives of the Treasury Department will take cognizance of this, so they might elaborate on it.

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[1] Source: Statistical Abstract of the United States, 1936, page 187.

(The paper referred to is as follows:)

PROPOSED REVENUE ACT RELATING TO ESTATE TAXES REDUCES STATES' REVENUE

Additional encroachment upon State tax systems and inroads into State revenue are contained in the Revenue bill of 1938, as introduced on March 1, pertaining to estate tax.

At the time the 1926 estate-tax law was adopted, credit was allowed an estate for 80 percent of the tax if paid to a State under that law, provided an amount equal to such 80 percent was paid to the State government. The various States were urged to pass laws enabling them to take advantage of this source of revenue, derived from a Federal tax bill. Although this advantage was not extended in the revenue law of 1936 pertaining to estate taxes, neither was it restricted by the later law.

Analysis of the 1938 revenue bill indicates that if it is passed every State which has enjoyed the equalization features of the 1926 bill (in some cases at the insistence of the Federal Government) will derive much less revenue than under the present 80-percent provision, according to every case reviewed by the State tax department. In no case did gift taxes act to reduce the amount of the credit previously enjoyed by this State. If such gift-tax credit had been allowed before computing an 80-percent credit under the 1936 act, no case has been found where the amount accruing to the State would be less than 80 percent, yet it is proposed to reduce this credit to 16½ percent and give the impression that the States will enjoy the same yield.

The proposed law provides for a credit of 16½ percent. On all estates valued at $1,500,000 or more the decrease and consequent loss to the States from this change in credits allowable is as shown in the following table:

Net estate after $40,000 exemption	Amount of Federal estate tax	80-percent credit under 1926 act	16½-percent credit under proposed law	Decrease	
				Amount	Percent
$1,500,000	$382,600	66,960	$63,129	$3,831	5.7
$2,000,000	557,600	102,480	92,004	10,476	10.2
$2,500,000	747,600	142,000	123,354	18,646	13.1
$3,000,000	952,600	185,520	157,179	28,341	15.2
$3,500,000	1,172,600	233,040	193,479	39,561	16.9
$4,000,000	1,407,600	284,560	232,254	52,306	18.3
$4,500,000	1,657,600	340,080	273,504	66,576	19.5
$5,000,000	1,922,600	396,080	317,229	78,851	19.9
$6,000,000	2,482,600	515,600	409,629	105,971	20.4
$7,000,000	3,072,600	643,120	506,979	136,141	21.1
$8,000,000	3,682,600	778,640	607,629	171,011	21.9
$9,000,000	4,312,600	922,160	711,579	210,581	22.8
$10,000,000	4,962,600	1,073,680	818,829	254,851	23.7
$20,000,000	11,662,600	2,673,200	1,924,329	748,871	28
$50,000,000	32,302,600	7,473,200	5,339,829	2,133,371	28.5

Prepared by State Tax Department, State of Delaware, Mar. 16, 1938.

The CHAIRMAN. I again implore the witness to try to stay within the time limit, because it is not a pleasure for the chairman or anyone on the committee to call anybody down or to suggest to them that their 10 minutes' allotment has expired.

Mr. W. J. Kelly, of Chicago, representing Machinery and Allied Products Institute.

STATEMENT OF WILLIAM J. KELLY, CHICAGO, ILL., PRESIDENT, MACHINERY AND ALLIED PRODUCTS INSTITUTE

Mr. KELLY. The course of a nation's history can be determined in substantial measure by its tax policies.

The future of millions of Americans will be permanently affected by tax policies instituted, perpetuated, or discontinued at this session of the Congress of the United States.

The questions involved are grave. Practically every citizen—certainly every businessman and every business organization—now has a broad and active interest in the proposed provisions of the Revenue Act of 1938. They should freely comment upon them for the welfare of the Nation demands and past experience proves that thoughtful consideration must be applied to them if further pitfalls of entrancing theory are to be avoided. In that spirit and in the hope that our views may make some contribution in aiding your committee and the Congress to exert a positive and constructive influence on the future course of the Nation's business and industrial history, Machinery and Allied Products Institute makes this statement to your committee, now charged with the great responsibility of developing the needed modifications.

Sweeping changes have occurred during the last 5 years in tax policies in the United States. These changes have exerted profound influence upon the saving and investment policies of individuals and upon the operations of private business and industrial corporations. But, unfortunately, we had to be visited by a so-called recession before public opinion became aware of the uncertainty current tax policies had created in the minds of that large segment of the American people which either invests accumulated savings or bears the responsibility of protecting the savings of stockholders invested in business enterprises.

Let us carefully note right here that adequate savings and investment policies of individuals are not ends in themselves. Neither are such progressive practices and operations of the corporate enterprises of private business as to stimulate initiative and the hazarding of capital and credit in long-range plans ends in themselves. They all combine merely as means to an end. That end is the gainful employment of so large a proportion of the employable population of our country as will sustain and raise the American standard of living for all our people. That is the sole result which produces progress for the Nation, happiness for our countrymen, and profits for business.

Tax policies today more than ever before are a determining factor in business conditions. Twenty-five years ago, when only 6 cents of each dollar of national income was taken in taxes, taxes had little economic or social effect. Now, with 20 to 25 percent of each dollar taken as taxes they have become a factor having profound economic and social effect. The sweeping changes of the past few years in types of levies have made the effect even more pronounced, so that the tax policies now under consideration by this committee are incomparably more important to business conditions and national welfare than those of a decade ago.

Further than that, our economy is more susceptible to fluctuation today than formerly because an increasing proportion of all goods produced are of a durable or semidurable character, and purchase of them can be postponed when confidence in the future is lacking. Tax measures which affect confidence tend to paralyze the 40 percent of our productive system which is devoted to durable-goods production. It is in the durable-goods industries and activities dependent upon them where our principal unemployment has existed since 1930; it is in these industries that unemployment is being

forced upon us most rapidly today, and it is here also that the potentialities for new employment are greatest.

Now the citizen, and perhaps least of all the business man, can make no just complaint against paying equitable and reasonable taxes. The spirit that prepares the good citizen cheerfully to carry his end of the tax load is the same urge that makes him insist moreover that the total tax bill be the lowest possible and the spreading of the assessment the fairest possible. Above all he expects his Government to be practical.

Unhappily, the sweeping changes in tax policy referred to have been far from practical, however proper and praiseworthy in theory, the underlying ideals and aims may be. For recent tax policy has been premised, in our judgment assertedly and evidently, upon the following ideals and aims (undoubtedly among others of minor importance):

A. That taxation be based strictly upon ability to pay.

B. That income from corporate operations be uniformly taxed, whether paid out or retained; that failure to disburse income as taxable dividends not permit a corporation to deprive the Government of revenue.

C. That income realized by capital gains, enjoying equal purchasing power, be taxed equally with income otherwise earned or received, and that allowance of capital loss as an offset be restricted in order to prevent excessive speculation in securities.

D. That large family fortunes and consequent concentration of wealth be not perpetuated to the extent of past years.

E. That personal incomes of unreasonable size be reduced by high surtaxes on individual incomes of large amounts.

I draw your particular attention to these ideals and aims, for I now make the assertion and will spend some time in supporting the statement that in practice the results have been in some cases diametrically opposite, in others have failed in objective, and that the net effect of all this has been to deprive those most needing them of opportunities for employment and better living. It is not too much to add I think that our targets looked as though they should be hit, but our shells hurt the innocent bystander—the unemployed—much more than they punished the taxpayer.

Therefore I wish to discuss these subjects:

1. The surtax on undistributed earnings in theory and practice.
2. The graduated normal income rates in theory and practice.
3. The capital gains and losses tax and effect upon Federal revenues and activity in the securities markets.
4. Excessive inheritance taxes and their effect upon an open and free flowing capital market.
5. Excessive taxes on income of individuals in the higher brackets, relative to tax policy and effect upon business enterprise.

1. THE SURTAX ON UNDISTRIBUTED EARNINGS IN THEORY AND PRACTICE

A tax upon undistributed earnings first received serious consideration in the proposals advanced by the Treasury Department for incorporation in the Revenue Act of 1936. You will recall that as so recommended it was passed by the House as a punitive tax of confiscatory proportions replacing the normal income tax on corpora-

tions. Such a concept of tax method had no precedent in the statutes of the United States, and it had no sponsorship or backing in business and economic fields.

A popular reason then advanced for this method of tax was that it assured payment of equal taxes upon equal income and applied more equitably the principle of taxation on the basis of ability to pay. While all corporate income was taxed at normal rates when earned, it was pointed out in support of the undistributed earnings tax that while a part of corporate income was again taxed as dividends in the hands of stockholders, the remainder of it avoided being taxed again if it was retained by the corporation as surplus instead of being disbursed to stockholders. Therefore the claim was made that the tax upon undistributed corporate earnings, replacing the normal income tax, would either force out income to stockholders in whose hands it would be taxed, or would subject it to heavy penalty if retained by the corporation.

Among many effective arguments presented to your committee against it, proof was offered that the House bill would have had the result of wholly exempting from Federal income taxation the earnings of hundreds of large corporations possessing substantial reserves, while transferring the burden to relatively small or less-well-financed companies needing to retain part or all of their earnings for the purposes of their businesses. Prominently included in this classification were countless companies in industries, such as the capital-goods industries, where volume of business is subject to wide fluctuations, and a larger proportion of earnings is necessarily retained for future operations. Rather than promoting the objective of equal taxation on basis of ability to pay, the House bill stood convicted of accomplishing the exact opposite.

You will remember, too, that despite administration insistence in favor of it, your committee wisely recommended modification and combination with the normal income tax. By so doing your committee, in our judgment, averted a drastic and immediate unbalancing of the economy. Aside from a small and shrinking minority we all agree now, I think, that your action was not nearly far reaching enough, however, for while it deferred the cause of much of the subsequent unbalance and loss of confidence culminating in the present business recession, it was not by any means sufficient to remove the cause, and tremendous distress has ensued.

Nevertheless, despite our costly experience, the same reason has again been directly or inferentially advanced by the proposals of the House subcommittee for retention of the undistributed-earnings surtax in reduced amount, and for imposition of the surtax on "closely held" corporations. Before commenting further on the proposed retention of the surtax in reduced amount I want to express our great gratification that the proposed "closely held" corporation surtax has been so overwhelmingly defeated by the action of the House of Representatives. If enacted, it would have constituted gross inequity and placed an unbearable load upon the kind of companies which more than any other has brought profit and progress to our Nation. Indeed, it would have surpassed in unfairness the provisions of the present Revenue Act.

A further argument made for the surtax on undistributed earnings of corporations is to the effect that the accumulation of savings or

surpluses on the part of corporations is harmful and should be prevented. Does this not mean that the surtax was predicated upon the erroneous assumption that government in a free-enterprise system should undertake to determine the distribution of the national income between savings for reinvestment and expenditures for current living?

Indeed, the objective reveals itself as threefold:

First, to force such savings into circulation as purchasing power in the consumption-goods industries on the mistaken theory that such savings, if retained by the corporations, would not contribute to purchasing power.

Second, by forcing such disbursements to remove the possibility that such funds would be used in the securities markets by a corporation to bid up the prices of securities. Presumably, this idea was advanced on the mistaken information that the savings of corporations were substantially responsible for the extent of 1929 speculation.

Third, by forcing such disbursements to deprive corporations of some or all of their liquid assets, and so control the extent to which capital facilities would be expanded. This apparently on the theory, again mistaken, that the expansion of plant facilities in the twenties was excessively large, and that capital-goods industries should never be permitted to advance faster or to reach a larger volume of production than the consumption goods industries. Each of these premises in our judgment was based upon misinterpretation of economic fact and social effect.

In its statement before your committee in May of 1936, directly pertinent both to the House bill then before you for consideration and the Revenue Act of 1936 as enacted, the Machinery Institute listed 10 evils which the undistributed-earnings surtax would inflict upon the economy of the country. Experience since has compelled universal recognition of these ill-effects, for the undistributed-earnings surtax has been found to have—

(1) generated uncertainty and lack of confidence.

(2) unduly encouraged liberalized dividend policy which will result in deepening and lengthening depressions.

(3) fostered industrial inefficiency and obsolescence.

(4) penalized new corporate enterprise, expansion of industrial activity and development of new products.

(5) multiplied taxation on depreciation reserves.

(6) resulted in the imposition of heavy tax penalties on unrealized or "book" profits.

(7) inequitably subjected capital gain to heavy surtax without allowance of offsetting capital loss on depreciable assets.

(8) resulted in a confusing multitude of inequitable exemptions and "relief provisions."

(9) borne out prognostications of harmful fiscal effects, made on the basis of itemized comparisons of the operating statements of individual companies for prior periods.

(10) unfairly penalized capital goods companies without recognition of fundamental differences in operating conditions and financial ratios existing between capital goods and consumption goods companies.

The bill now before you embodying the recommendations of the House Ways and Means Committee for the Revenue Act of 1938 provides for a continuation in modified yet substantial degree of this detrimental surtaxing of undistributed profits.

The bill seeks to retain the surtax to such extent as still to bulk as large as 25 percent of the basic 16-percent normal tax proposed in the "general rule."

If, as is overwhelmingly established to be the fact, the effects of the undistributed earnings surtax are economically unsound, there can be no justification for continuing the precedent in any degree whatever. Industry and all of business need now to be assured that Congress recognizes the evidence presented in the record convicts the surtax, and that the threat of unsound manipulation of corporation income will be definitely and finally removed. Long-term planning in industry, upon which so much employment depends, demands that by positive action industry be assured that this method of taxation will not again be forced upon it.

We reiterate that mathematics do not comprehend a program embracing this form of surtax which is equitable. In whatever degree it is retained it is unfair to the capital-goods industries where business and profits fluctuate widely in contrast to consumption-goods industries where business and profits are relatively stable. Fairness and common sense demand its complete repeal.

I do not wish by what I say to imply that we fail to recognize that instances exist of unreasonable retention of earnings for the purpose of avoiding Federal taxation. But as we stated to the Ways and Means Committee of the House on January 22, repeal of the undistributed-earnings surtax having been accomplished, we are confident that on the side of necessary reform reinforcement of section 102, which is the provision of the present act against unreasonable retention of earnings, can be successfully implemented. Similar beliefs as to this have recently been expressed on the floor of the House, and I confidently believe that a public-spirited committee of tax experts, attorneys, and businessmen working with Treasury officials would find sufficient ingenuity within it to accomplish such reinforcement of the present section as would be equitable to all.

2. THE GRADUATED NORMAL INCOME-TAX RATES IN THEORY AND PRACTICE

The Revenue Acts in 1935 and 1936 introduced for the first time the practice of using graduated rates of Federal normal income tax for corporations, based solely upon the volume of income. The 1935 act substituted for the flat percentage tax upon corporate income applicable to all corporations, a tax ranging from 12½ to 15 percent—12½ percent upon income of $2,000 or less, 13 percent upon income of $2,000 to $15,000, 14 percent upon income of $15,000 to $40,000, and 15 percent on incomes over $40,000. The Revenue Act of 1936 widened these graduations, by increasing the range to from 8 to 15 percent.

In the bill for the Revenue Act of 1938 now before you it is proposed to retain the principle of graduated rates.

The theory underlying the levy of a tax graduated in relation to volume of income is presumably that of taxation on the basis of ability to pay, with the premise accepted that large corporations are better

able to pay higher percentages of their incomes than are small companies. Obviously, therefore, the theory of graduated tax in relation to volume of income overlooks the fundamental fact that corporations are merely groups of individuals organized for profit. Yet no such claim has ever been proved, for the simple reason that statistics upon which to prove any such claim do not exist—that large companies are owned entirely, characteristically, or even to average extent by stockholders best able to bear the burden of higher Federal income-tax rates. Similarly there is no evidence that small companies consist entirely, characteristically, or even to average extent of stockholders least able to bear the burden of higher Federal income-tax rates. And again, mere volume of income, without reference to its proportion to the investment in the business and rate of profit yield, is no measurement of ability to pay.

A tax levied upon corporate income, graduated in relation to the volume of such income, and without consideration of the relation of such income to invested capital, penalizes apparent size only. The precedent of such taxation opens the way for far-reaching inequities and oppressions of the small stockholder in a large company, as against the large stockholder in a small company.

3. THE CAPITAL GAINS AND LOSSES TAX AND EFFECT UPON FEDERAL REVENUES AND ACTIVITY IN THE SECURITIES MARKETS

An open and free-flowing capital market is an essential to all business, but absolutely so as to the machinery, capital-goods, and related lines of business. Because of their reliance upon long-range plans and long-term credit, it is of transcendent importance to durable-goods lines. It is in the durable-goods lines, I take the liberty of reminding you again, where we have great resources comparatively paralyzed and contributing vastly to a precipitately declining national economy.

The volume of transactions in the securities of business has been greatly reduced. New securities issues still total less than one-third of normal amount. Investment capital ordinarily available to new enterprise has shifted to large extent to tax-exempt securities and other securities which fluctuate little in price. Venture funds are lacking.

The dearth of activity in the securities of business may be explained in important part by the policy of taxation embraced in the capital gains and losses tax. The capital-gains tax, which in 1932 provided for offset of capital losses before application either of normal rate or of a flat tax of 12½ percent on net capital gains, whichever was lower, has been progressively increased. The Revenue Act of 1934—continuing to date—restricted the offset of capital losses to $2,000 above the capital gains in that year and, in lieu of the 12½-percent rate, provided for inclusion in normal income of proportions of capital gains, varying from 100 percent of capital assets held 1 year down to 30 percent of those held more than 10 years, subject to full normal and surtax rates.

More than anything else, the capital-gains tax, in our judgment, is responsible for—

(1) The widespread postponement of taking of capital gains, and an unwillingness to risk capital in pursuit of new capital gains, thus

reducing the volume of trading in securities and subjecting the securities markets to wide fluctuations in prices as a result of "thin" markets;

(2) The shift to tax-exempt securities—to which I will later refer in greater detail—and to securities of minimum risk and little price fluctuation, with consequent reduction in the supply of venturesome capital; and

(3) The lack of favorable capital markets available to small, marginal, and new enterprises. Taxpayers subject to heavy gains without full privilege of offsetting capital loss are reluctant to purchase securities of high risk and consequent prospect of sharp fluctuation in price, because it becomes too costly to sell when a sale appears desirable, and in event of loss little if anything can be taken as a tax credit.

It is time the proposals before you modify the tax rates upon capital gains and we note with encouragement their improvement over the provisions now contained in the Revenue Act of 1936. Particularly do we welcome as a necessary and very helpful change the recommendation of the House that the definition of "capital assets" in section 117 (b) of the Revenue Act of 1936 be amended so as to except depreciable assets used in business and trade. This modification, by which such depreciable assets will be exempted from the $2,000 limitation on capital loss, is of vast importance to machinery manufacturers and their customers. The Machinery Institute has urged this new provision upon many occasions. A flagrant inequity of past treatment of depreciable assets has now been removed if acceptable to you. We commend and are most appreciative of the action of the House in this respect. We urge and hope for the concurrence of the Senate.

We are happy to observe also that even as they are now drafted in the House bill, the provisions for taxation of capital gains and losses will result in increased revenues to the Government, because by reducing to the extent proposed the burden of taxation of capital gains, the free flow of capital will to a degree be stimulated, with a resulting number of transactions subject to tax. It is our judgment, however, that the proposals do not begin to go far enough in this direction. This may be said not alone from the standpoint of the objective of a productive rather than a punitive tax—of stimulating the free flow of capital into securities of business—but also from the standpoint of Government revenues on securities transactions.

It is axiomatic that a tax which discourages capital transactions will produce less revenue than a reasonable tax which does not deter such transactions. We believe that figures compiled in the Treasury Department must show that the tax on capital gains has reached a point of diminishing returns and that in comparison with volumes of transactions normally and reasonably expected under conditions of free and open capital markets the lowering of rates of tax upon capital gains will sustain and increase Federal revenues from this source.

Therefore we urge:

(1) That the rates of tax on capital gains now proposed in the House bill be further reduced to a flat rate low enough to encourage the taking of gains.

(2) That provision be made for full offset of capital losses against capital gains, now denied in the House bill recommendations, with-

out any restrictive provision such as that to compel the application of short-term losses against short-term gains, and vice versa.

(3) That the net capital loss carry-over recommended in the House bill be extended to permit carry-over of all capital losses not offset by capital gains into any one of 3 succeeding years.

Such changes in the revenue act will generate confidence in business enterprise on the part of owners and managers. They will stimulate enthusiasm for the securities of business on the part of the American public. Renewed business activity and employment will quickly follow.

4. EXCESSIVE INHERITANCE TAXES AND THEIR EFFECT UPON AN OPEN AND FREE-FLOWING CAPITAL MARKET

During the last few years inheritance or estate taxes have been staggeringly increased. Commencing with 1932 the rates were tremendously increased, while the specific exemption was substantially decreased and credits for State taxes remained stationary. The following approximation will serve, however, to illustrate the immensity of the increases:

	Rates (percent)
1926: $100,000 exempt	1–20
1932: $50,000 exempt	1–45
1934: $50,000 exempt	1–60
1935: $40,000 exempt	2–70
1938 (proposed): Previous exemptions of $40,000 each for inheritance and gifts, total $80,000, reduced to total $40,000	2–70

The approximate effect assuming an estate of $150,000 after gifts to individuals prior to death of $40,000 may be roughly seen as follows:

1926: 1 percent of $50,000	$500
1932: 1 to 7 percent of $100,000	4,600
1934: 1 to 9 percent of $100,000	5,200
1935: 1 to 17 percent of $110,000	10,900
1938 (proposed): 1 to 17 percent of $150,000	15,113

Need for revenue has of course increased substantially during these years, but further than this it is apparent that increases of such proportion have been the result of an underlying philosophy expressed in the doctrine that the wealth of America is unduly concentrated. Such fiction as the recent Sixty Families is an exposition of this poorly based belief. The doctrine that redistribution of wealth should be and can be forced overlooks at least two significant facts:

1. In America more than in any other major country in the world wealth is not perpetuated indefinitely. American competitive enterprise is such that opportunity for wealth is available to the average man to a degree without precedent in any part of the world. The ability to retain it once it is acquired also requires rare skill, if we are to judge from the history of fortunes made and lost. The process of accumulation and dissipation are constant and reasonably equalized. In America, family fortunes as a rule have not been perpetuated over many generations nor as is generally supposed have all large companies managed to retain their positions.

A study by the Twentieth Century Fund indicates how transitory is the leadership of business and industrial corporations. Of the

200 largest corporations in 1909, this study reveals, 89 had dropped out of the list by 1924. Many which remained on the list were operating unprofitably and clearly on the decline. Fourteen of the forty-six railroads on the list had lost their positions of dominance by the end of 15 years; of the 55 utilities, 28 had disappeared from the roster of the 200 largest corporations; 47 of the 99 industrials had dropped out by the end of 1924.

The nominal capitalization of the 200 largest corporations of 1909 rose in each of the next 15 years (1909–24) at the rate of 3.5 percent annually. During the same period national wealth rose at the rate of 5.1 percent, and the national income at the rate of 6.6 percent. Workingmen's wages, wholesale prices, and cost of living all rose at a more rapid rate than the capitalization of these corporations. These statistics present convincing evidence that there is neither an alarming growth in number of dominating corporations nor a perpetuation of leadership by the same corporations from generation to generation.

2. Indirect attempt to redistribute wealth through confiscatory inheritance and gift taxes, even though it be pursued with the intensity of the past few years, cannot on the one hand be successful, and on the other cannot avoid resulting in such widespread retardation of our processes of saving and investment as to bring far more social detriment than benefit. Significant in this connection is the recent statistical study of wealth owned by persons having income of more than $5,000.

The study was made by Gerhard Colm and Fritz Lehmann, of the graduate faculty of political and social science, New School for Social Research, and concludes:

> In 1930 we estimated 30 percent of the total amount of this property was in the hands of 2 percent of the property owners, while under the impact of the present tax rates the same 30 percent of the property after 30 years would be owned by 3 percent of the property owners.

This conclusion is noteworthy in part for its showing that attempt to redistribute wealth through heavy taxation—unless we are to progress to the point of confiscation—cannot succeed except minutely. But it is much more significant as a yardstick of possible accomplishment in this direction against which to compare the great social detriment in having wealth in hiding, unproductive, and incapable of originating gainful employment.

Estates almost universally consist of property which must be sold, or liquidated, in proportion to the taxes assessed upon them. With death duties at their present height, instead of concentrating on the planning of expansions or new ventures, which would produce more jobs, wages, trade, and public revenues, the major task instead must be to keep the wealth in shape to be immediately liquidated on favorable terms, so that in event of death the taxes may be paid without rendering insolvent the property or the business concern.

The result of the excessively high inheritance taxes has been constant diversion of investment money to offset the necessities of liquidity, and its consequent unavailability for enterprises which would produce employment. The policy of reform and redistribution of wealth through punitive estate taxes is a brake on progress and an interference with a higher standard of living for all.

5. EXCESSIVE TAXES ON INCOME OF INDIVIDUALS IN THE HIGHER BRACKETS, RELATIVE TO TAX POLICY AND EFFECT UPON BUSINESS ENTERPRISE

The record of tax increases against the larger incomes of individuals parallels the record of the increase of inheritance taxes. In the 1926 Revenue Act the surtax on individual income provided for a basic exemption of $10,000, and the tax ranged from 1 to 20 percent. Increases since make the following comparison: 1926, $10,000 exempt, rates 1 to 20 percent; 1932, $6,000 exempt, rates 1 to 55 percent; 1934, $4,000 exempt, rates 4 to 59 percent; 1936, $4,000 exempt, rates 4 to 75 percent; proposed 1938, $4,000 exempt, rates 4 to 75 percent. These surtaxes must be read in conjunction with the normal rates on individual income, which were as follows: 1926, first $4,000, 1½ percent, second $4,000, 3 percent, remainder, 5 percent; 1932, first $4,000, 4 percent, remainder, 8 percent; 1934, on all taxable income, 4 percent; 1936, on all taxable income, 4 percent; proposed 1938, on all taxable income, 4 percent.

The growing penalty upon individual incomes of larger amounts may be illustrated as follows: Individual taxable net income of $60,000 before minimum exemption taken:

Combined normal tax and surtax:

1926	$7,091
1932	12,020
1934	12,898
1936	12,958
1938 (proposed)	12,958

Here again the desire to redistribute wealth by heavily penalizing it does not take into account the resultant loss to the man without a job. I call your attention to the fact that combined with the capital-gains tax, the high surtax rates on income of individuals have driven an enormous sum of capital from the markets serving the securities of business and thus has eliminated jobs. A table, taken from the New School for Social Research statistical study previously referred to, is indicative of the extent to which the shift to tax-exempt securities has already taken place.

Percentage of tax-exempt securities in estates [1]

Size of estate	1927	1931	1935
$100,000-$200,000	4.6	4.2	8.9
$200,000-$2,000,000	7.6	8.1	16.1
$2,000,000-$4,000,000	8.3	10.4	26.7
$4,000,000 and over	9.2	15.3	44.0

[1] The higher percentage of tax-exempt securities for 1935 is also in part due to lower stock prices in 1934 and 1935. The group of estates of over $4,000,000 contained only 41, 63, and 10 cases for the years 1927, 1931, and 1935.

The significant facts revealed by this study are that holdings of Government securities increase disproportionately with size of the estates, and that this disproportion has been greatly accentuated since the heavier estate taxes were imposed. In the estates of over $4,100,000, 44 percent of all assets are tax-exempt Government securities, as compared to six-tenths of 1 percent for estates valued at less than $5,000. The concentration of large estates in Government securities is revealed by the fact that in estates of from $50,000 to $100,000 only 7.5 percent are Government securities. In estates of

$200,000 to $2,100,000 the percentage is doubled, or 16.1 percent. In estates of $2,100,000 to $4,100,000 the holdings represent 26.7 percent and over $4,100,000 the percentage is 44.

This large shift to tax-exempt securities and away from investments in business in order to avoid high-surtax rates, is obviously far from an end, and so long as the present rates continue business will be robbed of the capital which should be flowing into employment-making and wealth-producing enterprises.

The economists who compiled the table referred to above estimate that an additional $15,000,000,000 now invested in business securities is in danger of being gradually transferred to tax-exempt securities by holders whose incomes are of such proportions that they could obtain a higher net yield from tax-exempt securities than they now obtain from net dividends on business securities after deduction for taxes.

The present policy, viewed entirely from the standpoint of the real interests of those in the lowest income brackets or without income, is a mistaken one. Surtaxes on individual incomes most not be permitted to continue at such punitive rates as to eliminate individual incentive for enterprise and deprive the country of resulting employment-making activities.

In conclusion, permit me to speak briefly on the present opportunity of your committee and of Congress to build confidence and increase employment through the medium of a thoroughly equitable and reasonable revenue act.

As the Congress assembled last October in special session, there was being expressed in the Senate, in the House of Representatives, and throughout the country a common concern over the part played by the discredited tax policies enacted in the Revenue Act of 1936 in causing the business recession.

More than a half year will have passed before that act can be superseded by a Revenue Act of 1938. This half year will have witnessed no lessening of recognition of the great need for drastic and immediate change. Rather, that need has deepened and the recognition of it has increased as employment has dropped precipitously in the most rapid decline in business the country has ever experienced within a similar period of time.

The constructive attitude of your committe is well known. We applaud it for we know your purpose is to deal realistically with the important problems involved. If the Congress takes full advantage of its opportunity it will lead the country on a course of encouragement and hope which will enable business to renewed advance upon our great economic frontiers. It will declare against erroneous theories of overproduction and oversavings which have been and are now stultifying our national policies and drastically impeding progress. Moreover, Congress will give positive demonstration that it is firmly behind equity and reasonableness in all taxation; thus Congress will hearten the discouraged and thus it will call forth the enthusiasm and galvanize into action the combined great forces of America's savers and investors, its workers and its managers of business in the common task of achieving full employment, prosperity, and happiness for all.

The CHAIRMAN. Mr. Maurice E. Peloubet of New York City, representing the Copper and Brass Mill Products Association.

STATEMENT OF MAURICE E. PELOUBET, NEW YORK CITY, THE COPPER & BRASS MILL PRODUCTS ASSOCIATION

Mr. PELOUBET. I am Maurice E. Peloubet, a member of the firm of Pogson, Peloubet & Co., certified public accountants, of New York City. I am speaking for the Copper and Brass Mill Products Association, a group of manufacturers who produce copper and brass sheets, tubes, rods, and other shapes, principally for further fabrication by other manufacturers but to some extent for use as finished products. The members of this Association wish to have that section of the proposed Revenue Act which corresponds to section 22 (c) of the Revenue Act of 1936 so worded as to permit members of the association to use, for purposes of computing income subject to Federal income and excess profit taxes, the same accounting methods which are generally accepted as correct for reporting to the Securities and Exchange Commission, reporting to their stockholders and for other corporate purposes. This method is the last-in, first-out method of applying current costs to current sales and is not now permitted by the United States Treasury Department to be used as a basis for determining taxable income.

I appeared before this committee at the hearings on the Revenue Act of 1936 to request legislation in that act to permit the use of this method and was told that it was within the power of the Commissioner of Internal Revenue to permit the use of the last-in, first-out method and that legislation was not, therefore, required. Those whom I represented were advised that appropriate action could be obtained from the Treasury Department, but while they have been in almost continuous touch with the Department since the passage of the Revenue Act of 1936, the Treasury has continued to require the use of methods of determining income which are not generally considered to be correct for the copper and brass mill products industry.

The copper and brass mill products industry conducts its business so as to avoid loss and thereby preclude gain from market fluctuations, which is accomplished by matching purchases and sales in the following manner:

Orders are customarily taken for delivery some time in the future—generally 90 days, sometimes more. The price at which the orders are taken is a combination of the fabricating charge, generally known as the fabricating differential, and the price of the metals used in the product on the day that the order is taken. Promptly thereafter a purchase commitment is made for copper, zinc, or other metals required to fill the orders taken.

The products may not be delivered and the metal may not be received for several weeks or months, but the manufacturer knows that he can obtain metal to cover the sale he has made and that he will neither gain nor lose on the metal but will make his profit on the difference between his fabricating cost and the differential charged the customer, which is the basis on which his business is done.

The prices of copper and brass mill products are increased or lowered as the prices of copper and zinc change. Price changes on products are made within a few hours after a change in metal prices, and it is of the utmost importance to each fabricator to have a system and organization by which these prices can be changed and made effective promptly. If this were not done, heavy losses could result.

Thus, on the metal itself which is bought for and included in the products sold to customers, the brass manufacturer neither gains nor loses. It is not possible, however, to run a mill solely on the metal which the manufacturer has contracted to deliver to his customer in the form of finished products. He must, in addition, maintain a substantial inventory of metal. This inventory is in many different forms. Beginning at the casting operation, an excess of metal must be provided to allow discarding of unsound metal and dross. Similarly, in the rolling, drawing, and extrusion operations, unsound surfaces, edges, and ends must be removed. In finishing operations the product is reduced to proper dimensions by cutting off surplus material.

In other words, to produce a given quantity of a product a substantially larger quantity must be processed, the difference being mill scrap which is reclaimed and constitutes a constantly revolving inventory within the mill. Besides this, quantities of partially processed material must be kept at various points in the mill to permit economic production of the stream of orders which vary widely as to their individual quantity requirements. Altogether, therefore, the manufacturer must keep on hand an inventory which in metal content may equal several months' production. The inventory must always be kept on hand; a mill could no more operate without this inventory or so-called metals in process than it could operate without its plant or any of its equipment. And its practice, as I have explained to you, recognizes this fact. Sales are not made against this inventory; they are made against purchases of metal which occurred at approximately the same time as the sale.

In spite of this, the regulations of the Commissioner under section 22 (c) compel the fabricator to apply his current sales against an inventory deemed to be the earliest purchases when this, in fact, is exactly contrary to the fabricator's business practice. This results in inclusion in the computation of income, for income-tax purposes, profits or losses which are not the result of actual transactions.

The resulting distortion becomes particularly important in the copper and brass mill products industry because of the nature of their manufacturing operations, the relatively high cost of the metals they use, and the fluctuations in price to which those materials, particularly copper, are subject and over which the mills have no control. Their manufacturing operation is a complicated process bristling with physical and technical difficulties, and such a long period is involved that changes in price of inventory have a a maximum effect. The cost of the metal is the principal single cost of their product—often representing 60 percent or even more of the price which they receive for the product. Furthermore, copper is subject to wide fluctuations in price. During 1937, for example, copper rose from 12 cents at the beginning of the year to 17 cents, then declined again to 10⅛ cents at the end of the year. The reflection of this market fluctuation in the manufacturer's taxable income for that year might either double his actual profits for tax purposes, or result in a loss for the year, depending solely upon which his fiscal year ended. Certainly uniform and equitable taxation cannot be predicated on such an unreal base.

The taxation of fictitious incomes cannot be justified by the allowance of fictitious losses. The taxation of profits based on assumed

transactions which do not occur in periods of rising prices and expanding business forces a taxpayer, at the time when his working capital is most fully employed and most urgently required, to provide money for tax payments at effective rates double, triple, or quadruple those nominally in force. No matter how much benefit he may receive later in periods of declining prices and declining business, when through contraction of operations his needs for working capital are less and his position more liquid, he will still have no relief from his present compulsion to obtain by any means and under any terms money to pay the taxes then assessed on income assumed to have been realized. Over a period of years total income will be the same under any method of accounting consistently applied, and if taxed at a flat rate the aggregate tax will be the same.

What the members of the Copper and Brass Mill Products Association want is an amendment in section 22 (c) which will permit them to determine the cost of current sales by using the cost of the metal which they buy currently to cover such sales. This is the system which I have described as "last in, first out"—that is, metal which is sold is deemed to be the last acquired instead of the first acquired, as the Treasury Regulations now provide. This method corresponds with the mills' actual practice in conducting their business and is the method which many of them now use for their corporate accounts, although they are not allowed to use it for tax purposes. It determines all of the profit which they have actually realized, but it does not tax them upon profits or allow them losses which have not occurred as the present method does.

There can be no doubt that the last-in, first-out method is an approved accounting practice, Statements filed on this basis have been accepted by the Securities and Exchange Commission and the special committee on inventories of the American Institute of Accountants approved this method in a report dated May 7, 1936. In A Statement of Accounting Principles prepared by Professor Sanders, of the Harvard School of Business; Professor Hatfield, of the University of California; and Professor Moore, of the Yale University School of Law, the authors expressed their approval of last in, first out or similar methods. This study was prepared under the auspices of the Haskins & Sells Foundation, an organization formed for research into accounting matters, and was published by the American Institute of Accountants.

I have here letters from members of nine of the most prominent accounting firms in the United States approving the use of this method.

The members of the association which I represent do not ask for any special consideration, they do not wish any preferential treatment; they merely ask to be placed on a par with other industries which are permitted to determine taxable income on the basis of accounting methods recognized as correctly determining income in the industries in which they operate. No one inventory method is suitable for all industries, and the members of the Copper and Brass Mill Products Association merely ask that they be permitted to pay income and profits taxes on income actually realized rather than on the basis of a method which is not applicable to their particular industry, which shows profits in periods of rising prices which are not and can never be realized and which show losses in periods of falling prices which are equally fictitious.

The copper and brass mill products industry is being subjected to discriminatory treatment by the United States Treasury Department because other manufacturing industries are permitted to use their recognized accounting methods to determine taxable income and are taxed on income which is admittedly realized or realizable while the copper and brass mill products industry is taxed on unrealized and unrealizable income determined by methods not recognized by the industry.

Other industries are permitted to determine income and inventories by methods substantially similar in purpose and effect to the method the use of which is denied to the copper and brass mill products industry.

Industries dealing in a product such as cotton textiles or flour, where the conditions are similar to those in the industries described above, apply "hedging" transactions to their inventories and are thus able to get for themselves the same sort of results as the industries under discussion obtain by the use of the "last-in, first-out" method. The cotton and flour milling industries are permitted to use their "hedging" methods for tax purposes. The leather, nonferrous metal and other industries are not permitted to use an accounting method producing the same results. The entirely fortuitous circumstances of the existence or absence of an effective futures market is thus made the basis of discrimination between various taxpayers similarly situated. (See general counsel's memorandum 17,322.)

The high rates of tax which are generally considered to be inevitable for many years in the future magnify the importance of using accounting methods which reflect only such income as can actually be dispersed in taxes. A nominal tax rate of 5 percent, which by the inclusion of fictitious income becomes an actual rate of 10 percent, is unfair but will not ruin an industry. A nominal rate, however, of 20 to 30 percent levied on the fictitious income may easily become an actual rate of 40, 60, 80, or 100 percent on realized income. The members of this association do not wish to pay an effective rate of 3 or 4 times that of most industries and I cannot believe that it is the intention of Congress that they should do so.

I ask, therefore, that the section of the proposed act which deals with inventories should be so worded as to make it possible for the members of this industry to determine their taxable income on a basis which is generally accepted as that which shows as nearly as possible the actual results of operations and the actual realized income. They ask relief from the arbitrary imposition on their industry of a method which is clearly unsuited to it and which shows results which are demonstrably at variance with the facts.

To accomplish this I suggest the addition of the following language to section 22 (c) of the revenue act now under consideration:

"Goods remaining in inventory which have been so intermingled that they cannot be identified with specific invoices may be deemed to be the goods first purchased or produced during the period in which the quantity of goods in the inventory has been acquired and the cost of goods most recently sold may be deemed to be the cost of those most recently purchased or produced, if in conformity with the taxpayer's method of keeping his books or records and with the best accounting practice in the trade or business."

The CHAIRMAN. You say it is a question then of regulation by the Department?

Mr. PELOUBET. I think not, because the Department has refused to recognize an accepted method.

The CHAIRMAN. I understood that the Treasury Department, in 1936, had stated that they had the power to effect it by rules and regulations.

Mr. PELOUBET. They now say no.

The CHAIRMAN. Is that the only question you discussed in your brief?

Mr. PELOUBET. That is the only question.

The CHAIRMAN. When was the last time you had a conference with the Treasury officials?

Mr. PELOUBET. A few days ago, with no results whatever.

The CHAIRMAN. With whom did you talk?

Mr. PELOUBET. That was not a conference at which I attended personally, but I understand they spoke with Mr. Kent and with some of the other officials working under him.

The CHAIRMAN. You did not get very far?

Mr. PELOUBET. We got nowhere, I think there is no question about that.

The CHAIRMAN. I might say to you that this is not a new question. I remember it was presented in 1936.

Mr. PELOUBET. Yes.

The CHAIRMAN. The committee will inquire into it very definitely and will take your brief in connection with it. I was going to suggest, if you had not talked to these experts it might be well to bring it up to date, because we have some experts at one time and at another time we have different experts. They change them at times.

Mr. PELOUBET. We haven't gotten very far with them.

There is one thing that I might bring out. Of course we are not asking for privileges, we are not asking for anything exceptional, and there is nothing in this method which will reduce revenue over a period. As a matter of fact, in the year 1937 the revenue would have been increased if we had been permitted to use this method, for the year 1937 there would have been more taxable income in a number of industries than there are. Of course that will always happen in a period of declining prices. It works both ways. Our people are perfectly willing to take the consequences either way. The only thing is we do not want to pay taxes 2 or 3 years before we make any profits just because we must write up inventories which we cannot sell.

The CHAIRMAN. I will ask the representative of the Treasury to bring those matters to their attention.

(The memorandum heretofore referred to is as follows:)

BRIEF OF MAURICE E. PELOUBET ON BEHALF OF COPPER AND BRASS MILL PRODUCTS ASSOCIATION

The members of the copper and brass mill products industry desire to be permitted to use the last-in, first-out, or replacement method of costing inventories for purposes of computing taxable income for Federal income and excess-profit taxes. These methods are already in use by representative members of the industry for corporate purposes and it is desired to compute taxable income on this basis because it conforms more nearly to the basis on which business is actually done.

The members of the Copper and Brass Mill Products Association, which includes practically all the makers of what are known as copper and brass mill

products, that is, copper and brass sheets, tubes, rods, and extruded shapes, and similar and related products, carry on their business in very much the same way. By far the larger part of their business is made up of sales of substantial quantity and amount to other manufacturers who in turn produce the goods which go into direct consumption or to jobbers and distributors whose business it is to deal with the small user of the products of the various mills. There is, of course, a comparatively small volume of business which might be almost considered "retail," sales to small manufacturers, to individuals living in a territory not served by a distributor and the like, but the amount of such business in most mills is relatively unimportant. The first two classes of business with other manufacturers and distributors is done by means of contracts calling for delivery of substantial amounts of material over an extended period of time. Contracts calling for delivery within 60 to 90 days are probably the most frequent although it is not unusual for them to extend further.

The purchaser who is in all probability already committeed to his own customer for the price and amount of material to be furnished must know the price he will need to pay for his sheets, tubes, rods, or whatever products he requires and, therefore, enters into a contract not only to take delivery of a specified amount of material but to take delivery at a fixed price. In determining this price the copper or brass mill takes two factors into consideration: First, what the mill should charge the customer for the fabrication of the product which he ordered, and, second, what should be charged for the metallic content of the material. The first charge is determined by the usual competitive considerations, the mills' own cost and what others are charging for a similar service. This charge, which is generally known as the manufacturing or fabricating differential, does not change frequently but responds somewhat slowly to changes in wage rates and other factors affecting manufacturing cost. That part of the price representing metallic content, however, is determined promptly and definitely and without reference to any competitive considerations or to any profit or loss to be made by the sale of the metal to the customer.

The prices of copper, zinc, lead, nickel, and other metals used in the production of copper and brass mill products are quoted daily and publicly. The metal producer, the management of the copper and brass mill, and the purchaser of the mill's product all have available to them at the same time the same information on metal prices. The mill's customer, therefore, if he orders today a product which will require, say, 1,000,000 pounds of copper and 400,000 pounds of zinc will receive a contract stating that the mill will deliver to him 1,400,000 pounds of product as specified by the customer within the agreed time at a price determined by the metal prices of the day on which the order was taken and plus the fabricating differential which was in effect on that day.

Long experience has taught the members of the copper and brass mill products industry that it is more profitable for them in the long run to confine themselves to fabrication and to make their profits on the difference between the manufacturing cost and the fabricating differential charged to the customer. The fabricators, therefore, wish to avoid any possibility of loss to themselves by reason of fluctuations in metal prices and are willing to forego any possibilities of profit from this same cause. Obviously, if an order is taken today and a contract made at today's metal prices for delivery 2, 3, or more months in the future, a speculative risk would be taken by the fabricator if he failed to make certain that he would have metal available to him at the same price as that on which the order was placed at the time it was necessary to fill the order. There is, of course, but one general method of bringing this about, that is, to make a forward purchase commitment for the same amount of metal as will be required to cover his forward sales commitment and at the same price. This is the general custom of the industry and as soon as a fabricator receives an order he "covers" this by making a purchase commitment for the metal required. Obviously, every small order for a few thousand or even a few hundred thousand pounds is not covered individually but it is generally the custom to calculate the amount of metal required to fill the orders of any one day and to make purchase commitments to cover immediately.

The comparatively small amount of business which is done on what might be called a "spot" basis can generally be estimated and provided for with a considerable degree of accuracy.

Most mills have agreements with customers to buy back scrap from their own product and it is possible for those experienced in the business to estimate the amount of scrap which will be received from customers with a considerable degree of accuracy and this intake of metal is considered when de-

ciding on the amount of purchase commitments for raw metal. On the whole, it may be said that it is the constant and generally successful endeavor of the management of a copper and brass mill to protect themselves against any fluctuation in the price of the metal included in their sales and that they accomplish this by means of covering purchase commitments made with individual metal producers.

Obviously, this method, while always working towards the norm of exact coverage, will inevitably result in some lack of balance between purchase and sales commitments caused perhaps by the failure of a customer to carry out a contract, by a change in specifications, or by some condition in the metal market over which the fabricator has no control.

When metal prices change the price lists of the fabricators change at the same time and in the same proportion and it is only a matter of hours after a change in the metal price before changes in the prices of copper and brass mill products are notified to the trade.

It is obvious that the method of doing business adopted by the industry, which is designed to eliminate so far as possible profits or losses on metals, puts the fabricator, so far as metals are concerned, practically in the position of a buying agent for his customer.

If the fabrication of copper and brass mill products were a simple process completed within a relatively short period of time, the method of applying costs to sales and consequently of determining income and inventories would be of little importance and almost any recognized method consistently applied would produce a substantially correct income account. This, however, is not the case. The process of manufacture in a copper or brass mill is long and complicated and in many of the processes time is an important element. The conversion, for instance, of an ingot of raw copper and a slab of raw zinc into a brass tube where the alloy must be exact and uniform, the metal of a specified hardness, and the thickness of the walls and the inside and outside diameter accurate within a very small limit of tolerance, is a long and involved technical process and cannot be successfully completed within a short period of time. In general, the turn-over in a copper and brass mill is slow, three to four times a year being representative.

Many of the operating processes are continuous and in almost every operation it is desirable to have some material constantly in the department or in process. Every manager of a copper and brass mill knows it is expensive to carry inventories, and it may reasonably be assumed that inventories are generally maintained at the lowest practicable point and that the turn-over in the industry is as rapid as is consistent with satisfactory operations.

The practical requirement that a minimum inventory be maintained in the mill makes it necessary that each sale should be covered by a forward purchase rather than applied to stock in works already on hand. The management know that if any order were considered to be covered by stock in works, a substantially equivalent amount of metal would need to be purchased when delivery to the customer was made, and this might easily be at a higher price than the metal prices on which the sales contract was based. In a copper and brass mill the management do not consider that they may apply current sales to stock in works, but they know that they must purchase to cover their sales commitments. For this reason it is the custom in the industry to calculate income by applying current purchases to current sales without changing the metal prices applied to stock in works. This is the method known as last-in, first-out, under which it is assumed that the latest purchases are those first consumed rather than as is the case in other industries, assuming that the first purchases are the first consumed.

Obviously, the amount of stock in works required for successful operation will vary from time to time. If during a period of rising prices stock in works is increased, that is, if metal is bought for which there are no corresponding sales, such metals should be carried in the inventory at its cost. If, in a period of declining production which will, in all probability, be a period of declining prices this metal is sold, it should be applied against sales not otherwise covered. By this method the necessary flexibility of the amount of inventory required at different volumes of operation will be automatically maintained and the income of the fabricator will be affected by the liquidation of his inventory at the time this actually takes place. This is the principal difference between the "normal stock" method and the last-in, first-out method. While the results obtained by the use of a normal stock, if this method is properly applied, will frequently closely approximate the results obtained under the

last-in, first-out method, the normal stock method is, nevertheless, based on the arbitrary assumption that one unchanging normal quantity at one unchanging price exists. This can hardly be exactly true in any case and in most cases it is demonstrably incorrect. This element of rigidity and arbitrary assumption is probably the reason why the courts and the Treasury Department have not looked on the normal-stock method with favor. The last-in, first-out method has been devised to eliminate the arbitrary features of the normal-stock method and to retain at the same time those features of the normal-stock method which are based on correct theory and which corresponds to actual business practices and operations.

If a fabricator must keep in process at all times 1,000,000 pounds of copper he must maintain this amount in order to operate his business.

Accordingly, on January 1, 1937, he has on hand 1,000,000 pounds (cost 10 cents per pound).

During the year he sells 4,000,000 pounds (selling price 15 cents per pound).

In the course of the year he purchases, as he sells, 4,000,000 pounds (cost 15 cents per pound).

He has left at the end of the year 1,000,000 pounds (cost ?).

The Treasury Department's position is that he has sold 1,000,000 pounds on hand at the first of the year costing him 10 cents and 3,000,000 out of the 4,000,000 pounds purchased during the year at 15 cents; that he has, therefore, realized a profit of 5 cents a pound on the 1,000,000 pounds, but the fabricator started out with 1,000,000 and ended with 1,000,000 pounds of the identical material. He has not bargained for a profit on the commodity; his whole course of business was to avoid it. The so-called profit cannot be realized unless the 1,000,000 pounds of copper are sold at 15 cents but in order to operate his plant the fabricator must immediately replace his 1,000,000 pounds of copper at 15 cents and his profit is back in copper again. Yet this is the profit from which he must pay taxes at high rates or which he must distribute in dividends.

The question mark under the cost of the last million pounds presents the issue. Does he have on hand a new million pounds of copper at 15 cents (having realized a profit of 5 cents on the first 1,000,000 pounds) or, does he really have on hand nothing but what he originally started out with—1,000,000 pounds of copper at 10 cents? This is really the heart of the question. The more detailed examples serve to illustrate this in different situations and to varying degrees but the principle remains the same in every instance.

The following table shows the results in periods of stable rising and falling prices of the application of the first-in, first-out method to the operations of a hypothetical mill which handles, for simplicity, copper only. It is assumed that the mill has a capacity of 500,000 pounds per month and carries an inventory equal to 2 months' production. Inventory prices on the first-in, first-out method are taken at the average of the last 2 months of operation.

STABLE MARKET—CONDITIONS SUBSTANTIALLY THOSE OF YEAR ENDED DEC 31, 1935

First-in, first-out	Pounds	Cents per pound	Amount
Sales:			
Metal	6,000,000	8.8	$526,875
Fabricating differential		4.0	240,000
Total sales value	6,000,000	12.8	766,875
Cost of sales:			
Metal cost:			
Inventory beginning	1,000,000	9.0	90,000
Purchases	6,000,000	8.8	526,875
Total	7,000,000		616,875
Less inventory end	1,000,000	9⅛	91,250
Cost of metal sold	6,000,000	8.8	525,625
Manufacturing cost		3.0	180,000
Total cost of sales	6,000,000	11.8	705,625
Profit			61,250

RISING MARKET—CONDITIONS SUBSTANTIALLY THOSE OF YEAR ENDED MAR. 31, 1937

First-in, first-out	Pounds	Cents per pound	Amount
Sales:			
Metal	6,000,000	11.1	$665,620
Fabricating differential		4.0	240,005
Total sales value	6,000,000	15.1	905,625
Cost of sales:			
Metal cost:			
Inventory beginning	1,000,000	9¼	92,500
Purchases	6,000,000	11.1	665,625
Total	7,000,000		758,125
Less inventory end	1,000,000	14½	145,000
Cost of metal sold	6,000,000	10.2	613,125
Manufacturing cost		3.0	180,000
Total cost of sales	6,000,000	13.2	793,125
Profit			112,500

FALLING MARKET—CONDITIONS SUBSTANTIALLY THOSE OF YEAR ENDED DEC. 31, 1937 BUT WITH LOWER CLOSING PRICE

	Pounds	Cents per pound	Amount
Sales:			
Metal	6,000,000	13.0	$780,000
Fabricating differential		4.0	240,000
Total sales value	6,000,000	17.0	1,020,000
Cost of sales:			
Metal cost:			
Inventory beginning	1,000,000	10⅞	108,750
Purchases	6,000,000	13.0	780,000
Total	7,000,000		888,750
Less inventory end	1,000,000	9.0	90,000
Cost of metal sold	6,000,000	13.3	798,750
Manufacturing cost		3.0	180,000
Total cost of sales	6,000,000	16.3	978,750
Profit			41,250

In each case the 6,000,000 pounds of metal included in sales and the 6,000,000 pounds of purchases were made at the same price. The profit is, therefore, composed of two elements—$60,000 being 1-cent-per-pound profit on 6,000,000 pounds of production and the difference in the value of inventories as calculated on the first-in, first-out basis, although the nature and amount of the inventory was the same at all times.

Under the last-in, first-out method, the profit would amount to $60,000 in each of the three periods, as shown below:

STABLE MARKET—CONDITIONS SUBSTANTIALLY THOSE OF YEAR ENDED DEC. 31 1935

Last-in, first-out	Pounds	Cents per pound	Amount
Sales:			
Metal	6,000,000	8.8	$526,875
Fabricating differential		4.0	240,000
Total sales value	6,000,000	12.8	766,875
Cost of sales:			
Metal cost:			
Inventory beginning	1,000,000	9.0	90,000
Purchases	6,000,000	8.8	526,875
Total	7,000,000		616,875
Less inventory end	1,000,000	9.0	90,000
Cost of metal sold	6,000,000	8.8	526,875
Manufacturing cost		3.0	180,000
Total cost of sales	6,000,0000	11.8	706,875
Profit			60,000

RISING MARKET—CONDITIONS SUBSTANTIALLY THOSE OF YEAR ENDED MAR. 31, 1937

Last-in, first-out	Pounds	Cents per pound	Amount
Sales:			
Metal	6,000,000	11.1	$665,625
Fabricating differential		4.0	240,000
Total sales value	6,000,000	15.1	905,625
Cost of sales:			
Metal cost:			
Inventory beginning	1,000,000	9.0	90,000
Purchases	6,000,000	11.1	665,625
	7,000,000		755,625
Less inventory end	1,000,000	9.0	90,000
Cost of metal sold	6,000,000	11.1	665,625
Manufacturing cost		3.0	180,000
Total cost of sales	6,000,000	14.1	845,625
Profit			60,000

FALLING MARKET—CONDITIONS SUBSTANTIALLY THOSE OF YEAR ENDED DEC 31, 1937, BUT WITH LOWER CLOSING PRICE

	Pounds	Cents per pound	Amount
Sales:			
Metal	6,000,000	13	$780,000
Fabricating differential		4	240,000
Total sales value	6,000,000	17	1,020,000
Cost of sales:			
Metal cost:			
Inventory beginning	1,000,000	9	90,000
Purchases	6,000,000	13	780,000
Total	7,000,000		870,000
Less inventory end	1,000,000	9	90,000
Cost of metal sold	6,000,000	13	780,000
Manufacturing cost		3	180,000
Total cost of sales	6,000,000	16	960,000
Profit			60,000

If the fabricator acts as the buying agent for his customer and not as a dealer in metal it should make no difference by whom the metal is bought. It is not uncommon for the larger customers of some copper and brass mills to buy their own metal and to ship this to the fabricator, paying the fabricator only his manufacturing differential. If the assumption that the fabricator is merely the buying agent is correct, and the general universal practice of the trade bears this out, then the results of a correct method of accounting where the fabricator buys the metal should be the same as the results where the customer buys the metal.

The following table is given for illustration only, as it is highly improbable that any mill would operate entirely on customers' copper:

	Pounds	Cents per pound	Amount
Sales:			
Metal belonging to customers	6,000,000		
Fabricating differential		4	$240,000
Cost of sales:			
Inventory beginning	1,000,000		
Receipts	6,000,000		
Total	7,000,000		
Less inventory end	1,000,000		
Total	6,000,000		
Manufacturig cost		3	180,000
Total cost of sales			180,000
Profit			60,000

The profits under the last-in, first-out method and the profit which would result if all metal belonged to customers are the same. These profits also represent the only profits which would be realized in cash as the remainder of the so-called profit on the first-in, first-out basis is represented entirely by changes in the valuation of inventories.

GENERAL USE AND RECOGNITION OF LAST-IN, FIRST-OUT METHOD IN THE INDUSTRY

The following members of the Copper and Brass Mill Products Association have stated through the medium of published accounts that the last-in, first-out is used by them for determining their corporate income: The American Brass Co.; Bridgeport Brass Co.; Phelps Dodge Corporation; Revere Copper & Brass, Inc.; Scovill Manufacturing Co.

A number of other members who keep statistical records on substantially this basis have stated that they would use the method in their financial books if it should be allowed for tax purposes, their reason for not using it at present in their financial books being that it was not permitted for tax purposes.

The method is recognized by the Securities and Exchange Commission, educators, and leading practicing accountants as a correct method of determining income for industries situated as is the copper and brass industry. To establish the recognition of the method by accounting authorities there is submitted:

(*a*) Opinions of: Paul K. Night, of Arthur Anderson & Co.; Deloitte, Plender, Griffiths & Co.; Edward A. Kracke, of Haskins & Sells; Dr. Joseph J. Klein, of Klein, Hinds & Fink; Walter A. Staub, of Lybrand, Ross Bros. & Montgomery; Samuel J. Broad, of Peat, Marwick, Mitchell & Co.; Rodney F. Starkey, of Price, Waterhouse & Co.; C. Oliver Wellington, of Scovell, Wellington & Co.; Victor H. Stempf.

(*b*) Excerpts from: A Statement of Accounting Principles, prepared by Thomas Henry Sanders, Harvard University Graduate School of Business Administration; Henry Rand Hatfield, University of California; Underhill Moore, Yale University School of Law; referring, on pages 15, 43, 73, and 74 to last-in, first-out, or similar methods with approval.

(*c*) Resolutions of committee on Federal taxation of the New York State Society of Certified Public Accountants.

(*d*) Data on last-in, first-out, and similar inventory methods: Corporations using last-in, first-out, or similar methods in corporate accounts; bibliography on last-in, first-out, or similar inventory methods; list of trade and other associations approving last-in, first-out, or similar methods.

LAST-IN, FIRST-OUT IS A METHOD OF DETERMINING COST

"Last-in, first-out" or "replacement" method of costing sales is merely one of several methods commonly used to determine cost for the purpose of arriving at taxable or corporate income and is, therefore, a permissible method, subject to the same regulations as any other method of arriving at cost in situations to which the various methods are adapted.

DISCRIMINATORY TREATMENT OF THE COPPER AND BRASS MILL PRODUCTS INDUSTRY

The copper and brass mill products industry is being subjected to discriminatory treatment by the United States Treasury Department because:

(*a*) Other manufacturing industries are permitted to use their recognized accounting methods to determine taxable income and are taxed on income which is admittedly realized or realizable while the copper and brass mill products industry is taxed on unrealized and unrealizable income determined by methods not recognized by the industry, and

(*b*) Other industries are permitted to determine income and inventories by methods substantially similar in purpose and effect to the method the use of which is denied to the copper and brass mill products industry. Industries dealing in a product such as cotton textiles or flour, where the conditions are similar to those in the industries described above, apply "hedging" transactions to their inventories and are thus able to get for themselves the same sort of results as the industries under discussion obtain by the use of the "last-in, first-out" method. The cotton and flour milling industries are permitted to use their "hedging" methods for tax purposes. The leather, nonferrous metal, and other industries are not permitted to use an accounting method producing the same results. The entirely fortuitous circumstances of the existence or

absence of an effective futures market is thus made the basis of discrimination between various taxpayers similarly situated. (See General Counsel's Memorandum 17822.)

To accomplish this, I suggest the addition of the following language to section 22 (c) of the revenue bill under consideration:

"Goods remaining in inventory which have been so intermingled that they cannot be identified with specific invoices may be deemed to be the goods first purchased or produced during the period in which the quantity of goods in the inventory has been acquired and the cost of goods most recently sold may be deemed to be the cost of those most recently purchased or produced, if in conformity with the taxpayer's method of keeping his books or records and with the best accounting practice in the trade or business."

[Letterhead of Arthur Andersen & Co.]

NEW YORK, *February 25, 1938.*

Mr. MAURICE E. PELOUBET,
Pogson, Peloubet & Co., New York, N. Y.

DEAR MR. PELOUBET: As representative of the Copper and Brass Mill Products Association, you have asked my opinion of the propriety of the use in the industry represented by that association of the last-in, first-out, or replacement method of costing sales and determining inventories, and you have particularly asked whether this method may be considered to be in accordance with present standards of good accounting practice.

The last-in, first-out, or replacement method of costing sales and determining inventories is appropriate in those industries which meet the following main requirements:

1. The investment in inventories is large relative to other assets.
2. The inventory consists of a few basic materials which form a substantial part of the cost of the product sold.
3. The spread between raw material prices and finished goods prices is relatively constant.
4. The turn-over is slow because of the length of the processing.

The fabrication of copper and brass appears to be an industry which meets these requirements. The last-in, first-out, or replacement method of costing sales and determining inventories is therefore applicable to this industry. It is my opinion that this method is in accordance with good accounting practice for this industry and for any other industries which have similar characteristics.

A number of important industrial companies are now using this method and have used this or similar methods for many years. Accounting authorities, both educators and practicing accountants, have, by the written or spoken word, advocated the use of this method in those industries to which it applies, and accounts prepared on this basis have been accepted by the Securities and Exchange Commission.

I see no reason why the United States Treasury Department or any other department or commission concerned should hesitate to recognize the last-in, first-out or replacement method as good accounting practice and as a method which is acceptable, both for corporate purposes and for determining taxable income. in certain industries.

Very truly yours,

PAUL K. KNIGHT.

[Letterhead of Deloitte, Plender, Griffiths & Co., United States, Canada, Cuba, Mexico, South America, Great Britain, Continental Europe, and South Africa]

NEW YORK, *March 2, 1938.*

Mr. MAURICE E. PELOUBET,
Pogson, Peloubet & Co.,
New York, N. Y.

DEAR SIR: As a representative of the Copper and Brass Mill Products Association, you have asked our opinion of the propriety of the use in the industry represented by that association of the last-in, first out or replacement method of costing sales and determining inventories and you have particularly asked whether this method may be considered to be in accordance with present standards of good accounting practice.

In our opinion the last-in, first-out method of costing sales and determining inventories is an accepted principle of accounting and could appropriately be followed, in preference to other methods, in any business where raw material forms a major part of the cost of the finished product, where minimum inventories must be maintained and where the inventory is slow. We have had no experience of the application of the last-in, first-out method to the copper and brass mill industry but the use of that method has been advocated for the oil industry by the American Petroleum Institute.

We see no reason why the United States Treasury Department or any other Department or Commission should not be prepared to recognize the use of the last-in, first-out method as being good accounting practice and as being particularly appropriate in the case of any business which has the characteristics mentioned in the preceding paragraph.

Yours very truly,

DELOITTE PLENDER GRIFFITHS & CO.

[Letterhead of Haskins & Sells, certified public accountants]

NEW YORK, *March 3, 1938.*

Mr. MAURICE E. PELOUBET,
Care Messrs. Pogson, Peloubet & Co.,
25 Broadway, New York.

DEAR SIR: With regard to the allegation that the last-in, first-out basis of inventory valuation did not conform to good accounting practice, may I refer to the conclusion reached by the special committee on inventories of the American Institute of Accountants in its report to the council of the Institute, dated May 7, 1936, in which the committee gave its unanimous opinion as follows:

Our committee, after careful consideration of the matter, has found itself in agreement in arriving at the following conclusion:

"The last-in, first-out method for the valuation of oil company inventories, as recommended by the American Petroleum Institute, constitutes an acceptable accounting principle for those companies, which, finding it adaptable to their needs and views as correctly reflecting their income, apply it consistently from year to year; it is important, however, that full and clear disclosure, in their published financial statements, be made by the companies adopting it, both as to the fact of its adoption and the manner of its application, including information as to the period adopted for the unit of time within which the goods last in are deemed to be the first out, that is, whether the fiscal year or a shorter or longer period."

The above excerpt is, of course, a summarization of the committee's findings which that report set forth in the remainder of the report in extended form.

Sincerely yours,

E. A. KRACKE.

[Letterhead of Klein, Hinds & Finke, certified public accountants]

NEW YORK, *March 2, 1938.*

MAURICE PELOUBET, Esq.,
25 Broadway, New York, N. Y.

MY DEAR PELOUBET: I am glad to respond to your recent invitation to express my personal views regarding inventorying on the basis known as last-in, first-out. Under date of February 3, 1938, the chairman of the committee on Federal taxation of the New York State Society of Certified Public Accountants, I addressed a communication to the Honorable Roswell Magill, Under Secretary of the Treasury, with reference to the same subject.

The experience of professional accountants has demonstrated that no single inventorying method serves the purpose of all types of industries. The method with respect to which you wish my opinion is in quite general use and has justified itself in connection with enterprises (1) which must maintain a constant minimum or base inventory, (2) which customarily make purchases of raw materials to fill specific orders, (3) in which the cost of the raw material constitutes the predominant element in the value of the finished product, and (4) in which the chief income is represented by the charge for

processing. In the situations under discussion, considerable periods of time frequently elapse between the taking of the order and the delivery of the finished product.

In the determination of costs of operations for the types of business which I have in mind, it has been found that most dependable results are achieved when it is assumed that the cost of the raw-material ingredient of the finished product is represented by most recent purchases. In other words, in the determination of costs, it is assumed that the most recently acquired merchandise is first consumed; hence the designation of the formula as last-in, first-out.

In practice the accountant associates the concept of cost, not only with reference to income from operations, but likewise with respect to the effect on the balance sheet. If it is assumed that raw materials are exhausted in the inverse order of their acquisition, it follows that the cost of the inventory on hand is predicated on the earliest costs. Where the base stock fluctuates little in physical quantity, the balance-sheet value of the inventory may be based on prices of many years earlier. Regardless of which inventorying method is employed, the balance-sheet valuation should in general reflect the lower of cost or market value. It follows, therefore, that, regardless of which inventorying method is employed, the inventory should not be shown in an amount in excess of the lower of cost or market value. Thus, unless the base inventory is priced as of a time when the market was low, the results from the application of the last-in, first-out method may have to be modified so as to reduce the value of the end-of-the-period inventory to the currently lower market. If this precaution is observed, it would seem to me that neither management nor Government officials should object to the use of the last-in, first-out method by industries of the type herein referred to.

Very truly yours,

JOSEPH J. KLEIN.

[Letterhead of Lybrand, Ross Bros. & Montgomery, certified public accountants]

NEW YORK, *March 8, 1938.*

Mr. MAURICE E. PELOUBET,
25 Broadway, New York, N. Y.

DEAR MR. PELOUBET: At your request I am submitting herein my opinion as to the propriety of the use of the so-called last-in, first-out method of costing sales and determining inventory valuations and whether this method may be considered to be in accordance with present standards of good accounting practice.

I can perhaps most readily express my views on the general principle involved and the reasons for preferring the last-in, first-out method by quoting from my article written in the latter part of 1934, which was based on talks on the subject of Adjustment of the Balance Sheet to Present-Day Business Conditions, given at meetings of the Washington and Rockford chapters of the National Association of Cost Accountants in December 1933 and October 1934.

I append hereto a copy of that portion of the article which dealt with the subject of inventories and the costing of sales. The L. R. B. and M. Journal, in which the article appeared, is published primarily for distribution among the members of the organization at our different offices.

I first became interested in the subject almost 20 years ago when the tremendous rise in commodity prices occurred during the World War. I questioned the reality of profits which were then being shown as the result of the sales of products at greatly enhanced prices being compared with the lowest costs of materials or finished product included in the stock on hand. Unfortunately, however, there was not sufficiently general recognition at that time of the fallacy of costing sales and showing profits by the first-in, first-out method, which was suitable enough for ordinary circumstances but not, in my opinion, nearly as sound as last-in, first-out in times of wide fluctuation in prices. Also, the optimism of war times indulged in the hope that post-war reconstruction and similar influences would maintain and continue permanently the price level attained during the war.

The tremendous fall in prices in 1920 led to some recognition of the weakness of the first-in, first-out method, but, again unfortunately, the Treasury in its regulations regarding inventories adhered to the old method which had been evolved under comparatively stable conditions of pre-war times. These Treasury regulations for the administration of the 1918 Revenue Act (which was not actually passed until February 1919), and their substantial continuance under succeeding acts, had, I think, much to do with the slow recognition of the superiority of the last-in, first-out method, as businessmen were naturally

reluctant to keep their books on a different basis than that which they were required by the Treasury regulations to use for reporting profits or losses for income-tax purposes.

The rapid rise in commodity prices during the later twenties and the cataclysmic drop in prices during the depression, which completed a cycle similar to that of the war period and the post-war years of 1919-20, caused more serious consideration to be given to the subject than ever before. As you know, about 4 years ago one of the major industries of the country asked the American Institute of Accountants to appoint a special committee to confer with an accounting committee representative of the industry in an endeavor to determine the most satisfactory method of valuing inventories and consequently of determining profits. Although the industry was, naturally, most concerned with its own immediate problems, the committee of our institute obviously had to consider the question from the broader aspect of the basic principle upon which any particular method should rest. I served on that committee for a time, and urged strongly the use of the last-in, first-out method because of the superiority which I believe it enjoys as compared with the first-in, first-out method. The report of the institute committee expressed approval of the last-in, first-out method for use in that particular industry, and in my opinion it would be just as suitable for general use in the industry represented by the Copper and Brass Mill Products Association.

A number of representative companies have for years used the last-in, first-out method or its practical equivalent, and the number of such companies is, I believe, now larger than ever before. I am of the opinion that the method is in accord with good accounting practice of the present day for the purpose of determining the cost of inventories of industrial and mercantile enterprises other than in those cases where specific articles can be readily identified as used or sold and the nature of the business is such that the cost of specific articles should be used.

Very truly yours,

WALTER A. STAUB.

EXTRACT FROM ARTICLE ENTITLED "NOTES ON THE ADJUSTMENT OF THE BALANCE SHEET TO PRESENT-DAY BUSINESS CONDITIONS"

[L. R. B. and M. Journal, November 1934]

Inventories materials, goods in process, and finished product.—In the course of time the rule of "cost or market, whichever is lower," for which the public accountant profession consistently contended in season and out of season, and at a time when many businessmen did not agree with the rule, has become generally accepted by the banker, the manufacturer, the merchant, and the taxing official.

It is a rule of conservatism and safety rather than of logic. Logically, by the same token that inventories are written down to provide against potential losses not yet actually sustained but threatened by a fall of market prices below cost, it could be argued that inventories should be written up to recognize potential profits therein not yet actually realized but promised by a rise of market prices above cost. Long experience, however, has taught that the only course of safety is that of providing against threatened losses but of not counting chickens until they are actually hatched.

The time-tested principle of "cost or market, whichever is lower," is on the whole still the best to follow. But question has from time to time been raised which cost is to be applied to the goods sold and which cost is to be applied to the goods remaining on hand. Shall it be "first in, first out, or last in, first out, or average of the beginning inventory cost plus subsequent purchase or production cost (on a weighted average basis)?

This question has been receiving renewed consideration because it is of greatest importance in periods when a radical change in the price level occurs (whether up or down) as during the depression period. When the price movement is upward, as during the World War, the use of the first-in, first-out costing of sales tends to show large profits because of selling at mounting prices goods purchased at the lower price level, although if the concern is to remain in business it must immediately replace the sold goods with others purchased at prevailing higher prices.

The effect is that the valuation of the inventory is at the highest recent cost, and the profits shown on goods sold have to a large extent not been realized

in the sense that they are available for distribution but they have had to be reinvested in large part in maintaining a stock of goods no larger in quantity than that previously carried for a much smaller investment. When the inevitable drop in the price level occurs, large losses on inventory values are shown in adjusting to "cost or market, whichever is lower." In 1920 many concerns showed inventory losses which offset to a considerable extent the large profits apparently earned during the war period. Similarly, large inventory losses due to the tremendous drop in prices during the present depression have in the case of many companies absorbed profits shown during the time that a high cost was being developed for the inventory.

The question has been raised whether, assuming a starting inventory at a low enough level so that prices would hardly drop below it excepting under catastrophic conditions, the use of the formula of "last in, first out" in costing goods sold would not result in a truer picture of actual profit. The argument can be made that there is a closer relation between the prices of goods last purchased and of the goods currently sold then between the earliest purchases of goods on hand and of the goods currently sold.

In the case of industries or concerns the inventories of which are ordinarily very large in relation to other assets—as, for example, the oil industry where large quantities of crude oil may be carried in stock continuously—the last-in, first-out method of costing sales has a tendency to minimize the extremes of profits and losses. The profits shown in periods of rising prices would tend to be less than by using the formula of "first in, first out," and correspondingly in periods of falling prices such losses as might be shown in reducing inventories to lower market prices would not be as great as would otherwise have to be taken. It is to be noted that the formula of cost or market, whichever is lower, would still govern the violation of the inventory and would correct the tendency which might develop in a period of falling prices for the inventory to remain at a higher price level than the current prices at which sales would be costed.

The last-in, first-out formula is being given study by an inventory-methods committee in one of the large industries of the country at the present time. Any method which will tend to minimize the profits shown in periods of rising prices which are not actually available for distribution, because of the need for retaining at least a material portion of such profits in the business as added working capital and thus subjecting it to a business hazard which becomes greater the higher the price level rises, is worthy of careful consideration.

If such a cost formula or method were generally adopted in an industry, it would be desirable to show as a memorandum on the balance sheet the current replacement market value for the inventory. This would assist in giving a full understanding of the situation to those extending credit to a given concern or those who wish to make an intelligent comparison of the financial position of various companies in the same industry whose inventories may be carried at differing costs. Even under the present more general use of the first-in, first-out cost formula, the supplementing of the valuation at which the inventory is carried in the balance sheet by a memorandum of the approximate replacement market value thereof would be informing.

The average cost method of carrying or valuing the inventory may be said to be intermediate between the first-in, first-out and last-in, first-out methods. It is probably less used now than was at one time the case, though it is still the method generally used in at least one of the major industries of the country.

An inventory method which has somewhat the same end in view as the last-in, first-out cost formula is the base-stock method. It has the virtue of conservatism, both from a balance-sheet point of view (assuming, of course, that the base price, which remains unchanged, is set sufficiently low at the inception of the use of the method) and from the point of view of the earnings shown during an era of rising prices.

The leading exponent of this method in this country is the National Lead Co., which has clearly explained the method in its annual reports. Another of the prominent industrials of the country, the International Harvester Co., used the method for a few years at the close of the World War period but discontinued when the United States Treasury refused to accept the method for income-tax purposes. The refusal of the taxing authorities in both the United States and Great Britain to accept the base-stock method for valuing inventories has probably discouraged a more general use of it by industrial companies.

One other point in the valuation of inventories which requires especial consideration in the depression period is that only normal overhead should be

included in inventory value, even though under present conditions with greatly reduced output the actual overhead ordinarily exceeds a normal rate of overhead.

[Letterhead of Peat, Marwick, Mitchell & Co., accountants and auditors]

NEW YORK, N. Y., *March 3, 1938.*

Mr. MAURICE E. PELOUBET,
Messrs. Pogson, Peloubet & Co.,
New York, N. Y.

DEAR SIR: I refer to your recent discussion as to the propriety of the use in certain industries of the last-in, first-out method of costing sales and determining inventories, and particularly to your inquiry as to whether, in my opinion, this method may be considered to be in accordance with present standards of good accounting practice.

The commonly used basis of stating inventories is under the formula of cost or market, whichever is lower, but within that formula variations of method of determining cost and market prevail, consistency of treatment from period to period being, of course, essential whatever method be adopted. Your inquiry is directed to that method underlying cost which is designated "last in, first out."

It is well to point out, in the first place, that before determining the preferable method of computing the cost of inventory on hand there must be careful consideration of the purchasing and selling methods, rapidity of turnover of inventory, extent of inventory normally carried, and the timing of sale-price changes in relation to changes in purchase prices of materials entering into the product sold. It is impracticable and undesirable, in a period of changing cost prices for materials, to determine the cost of goods sold by following through from purchase to sale the specfic materials entering into the product sold; thus it becomes necessary to appraise the merits of various methods, i. e. whether the goods sold may be regarded as having been produced from materials purchased first or from those purchased last, or from the group of all similar materials purchased and on hand within a specified period.

In a period of stable prices it would not make much difference which method is used, because all would produce substantially the same results. Such is not the case, however, where purchase costs have changed materially during a period. Thus the problem resolves itself into a question as to which method would most adequately reflect the results of the transactions and managerial policies and methods.

The average manufacturing or processing company usually has a certain amount of inventory on hand in different stages of production. Where prices have changed between the beginning and the end of a period, the use of either the first-in, first-out method or the average-cost method results in a change in the costs used for the terminating inventory as compared with the inventory at the opening date even though substantially the same amount of goods may be on hand. Particularly in the case of industries where the turn-over is slow because of the length of the processing time, either method would thus introduce into the accounts an element of profit or loss on the inventory which is to some extent speculative in nature and which may never be realized.

In some businesses an attempt is made to eliminate so far as possible the the speculative element by relating sales commitments to current costs of materials; thus, when goods are sold, substantially the required amounts of raw material are either purchased concurrently or future commitments therefor may be entered into, the principal purpose being to avoid speculation and to eliminate the effect of market fluctuations from the profits. In cases where such procedure exists it would seem entirely arbitrary to declare that only the first-in, first-out, or the average cost, method should apply, or to take the position that market profits or losses reflected in the inventory as a result of determining them on such a basis had actually occurred.

I believe that these considerations are the more important in the case of those industries in which raw material costs form a relatively large part of the total cost of the product, and particularly where the raw material involved is subject to substantial price fluctuations. Due to the element of timing as between the purchase of raw materials and the shipment of the corresponding sales, an assumption that the last goods in are the first goods shipped is also arbitrary to a certain extent. But it is my opinion that this assumption, under the conditions outlined above, most nearly reflects the actual operating conditions,

and that the last-in, first-out method can be considered in such cases as in accordance with sound accounting practice for costing sales and for determining inventories.

While I realize that so far this method has not been accepted by the Treasury Department for the purpose of determining taxable income, some substantial corporations have adopted it for their fiscal purposes, notwithstanding the added difficulty of a double determination of the inventory; and this very fact would seem to justify the assertion that they regard this method the preferable one from a business standpoint and the one which most accurately reflects the profits or losses which have been realized.

Yours very truly,

SAMUEL J. BROAD.

[Letterhead of Price, Waterhouse & Co.]

NEW YORK, *March 4, 1938.*

Mr. MAURICE E. PELOUBET,
Pogson, Peloubet & Co., 25 Broadway, New York, N. Y.

DEAR SIR: You have requested my opinion of the propriety and use of the last-in, first-out method of costing sales and whether, in my opinion, this method may be considered in accordance with present standards of good accounting practice.

The question of determining the cost of sales and of pricing inventory at cost, whether this cost be used in the balance sheet or compared with market in order to determine inventory at cost or market for balance-sheet purposes, is, I believe, a broader subject than a mere consideration of whether a last-in, first-out method is in accordance with present standards of good accounting practice.

In a report in 1936 on a proposal of the American Petroleum Institute to adopt the basis of last-in, first-out for the oil industry, the special committee on inventories of the American Institute of Accountants made the folowing observations in regard to valuing inventories "at cost or market, whichever is lower":

"The principle of 'cost or market, whichever is lower,' which constitutes the present-day, generally followed method of inventory valuation, is one of long standing and dates from the days when the balance sheet was accorded much nore attention as compared with the income account than is the case today, and ccounting practices naturally reflect this viewpoint. To value inventories at ost was, of course, the logical thing to do, and to take cognizance of a declining market was equally logical and conservative. The question of what constituted cost, however, in the days of simple business relations did not give rise to the involved considerations called for by present-day business complexities, and because of the much greater emphasis laid on the balance sheet of effect upon income of the diverse views which are possible in regard to cost computation did not receive much attention."

In a recent booklet published by the American Institute of Accountants, entitled "A Statement of Accounting Principles," the first-in, first-out, last-in, first-out, and average cost have all been recognized as proper methods to be used in arriving at cost in any industry for which they may be appropriate.

Fundamentally, the determination of net income for income-tax purposes should not deviate from good accounting practice, and this has been consistently recognized in the Federal income-tax statute. Section 41 specifically provides that "The net income shall be computed * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but * * * if the method employed does not clearly reflect income, the computation shall be made in accordance with such method as, in the opinion of the Commission, does clearly reflect the income."

The regulations have amplified the general provisions of the statute, and in article 22 (c) (2) two tests are provided, to which each inventory must conform: "(1) It must conform as nearly as may be to the best accounting practice in the trade or business, and (2) it must clearly reflect the income." The regulations are principally concerned with the "valuation of inventories," whereas, in my opinion, more emphasis should have been put on the determination of "cost of goods sold."

Among the various bases which may be used in computing cost of goods sold are the following:

The actual identified cost of the materials used in production (this basis is applicable in cases where the material can actually be identified).

The basis of average cost (many variations of this basis may be made as required by conditions. The period of time used for averaging has to be considered. In some cases an average cost for a period of a year may be used and again it may be necessary to average the cost of current production with the unsold quantity and cost of prior production).

The last-in, first-out basis which has been adopted by the oil industry and a number of other industries.

The first-in, first-out basis which is also being used by a number of industries.

The various methods of determining cost of sales set forth in the foregoing paragraph are, in my opinion, appropriate and good accounting practice for certain companies and industries.

Yours very truly,

RODNEY F. STARKEY.

[Letterhead of Scovell, Wellington & Co., accountants and auditors]

NEW YORK, *March 10, 1938*.

Mr. MAURICE E. PELOUBET,
Pogson, Peloubet & Co.,
25 Broadway, New York, N. Y.

DEAR MR. PELOUBET: As a representative of the Copper and Brass Mill Products Association you have asked my opinion as to whether the last-in, first-out method of costing sales and determining inventories may be considered good accounting practice for the industry represented by the Association.

The use of the last-in, first-out method for determining cost of goods sold and net earnings has always been good accounting practice, and, in my opinion, is particularly well adapted to an industry such as that you are representing, with whose usual operating conditions I am familiar. While the use of the first-in, first-out method of determining cost of goods sold is more general and is applicable to the conditions in many industries, there has been in recent years an increasing adoption of the principle of last-in, first-out in place of first-in-, first-out for those companies where the last-in, first-out method most clearly reflects income.

The purpose of accounting is to state operating facts as clearly and accurately as may be under the circumstances. For companies in the industry that you represent, a comparison of the metal content of sales with the cost of the metal most recently received in my opinion comes closest to the actual operating facts, and more clearly reflects income than under the first-in, first-out method, where the cost of materials sold is assumed to be those first purchased.

Fundamentally, the function of the companies in the industry you represent is the fabrication of raw materials into a finished product. The profits should be and generally are from fabrication, and the gain or loss on raw materials is incidental. A well-operated company endeavors to cover current sales by current purchases. Many of the companies, if there were a market available for hedging transactions as is the case with some other raw materials, would undoubtedly make hedges to eliminate any gains or losses on raw materials. Lacking such an opportunity, the use of the last-in first-out method corresponds most closely with business conditions under which sales and purchases are made, and in my opinion most clearly reflects income and is therefore good accounting practice for the industry.

Sincerely, yours,

C. OLIVER WELLINGTON.

EIGHTY MAIDEN LANE, NEW YORK, N. Y.,
February 25, 1938.

Mr. MAURICE E. PELOUBET,
New York, N. Y.

DEAR SIR: As a representative of the Copper and Brass Mill Products Association, you have asked my opinion of the propriety of the use in the industry represented by that Association of the last-in, first-out, or replacement method of costing sales and determining inventories and you have particularly asked whether this method may be considered to be in accordance with present standards of good accounting practice.

The last-in, first-out, or replacement method of costing sales and determining inventories is appropriate in those industries in which:

1. Operating processes are continuous.
2. Turn-over is slow because of the length of the processing.
3. Minimum inventories must be constantly maintained.
4. Raw material costs form the greatest or a substantial part of the total cost of the product.

In such industries it is the custom to make purchases of raw material at the same time and at the same price as the sale is made, even though delivery to the customer is to be made some little time in the future. Generally, in such industries the price of the finished product varies with that of the raw material, which is the principal constituent of the product. In such industries profit on converting or fabricating is the principal object, and any gain or loss on material is incidental and frequently the result of circumstances beyond the control of the management.

A method of determining costs and inventories, therefore, which has the effect of applying current costs to current sales, reflects the income more correctly than any other. A method such as first-in, first-out which disregards the fact that purchases are made to cover sales and attempts to apply entirely unrelated purchase and sale transactions, must of necessity distort the results of operations.

The fabrication of copper and brass appears to be an industry which possesses the characteristics outlined above, which indicates that the last-in, first-out, or replacement, method of costing sales and determining inventories in applicable to it. In my opinion, therefore, the last-in, first-out, or replacement, method of costing sales and determining inventories may be regarded as good accounting practice in that industry, being the method which most nearly reflects the correct income for any given period.

I do not need to remind you that a number of important industrial companies are now using this method and have used this or similar methods for many years. Accounting authorities, both educators and practicing accountants, have, by the written or spoken word, advocated the use of this method in those industries to which it applies, and accounts prepared on this basis have been accepted by the Securities and Exchange Commission.

In view of all this I see no reason why the United States Treasury Department or any other department or commission concerned should hesitate to recognize the last-in, first-out, or replacement, method as good accounting practice and as a method which is correct, both for corporate purposes and for determining taxable income, in the accounts of companies or industries which possess the characteristics outlined in this letter and which carry on their business in the manner described herein.

Yours very truly,

VICTOR H. STEMPF,
Certified Public Accountant, Member American Institute of Accountants.

EXCERPTS FROM "A STATEMENT OF ACCOUNTING PRINCIPLES"

Prepared by Thomas Henry Sanders, Harvard University Graduate School of Business Administration; Henry Rand Hatfield, University of California; Underhill Moore, Yale University School of Law, for the Haskins & Sells Foundation, Inc., published by American Institute of Accountants

(P. 15)

Such inventory policies as the base-stock method frankly abandon the usual basis of keeping inventories within the cost or market area. A long-time view is taken; a low point is chosen as the inventory base price; the ups and downs of current prices above that point are ignored with respect to the base inventory; most of the time the inventories stand in the balance-sheet at something much below either cost or market, and there results some equalizing of profits over periods of prosperity and depression.

(P. 43)

If the management wishes to go further and adopt a still more conservative policy with respect to inventory valuation, calculated to reduce the fluctuations in profits, that should be regarded as well within its province. The base or normal-stock method is a notable example. It is not, as some suppose, an artificial treatment of the figures; on the contrary, it takes cognizance of two

important facts: First, that a minimum inventory is a constant necessity to the operating company, and, second, that in times of prosperity the incipient conditions of depression are already present. The basic question is, What is the accounting period? A narrow adherence to the conditions and figures for the one year will exclude any notice of what may come after, while a recognition of the fact that the year is simply a chapter in the company's history may lead to adoption of sounder policies.

If the base or normal-stock method is clearly explained in the annual reports, especially as is sometimes done, with tables showing the adjustments, a reader can compute for himself the approximate effects of the policy, and can adjust inventory and profit figures if he chooses. If a company can show a strong current ratio with inventories on the base-stock method, the ratio would be still stronger if they were stated on the usual basis. In these circumstances the base-stock method seems to be within the bounds of proper accounting principles. The policy of the Bureau of Internal Revenue in disallowing this method, while it may simplify the determination of income for tax purposes, is probably not a wise public policy in the long run. The subject of inventory valuation is further discussed in part III, page 73.

(P. 73)

Accepting the rule stated above that the lower of cost or market is the primary guide, the accountant should apply this rule reasonably and consistently. If by different interpretations of the rule it is possible to arrive at substantially different results, then it is desirable to indicate the method employed and to follow that method consistently from period to period.

Accountants may properly arrive at "cost" on a basis of (a) first-in, first-out; (b) last-in, first-out; (c) average cost; or (d) base-stock method, as may be most appropriate for the industry. For raw-materials "market" usually means the buying or replacement market; as to work in process and finished goods, "market" means the cost of reproduction or replacement, unless the realization prices are lower, in which case they would govern.

Discussions as to the auditor's responsibility for inventories should not obscure the fact that those who read the statements will in fact rely upon the inventory figures there given as a representation by the company's accountants and auditors. The latter are, therefore, bound to take reasonable and appropriate steps to ascertain that the inventory is as reported; if they know of any circumstances likely to invalidate conclusions drawn from the inventory figures, they are bound to endeavor to preclude the drawing of such erroneous conclusions, either by changing the figures themselves, or by suitable qualifications.

Rules like the lower of cost or market were devised as an aid to prudent business management and for the protection of investors, and not for tax purposes. But under these rules, cases have occurred of wide fluctuations of material prices resulting in losses of one period, followed by profits of another period, in which the latter were taxable without proper offset. In these cases such valuation methods as base stock, or last-in, first-out, are intrinsically proper, as well as being proper from a business point of view.

LETTER FROM DR. JOSEPH J. KLEIN, CERTIFIED PUBLIC ACCOUNTANT, CHAIRMAN OF THE COMMITTEE ON FEDERAL TAXATION OF THE NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS, TO THE HONORABLE ROSWELL MAGILL, UNDER SECRETARY OF THE TREASURY

Hon. ROSWELL MAGILL, FEBRUARY 3, 1938.

The Under Secretary of the Treasury,
Washington, D. C.

DEAR PROFESSOR MAGILL: The committee on Federal taxation of the New York State Society of Certified Public Accountants has given considerable thought to a suggestion made by the society's committee on inventory methods relative to the inventory regulations of the Commissioner.

As you know, section 22 (c) of the Revenue Act of 1936 and the corresponding provisions of the preceding acts, provide that—

"Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income."

You also know that General Counsel's Memorandum No. 17322 (reported on p. 151 of the Cumulative Bulletin XV-2) wisely and fairly permits industries processing certain raw materials, principally wheat and cotton, to apply the results of hedging transactions, entered into for the purpose of eliminating gains or losses on raw materials, to their inventories without the application of the limitation imposed on capital gains or losses, although such limitations are applied generally to futures transactions in these commodities.

There are, as you know, other industries producing, fabricating, or processing raw materials which are not permitted by the Commissioner to apply current costs to current sales under the replacement, or last-in, first-out inventory method. The committee on inventory methods urges that the presently unrecognized method of inventorying, under ordinary conditions, has a similar effect upon the determination of income as that produced by permissive open-market hedging transactions in commodities where effective and satisfactory futures markets exist.

As practicing accountants, the members of our committee are keenly aware of the fact that during a period of rising prices the first-in, first-out method of pricing inventories, as at present required by the Commissioner, where merchandise is commingled, results in taxing business income that is in part necessarily absorbed in increased inventories and working capital. Manifestly, the injustice of taxing such increase as a part of the income is grossly aggravated under a system of graduated taxes on income and on undistributed earnings.

It seems to us that the discrimination referred to, to the extent that it exists, is unintentional, because it is unthinkable that the tax authorities should wish to impose unlike burdens on different groups of taxpayers similarly situated in all respects except with respect to the possibility of access to an adequate futures market. The change advocated by the committee on inventory methods may be most simply made in the regulations, by including among permissive methods of computing income and valuing inventories, the method known as replacement or last-in, first-out. It may be that, for administrative reasons unknown to us, the alleged discrimination directed to your and to our attention may best be remedied by amendment of the revenue act.

This matter is brought to your notice at this time so that it may be before you in the consideration of necessary and desirable changes in the revenue act. From time to time we shall feel free to write to you about other technical matters.

Very truly yours,

——— ———,

Chairman, Committee on Federal Taxation, the New York State Society of Certified Public Accountants.

Corporations using last-in, first-in, or similar methods in corporation accounts

	Auditors	Date of first use of method
American Smelting & Refining Co	Scovell, Wellington & Co	1906.
National Lead Co	Bleth & MacNaughton	1913.
Chicago Frog & Switch Co		Previous to 1916.
Continental Can Co., Inc	Deloitte, Plender, Griffiths & Co	Do.
American Can Co	Lybrand, Ross Bros. & Montgomery	1917.
International Harvester Co	Haskins & Sells	1917.
U. S. Smelting, Refining & Mining Co	Lybrand, Ross Bros. & Montgomery	1924.
Graton & Knight Co	Arthur Anderson & Co	1925.
Anaconda Copper Mining Co	Pogson, Peloubet & Co	1927.
Anaconda Wire & Cable Co	do	1929.
Cero de Pasco Copper Corporation	Lybrand, Ross Bros. & Montgomery	1929.
The American Oak Leather Co	Ernst & Ernst	1932.
American Metal Co., Ltd	Lybrand, Ross Bros. & Montgomery	1933.
Bridgeport Brass Co	R. G. Rankin & Co	1933.
Consolidated Oil Co	Arthur Young & Co	Previous to 1934.
Vulcan Detinning Co	Loomis, Suffern & Fernald	1934.
Standard Oil Co. of California	Price, Waterhouse & Co	Previous to 1935.
Phelps Dodge Corporation	Pogson, Peloubet & Co	1935.
Revere Copper & Brass, Inc	Scovell, Wellington & Co	1935.
Gulf Oil Corporation of Pennsylvania	Price, Waterhouse & Co	1935.
Swift & Co	Arthur Young & Co	Previous to 1936.
Endicott Johnson Corporation	Touche, Niven & Co	1936.
Surpass Leather Co	Price, Waterhouse & Co	1936.
Socony Vacuum Oil Co., Inc	Arthur Young & Co	1936.
St. Joseph Lead Co	Haskins & Sells	1936.
International Paper & Power Co	Arthur Anderson & Co	1937.

This list is not complete nor exhaustive and cannot be so, as it is confined to companies which issued reports to the public or which have gone on record publicly through legal action or otherwise as using last-in, first-out or similar or equivalent methods. Companies which use these methods and do not publish their accounts cannot be included in this list nor can companies which use these methods but merely refer to them in their accounts as cost. It is impossible to estimate how many companies fall into these two classes but the probabilities are that the number is substantial. It will be observed from the dates shown above that the use of last-in, first-out or similar methods appears to be growing at an accelerated rate.

BIBLIOGRAPHY ON LAST-IN, FIRST-OUT AND SIMILAR INVENTORY METHODS TEXT AND OTHER BOOKS

Proceedings, International Congress on Accounting, 1929, 100 Washington Square East, New York City, Knickerbocker Press, G. P. Putnam's Sons, N. Y.; Valuation of Normal Stocks at Fixed Prices, M. E. Peloubet, pages 565–581. With discussion thereon, pages 1172–1177. Inventory Control, Including the Valuation of Basic Stocks at Normal Prices, Jaroslav Fukatko, pages 542–564.

Excess Profits Duty and Corporation Profits Tax, Roger N. Carter, M. Com., F. C. A., published by Gee & Co., Ltd., London, 1921. Contains the White Paper presented to the House of Commons, June 1917, entitled "Heads of Government Proposals upon the Valuation of Stocks for Purposes of Excess Profits Duty."

The War Finance Acts of 1914 to 1917 by "Income Tax Expert of 'The Accountant,'" second edition published by Gee & Co., Ltd., London, 1918. Covers much the same ground as the previous reference on pages 82 to 84.

The Law and Practice of Excess Profits Duty, William Sanders of the Inland Revenue Department published by Gee & Co., Ltd., London, 1918. Also contains on pages 54 to 62 the White Paper mentioned above together with a letter from A. Lowes Dickinson and other chartered accountants.

Auditing Theory and Practice, Robert H. Montgomery, Edition 5, pages 217–18. Says "base price" method has been successful, and successful business methods should be conformed to by accounting practices. Lists six objections of U. S. Treasury Department to its use.

Principles of Auditing, Kohler and Pettengill, Third edition, McGraw-Hill Book Co., Inc., N. Y., 1932, page 81. The replacement-cost method deserves serious consideration in the future as a basis for valuing inventories.

Intermediate Accounting, Taylor and Miller, Vol. 1, McGraw Hill Book Co., Inc., N. Y., 1933, pages 117–119. On pages 117 to 119 is a good discussion of the method with particular reference to its actual use by representative corporations and a description of the methods of the International Harvester Co. and the U. S. Steel Corp'n. whose methods are similar to normal stock.

Problems in Accounting Principles, R. G. Walker, A. W. Shaw Co., Chicago, 1929, pages 365–378. Discussion of National Lead Co.'s method, etc.

Present-day Problems in Inventory Valuation, M. E. Peloubet, National Association of Cost Accountants, Year Book, 1936, pages 164 to 187. Paper delivered at annual meeting of National Association of Cost Accountants, June 1936. A discussion of the situation at the present time with particular reference to the effect on taxable income and revenue of the adoption of methods applying current costs to current sales, the use of analogous methods for other purposes by the U. S. Treasury Department and the administrative changes which would be required in the Department to give effect to permission to use methods applying current costs to current sales without loss of revenue.

MAGAZINES AND NEWSPAPERS

HARVARD BUSINESS REVIEW

October 1924, Inventory Valuation and Business Cycle, by H. T. Warshow, Comptroller, National Lead Co., New York. This is a general discussion of the subject together with a description of its particular application to the National Lead Co.'s accounts.

January 1926, pages 129–137, The Role of Paper Profits in Industry, George E. Putnam. This article does not mention normal stocks specifically but is significant as it states the problem plainly.

Autumn 1936, pages 76 to 94, The Base Stock Principles in Income Accounting, Ross G. Walker. A carefully documented statement of the principles of

base-stock inventories with particular reference to financial statements for stockholders and the effect of this method in the internal administration of a business.

JOURNAL OF ACCOUNTANCY

December 1926, Some Variations in Inventory Valuations, by T. H. Sanders. This article discusses the normal stock method as applied to three representative companies and points out that it is a method sponsored by practical business men rather than accounting or economic theorists.

July 1930, Base Stock Inventories, L. G. Peloubet. A general discussion of the method with particular relation to taxation.

December 1932, Influence of Depression on Accountancy, George O. May. A portion of the article is devoted to the comparison of various inventory methods including normal or basic stock.

December 1937, Some Observations on Accounting Practice with Special Reference to Inventory Valuation, John L. Harvey. Discusses various methods of inventory valuation. No one method suitable to all industries. Recent developments in last-in, first-out method.

January 1938, Editorial, An Unintentional Discrimination. Discusses the analogy between "hedging" and last-in, first-out, and similar methods and shows the inequity of permitting hedges to be recognized when last in, first out is not permitted.

NATIONAL ASSOCIATION OF COST ACCOUNTANTS BULLETIN

Vol. XVIII, No. 13, March 1, 1937. Problems of Present-Day Inventory Valuation, Maurice E. Peloubet, page 741. Current Practices in Inventory Valuation, E. W. Graham, page 752.

Vol. XVIX (XIX), No. 3, October 1, 1937. Inventory Valuation, The Use of Price Adjustment Accounts to Segregate Inventory Losses and Gains, Clarence B. Nickerson, page 147.

Vol. XIX, No. 7, December 1, 1937. Inventory Valuation and Business Profits: The Case for a "Stabilized" Basis, Albion R. Davis, page 377. The Case for a "Cost or Market" Basis, Homer N. Sweet, page 400.

BULLETIN OF THE TAYLOR SOCIETY AND OF THE SOCIETY OF INDUSTRIAL ENGINEERS

May 1935, Principles of Inventory Valuation, Maurice E. Peloubet. This article describes various methods of inventory valuation including normal stocks and similar methods. Gives a history of the method and examples which illustrate its application. This article was reprinted in the New York Certified Public Accountant, April 1935, and in the Canadian Chartered Accountant, June 1935, in which issue an editorial appeared on the same subject.

PAPERS NOT PUBLISHED BUT PRESENTED AT MEETINGS

The Normal Stock Method of Inventory Valuation, H. T. Wawshow, Comptroller National Lead Co. (also included in year book of National Association of Cost Accountants, 1922). This is a specific description of the application of the method to the accounts of the National Lead Co.

A Practical Inventory Method for the Tanning Industry, Maurice E. Peloubet. This is a general statement of the normal stock and similar methods and an examination into the practicability of its application to the Tanning Industry.

WALL STREET JOURNAL

Inventory Losses (unsigned), February 7, 1935. Describes advantages gained by National Lead and American Can, 1917, through use of normal stock system.

Series of articles by Arundel Cotter, March 18, 19, 25, 28, April 1, 1935:

March 18.—Uses table to show "first-in, first-out," and "normal stock" differences, with a good discussion. American Smelting & Refining Co. installed system (normal) in 1903. Anaconda Copper Mining Co. is understood to have employed normal stock system until a few years ago when it changed to a "last-in, first-out" system.

March 19—Discusses "last-in, first-out" as applied to oil industry.

March 25—Gives case of American Woolen Co. Internal Revenue position discussed.

March 28—Gives case of Swift & Co. How it now sets up inventory reserve.
April 1—Reserve. Discusses tobacco inventories. Concludes normal stock should be carefully considered.

Discussing American Institute's bulletin by Arundel Cotter, January 20, 1936. Shows how meaningless "cost" is. Uses apple dealer to illustrate "first-in, first-out" and "last-in, first-out," as well as "average cost" methods. Urges fuller information from corporations on what is meant by "cost or market."

Series (3) articles on new tax proposals by Arundel Cotter:

April 20, 1936—Shows how tax, even in times of prosperity, would eventually consume cash and inventories, through tax on inventory profits.

May 2, 1936—Likens present situation to that in which German's many nails shrank to one. Gives figures of Tanners' Council to show changes in inventory value. Says non-distribution in dividends of these book profits has saved many companies, but taxation on them would be disastrous.

May 4, 1936—Points out Revenue Bureau does not recognize normal stock or "last-in, first-out" methods. Without it, however, new tax will be ruinous to many companies.

WORLD PETROLEUM

An article on the subject of normal stocks by C. C. Bailey appeared in December 1931.

LIST OF TRADE AND OTHER ASSOCIATIONS APPROVING LAST-IN, FIRST-OUT OR SIMILAR METHODS

American Mining Congress, The.
American Petroleum Institute, The.
Copper and Brass Mill Products Association.
Lead Industries Association, The.
National Association of Credit Men.
National Electrical Manufacturers Association.
Tanners' Council of America.
Trade Association for the Rope and Cordage Industry, The.

The CHAIRMAN. Mr. Victor H. Stempf, of New York City.

STATEMENT OF VICTOR H. STEMPF, REPRESENTING THE COMMITTEE ON TAXATION, AMERICAN INSTITUTE OF ACCOUNTANTS, NEW YORK CITY

The CHAIRMAN. You appeared before the House committee, I think.

Mr. STEMPF. I did not; I filed a brief with them.

The CHAIRMAN. Mr. Stempf, you represent the committee on taxation of the American Institute of Accountants?

Mr. STEMPF. Yes. My name is Victor H. Stempf, a resident of Larchmont, N. Y. I am a certified public accountant, a partner in the firm of Touche, Niven & Co., New York, N. Y. I am appearing as chairman of the committee on Federal taxation of the American Institute of Accountants. My associates on the committee are Mr. William L. Clark, of Tulsa, Okla.; Mr. James A. Councilor, of Washington, D. C.; Mr. Clarence L. Turner, of Philadelphia, Pa.; and Mr. Leon E. Williams, of New York, N. Y.

I request the privilege of filing, on behalf of the American Institute of Accountants, a memorandum dealing with revision of the revenue laws, with special reference to the bill recently passed by the House of Representatives. The report deals particularly with questions of an accounting nature and stresses—

(1) Outright repeal of the tax on undistributed profits;
(2) Further modification of the capital-gains section;
(3) Opposition to the reintroduction of the surtax on closely held corporations advocated in title B of the House bill;

(4) A sound broadening of the base of income taxation;
(5) The restoration of consolidated returns;
(6) The determination of fixed principles of income taxation; and
(7) The modification of rates generally in the belief that lower rates will induce business activity and result in equal or improved revenue yield.

The CHAIRMAN. Why do you say that?

Mr. STEMPF. I think that the history of our Revenue Act has demonstrated the fact that lower rates, by the reason of the incentive which they give to business, create business activity, greater profits, and thereby yield greater revenue at lower rates. I think that you yourself, Mr. Chairman, have admitted the application and the effect of the law of diminishing returns in statements that you have made, which I think are very properly applicable.

There are also included recommendations relating to technical revisions of existing provisions.

The CHAIRMAN. Does that statement apply to capital gains as well as the high surtax rates?

Mr. STEMPF. Most definitely so.

The CHAIRMAN. It does not apply to undistributed profits, does it?

Mr. STEMPF. I am unalterably opposed to the principle of the undistributed profits tax.

The CHAIRMAN. You do not know whether you can do justice by it?

Mr. STEMPF. Because I feel it is absolutely contrary to the fundamentals of sound corporate finance. There are also included recommendations relating to technical revisions of existing provisions; including a proposal to defer for an additional 30 days the filing date of returns. It is believed that some change in this respect is needed urgently to alleviate the growing difficulty of taxpayers to comply with existing requirements, due to the increasing complexity of the law and the more exacting attitude of the Bureau of Internal Revenue relative to extensions of time for filing returns.

In compliance with the wishes of your committee, I shall refrain from presenting any of these matters in further detail at this time; and offer the Institute's detailed memorandum which you and your technical assistants may consider in due course.

Senator LONERGAN. Mr. Chairman, I would like to ask the witness a question.

The CHAIRMAN. Senator Lonergan.

Senator LONERGAN. You say you are opposed in principle to the undistributed profits tax. What would be your remedy where a corporation intentionally withheld the distribution of profits?

Mr. STEMPF. I have included in my memorandum in support of that a statement recently made by Maurice Wertheim, in the Harpers Review, in which he says 102 is there in the act and he cannot believe that American ingenuity has gotten to the point where it cannot put teeth in that section. That is the remedy. Frankly, I have no suggestions to make as to strengthening that section. I do not believe it has been applied as fully as it might have been. There has been too much compromise in most of those cases, but I think that is the proper remedy for the improper retention of surplus.

Senator LONERGAN. We would be glad to get any suggestions that you and your associates might have.

Mr. STEMPF. I have discussed the thing at some length, but I have not arrived at any conclusions. I might say that this memorandum was prepared over night on Wednesday. This hearing came about 10 days sooner than we expected.

The CHAIRMAN. We do not work as slowly as some other committees.

Mr. STEMPF. I think you have done an excellent job.

The CHAIRMAN. You are the head of the American Institute of Accountants?

Mr. STEMPF. I am chairman of the committee on taxation.

The CHAIRMAN. How many members do you have?

Mr. STEMPF. We have approximately 5,000 members throughout the country.

The CHAIRMAN. Are they composed of certified public accountants?

Mr. STEMPF. All certified public accountants, and included in our group is an advisory council of State society presidents who, in turn, represent all of the certified public accountants within all of the States of the country.

The CHAIRMAN. Are there any of the members of your institute in the employ of the Treasury Department?

Mr. STEMPF. I would not doubt that there are, Senator.

The CHAIRMAN. I expect so.

Mr. STEMPF. Yes.

The CHAIRMAN. All right, thank you.

(The memorandum submitted by Mr. Stempf is as follows:)

MEMORANDUM FILED WITH THE SENATE FINANCE COMMITTEE BY THE COMMITTEE ON FEDERAL TAXATION OF THE AMERICAN INSTITUTE OF ACCOUNTANTS REGARDING THE PROPOSED REVENUE ACT OF 1938 (SUBMITTED MARCH 18, 1938)

NEW YORK, N. Y.,
March 18, 1938.

SENATE FINANCE COMMITTEE,
Washington, D. C.

SIRS: The committee on Federal taxation of the American Institute of Accountants respectfully submits its recommendations for revision of the revenue laws, with special reference to the provisions contemplated by H. R. 9682 as adopted in the House of Representatives, and at the outset stresses particularly that this memorandum:

(*a*) Approaches the subject of income-tax revision solely from the standpoint of sound principles of taxation, without regard to social or political aspects, and deals particularly with questions of an accounting nature.

(*b*) Urges outright repeal of the tax on undistributed corporate profits.

(*c*) Strongly recommends further modification of the capital-gains section.

(*d*) Opposes unqualifiedly the restoration of the "third basket" provisions, advocated by the Ways and Means Committee of the House.

(*e*) Supports a sound "broadening of the base" of income taxation, coupled with effective withholding at the source.

(*f*) Urges the requirement of consolidated returns as conforming to recognized sound business practice.

(*g*) Again favors the creation of a qualified nonpartisan commission to conduct the research required for the unbiased determination of fixed principles of Federal income taxation; and

(*h*) Advocates that taxation for revenue is best served at moderate rates which encourage enterprise, stimulate activity, increase employment, and produce more revenue than high rates which stifle initiative, freeze the service of capital, and retard employment.

Reference is also had in the data which follow to other matters which, although important from the viewpoint of sound administration of the revenue act, do not partake of the broader aspects of income taxation present in the foregoing items.

(a) Taxation should be based upon fixed principles having a closer relation to sound accounting procedure and conservative business practice.

This committee has stated repeatedly that taxation has become a major problem in business planning by reason of its repeated shifting in form and incidence. Our Federal income tax should have a long-range viewpoint, which would remove much of the uncertainty by establishing fixed principles at flexible rates to fit the needs of Federal revenue without change in the character of the tax or its application.

The creation of a popular belief that a taxing statute is impartially and equitably administered is essential to the ultimate success of any revenue program. Reassure the business community of a determined purpose to fix and abide by established rules of Federal income taxation and much will have been done to restore confidence. Taxation has become almost inscrutable, forcing upon business a policy of timid "hand-to-mouth" planning, a policy which cannot be changed until the effects of taxation upon operations may be reliably gaged on the basis of rational unchanging principles.

The ever-widening breach between "tax accounting" and "business accounting" has developed as a result of the attempt to refine the definitions of taxable income and allowable deductions, in the fallacious belief that these definitions should be applied inflexibly; with the unfortunate result of creating a labyrinth of exceptions incomprehensive to the average taxpayer. The law and regulations should be purged of these refinements, with a concurrent reversion to the simple fundamentals that "standard methods of accounting will ordinarily be regarded as clearly reflecting income" and that "each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose," with a mandate that these provisions be liberally construed. Without the latter, emphasis upon these fundamentals is futile. In any equitable tax law income and allowable deductions should be defined in broad terms, and liberal recognition should be accorded accounting procedures regularly and consistently employed by taxpayers with less opportunist stress upon the year in which an item belongs. Tax administration should give more weight to the consistency of successive returns instead of stressing the nearsighted and usually doubtful advantage of immediate revenue.

The renewal of confidence and the related stimulation of business activity and employment which would emanate from such settled policies of tax administration would have a salutary effect upon the Federal revenues.

(b) This committee remains unalterably opposed to the undistributed-profits tax, and urges outright repeal. Likewise, while there is distinct merit in the drawback principle, when properly applied, it too is wholly objectionable unless it be purged of the existing inequities in the undistributed-profits tax by the repeal of the latter, and unless related to business profits as distinguished from taxable income.

The Institute's committee opposed the enactment of the tax on undistributed profits in its memorandum filed with the Senate Finance Committee on May 7, 1936, summarizing its objections in item XIV of that memorandum, as follows:

"(1) That the potential revenue to be derived from the proposed legislation is conjectural;

(2) That the objective of simplification has not been attained, and that the provisions of the bill are in fact extremely complex;

(3) That the proposed form of taxing undistributed income will create a new field of problems of accounting and corporate finance which will aggravate the existing difficulties of determining the tax liability;

(4) That the administration of the act by the Bureau of Internal Revenue will be far more difficult than at present with attendant increased costs;

(5) That the proposed act will inflict undue hardship upon a large group of moderate-sized corporations having meager reserves, many of which are struggling to overcome the burden of accumulated deficits."

These reasons remain valid today. The basic principle of the undistributed-profits tax is unsound, violating as it does the rudiments of corporate finance and jeopardizing the stability of corporate enterprise.

In principle the harshness of the existing law has been modified to some extent in H. R. 9682 by the adaptation of the "drawback" method suggested as a compromise by this committee in May 1936. In the words of the report submitted by the House Committee on Ways and Means, March 1, 1938 (page 4) "the tax should not be framed as a penalty surtax on undistributed profits but should be designed on the basis of a flat tax rate with a tax credit which will give reasonable encouragement to the distribution of dividends."

However, in our opinion, the House bill does not accomplish this end because there remain in the law all of the complications of the old undistributed-profits tax and the objectionable inconsistencies in distinction between "taxable income" and "business income." Under proposed conditions, a corporation may have to pay not only normal income tax but also the surtax when it actually has no income measured by recognized principles of accounting ordinarily and consistently applied in commercial practice. A striking example of this remains uncorrected in the case of a corporation with an operating deficit at the beginning of the year, ordinary taxable income of $100,000, and a capital loss of the same amount. By reason of the $2,000 limitation on capital net losses, the corporation would pay not only a normal tax but, because of its inability to distribute a dividend, would also be liable to an unwarranted surtax. Even though such a corporation were to make a distribution to the full extent of its adjusted net income, it would get no dividends-paid-credit in view of the fact that the distribution would not be a taxable dividend under section 115 (a). By way of contrast, this inequity is recognized in section 102 relating to the surtax on improper accumulation of surplus.

(c) Further modification of the capital-gains section is strongly urged.

The report of the committee on Federal taxation, of the American Institute of Accountants, submitted to the Senate Finance Committee on September 23, 1937, stated:

"There is probably justification for the position that realized capital gains should bear their just proportion of taxation, instead of shifting the entire burden to those carrying on commerce and the professions, and complete elimination would aggravate rather than correct the existing differences between 'tax accounting' and 'business accounting.'

"It is recommended that capital gains and losses be segregated in a separate schedule from other income, taxable at a moderate, flat rate, without subjection to percentages depending on the period during which the asset was held. The $2,000 limitation on net capital losses should be removed, and the right to carry over net capital losses as an offset to gains for a period of 5 years should be established.

"Relief in taxation of capital gains would reopen the flow of capital transactions and the profits and employment that go with such transactions, which are now inhibited by inordinate taxation.

"Capital assets should be redefined to exclude land and depreciable assets used in the business."

H. R. 9682 has excluded property subject to depreciation from the definition of capital assets for purposes of the capital-gains section. We commend this provision. However, we strongly urge that land used in trade or business be likewise excluded from the statutory definition. There are no logical grounds for holding that buildings used in trade or business, and the land upon which the buildings stand, belong in different categories. The inclusion of land and buildings in different classifications would raise needless difficulties in the administration of the law, as it would necessitate the division of the proceeds from the sale of improved real estate, between the portion applicable to the land and the portion applicable to the buildings. Furthermore, a situation of this kind lends itself to tax evasion, as it would be possible to stipulate, in a sales contract, the division of sales proceeds between land and buildings most advantageous to the seller. The bill also makes a logical distinction between "short-term" or "speculative" profits and "long-term" capital gains. The former are properly placed on a basis comparable to ordinary income. As to the latter, however, we do not believe that adequate relief has been extended.

In this connection, we quote from recent editorial comment:

"Dr. Carl Snyder has reported that as the result of his own researches, it appears that the average investment in industry in this country is about $12,000 per man; and that comparing one country with another the wages of labor in industry are directly proportionate to the capital investment per man. Dr. Snyder also points out that the average rate of increase of industrial production in this country has been about 4 percent per annum compounded, and that the gain in capital supply required to produce this increase has been a little higher, around 5 percent per annum. This investment was supplied almost wholly from the industries themselves or from their owners and not from the savings of the people via the savings banks and the insurance companies, which invest primarily in mortgages and safe bonds and not in the equity position. This, Dr. Snyder points out, was up to 1930, since when there has been an abrupt reversal."

Unquestionably, this country needs the restoration of an abundant flow of equity capital. No one thing will do more to restore activity, employment, and prosperity. An overwhelming proportion of informed opinion believes that the capital-gains tax is one of the principal deterrents to this flow of capital. Why be niggardly in the revision? The report of the Ways and Means Committee points out that during the time capital gains were subjected to a flat 12½ percent the revenue from this source amounted to approximately 50 percent of the total income-tax collections from individuals, whereas, in 1934 and 1935, it made up but 3 and 13 percent, respectively. The law of diminishing returns has had its inevitable effect during the latter years of high capital-gains tax. Remove the deterrent effectively and the lower rate will produce increasingly greater revenue.

There is a natural reluctance to seeing those who enjoy true capital gains escape the heavier tax burden; but this must continue to be one of the rewards of equity risks if commerce is not to be stultified.

We urge again:

(A) That capital gains and losses be segregated in a separate schedule from other income; (B) taxable at a more moderate flat rate, say 12½ percent; (C) without subjection to percentage calculations depending on the period held; (D) that the $2,000 limitation on capital losses be removed entirely; and (E) that the carry-over provision should be extended to 5 years instead of 1.

Under such circumstances it will be impossible to make an equitable distinction between "short-term and long-term" capital gains. The speculative element in the stock market is an essential lubricant to the play of supply and demand; and as a necessary adjunct to the adequate release of capital, transactions may justifiably be granted the status of capital gains and losses, as in the past. There should be no major objection to an arbitrary 1-year rule, if the distinction be deemed essential.

(*d*) The third-basket tax recommended by the House Ways and Means Committee, but rejected by the House, imposes an arbitrary and unjust penalty upon legitimate business enterprises and should not be restored to the proposed revenue bill.

We are strongly opposed to the tax on closely held corporations contemplated by title 1B. Corporations of the type covered by title 1B are the very corporations which should be given protection and encouragement. By forcing closely held operating corporations to distribute their incomes, owner-management is being unjustly discriminated against in favor of absentee ownership. Family business concerns will be put at a competitive disadvantage with widely held organizations.

Nearly all successful businesses originate as one-, two-, or three-man affairs. Usually by the initiative and sacrifices of a small group, a large enterprise is developed and new employment opportunities created. Such enterprises must retain their income for expansion and for added working capital. They have limited credit lines which may be increased only by growth of capital arising through earnings retained in the business. To force these closely held corporations to distribute their net income is discriminatory, and places an oppressive burden on legitimate business enterprises. The title 1B tax is unsound and opposed to the best interests of industrial growth and the employment of labor.

While we oppose restrictions of any kind upon the retention of current earnings for expansion or other legitimate business purposes, we recognize the existence of abuses through the unreasonable accumulation of surplus. Mr. Maurice Wertheim, in Harpers Magazine of February 1938, said:

"I refuse to believe that American ingenuity or its legal talent is at so low an ebb that section 102 cannot be so redrawn as to make it work properly and cover completely the abuse of improperly accumulated earnings. It is not necessary or sound public policy to tax thrift in business in order to reach malefactors."

We, too, advocate the setting up of new administrative machinery to study cases coming within the purview of section 102 of the existing revenue act, with a view toward minimizing tax avoidance through improper surplus accumulations.

(*e*) We support a sound broadening of the base of income taxation, coupled with effective withholding at the source.

It seems desirable to broaden the base of income taxation by the reduction of personal exemptions, graduation of normal taxes, and otherwise, facilitated by an extension of the principle of withholding at the source. This proposal has

been made repeatedly since 1918, if not before, "so that a substantially large proportion of voters would become direct taxpayers and take a keener interest in government."

More important would be the substitution of such broadening of the base in lieu of existing indirect "nuisance" taxes, which, it is claimed, fall more heavily, dollar for dollar, on the low-income class of our population.

(*f*) Consolidated returns should be made mandatory. Such procedure conforms to ordinary business practice, enables the Treasury Department to deal with a single taxpayer instead of many, and eliminates the necessity for examining the bona fides of innumerable intercompany transactions.

Inasmuch as subsidiary companies are often organized merely to comply with the requirements of various State laws or to minimize risk in opening up new territory or establishing a new line of business, it is erroneous to treat them as entities distinct from the parent corporation. For all practical purposes they are branches or departments of one enterprise. Therefore, as the Treasury Department pointed out to the House Ways and Means Committee when it was considering the Revenue Act of 1934, the simplest way to secure a correct statement of income from an affiliated group is to require a consolidated return, with all intercompany transactions eliminated. This conforms to recognized, sound business practice. By requiring separate statements of income, as under the present law, nonexistent income is often taxed, profits and losses may be shifted from one subsidiary to another in such a manner that the Commissioner's power to reallocate income is ineffectual, and the earnings of particular units are not accurately presented. Moreover, administration of the income-tax law is simpler with the consolidated return, as it conforms to ordinary business practice.

Likewise, from the standpoint of the taxpayers, in cases in which corporations follow the consistent practice of preparing consolidated financial statements, the preparation of related tax returns is simplified if done on a consolidated basis. Accordingly it is urged that consolidated returns be required.

(*g*) Congress could do nothing of greater importance to assure the future stability of business than to bring about the creation of a qualified, nonpartisan commission to establish fixed principles of income taxation and related administrative procedure.

This committee has repeatedly urged the creation of such a body, latterly in its memorandum of September 23, 1937, filed with the Senate Finance Committee. The year-to-year revision of tax laws is an abomination, bred of political expediency. Fixed principles of taxation are needed to enable taxpayers to face the future with greater confidence based on known factors.

Permanent principles should be established, subject only to changes in rates to meet the requirements of the Federal Budget. Business can adjust itself to changing rates of taxation, but common sense decries a repeated shifting in the general scheme and incidence of taxation, which must be construed anew from year to year.

(*h*) The tax burden should be equalized, and the Federal revenue stabilized by the adoption of moderate rates of taxation which encourage enterprise, and thereby increase employment.

This committee has previously urged the principle of taxing corporate income on the basis of average earnings for 5 years, believing it to be inequitable to exact heavy taxes upon the full profits of successful years without relief in respect of unprofitable years which inevitably follow. By the same token, a basis of average earnings would assure less fluctuation in the level of revenues. It is recognized that this principle of averaging income entails some administrative difficulties, but these are not insurmountable. However, the simplest recognition of the principle may be obtained by restoring provisions for carrying forward losses as offsets to taxable income of subsequent years. We urge the enactment of such a general provision, permitting the forwarding of losses for 5 years.

The post-war period demonstrated the fact that progressively lower rates of taxation brought increasing revenues, through the release of capital into private enterprise with attendant enlargement of the market for labor in productive employment, whereas it is generally recognized that excessively high rates of tax have discouraged business expansion and have thereby adversely affected employment.

Although based upon authoritative statistical factors, the estimates of the Treasury Department relative to the adverse effects upon revenues of the elim-

ination of certain provisions, consistently predicate such conclusions upon current revenues at existing rates. We submit that such conclusions ignore the salutory effect upon revenues inherent in the reduction of rates demonstrated by the post-war experience previously referred to. We support the claim, broadly held, that "lower rates bring more revenue than higher rates." Excessive rates are nonproductive. Lower rates induce the release of capital into productive employment. Higher rates have the opposite effect, and in the face of declining national income might ultimately prove disastrous to the revenue.

(*i*) If the capital-stock tax be retained the adjusted declared value should be reduced by Federal income taxes and excess capital net losses.

Many business leaders look upon the capital-stock tax and related excess-profits tax as "Siamese twins" which are unconscionably speculative and vicious, and advocate repeal of these sections of the law. However, if the way cannot be opened to outright repeal, we advocate that one amendment particularly be made. Under the present and proposed laws, no reduction in the adjusted declared value is permitted for Federal income taxes or for excess capital net losses. This treatment tends to create artificial situations whereby the adjusted declared value increases more rapidly than the actual net worth and, in many instances, increases while the actual net worth decreases. The adjusted declared value of capital stock should be brought into line with actual conditions by permitting deductions for Federal income [illegible] and excess capital net losses.

(*j*) The excess-profits tax, if retained, should be based upon predictable ordinary business net income and should exclude capital gains and losses.

The excess-profits tax as provided by section 602 of the proposed bill, if retained, should be modified in one important respect. When a corporation realizes a large unforeseen capital gain, it may be subjected to an onerous excess-profits tax. In some instances, the profitable disposition of a capital asset might be discouraged because of the high excess-profits tax. It is urged therefore, that capital gains and losses, because of their unpredictable nature, be excluded from net income subject to the excess-profits tax and that the tax be based solely upon ordinary net income.

(*k*) This committee endorses the "consent dividends credit," but objects to certain inequitable provisions relative thereto embodied in H. R. 9682.

Section 28 is intended to provide a method whereby corporations in a poor cash position, unable to distribute taxable-stock dividends or dividends in their own obligations, may secure a dividends-paid credit by obtaining "consents" from stockholders to include portions of the undistributed corporate net income in their own net incomes. Obviously, this expedient will be practicable only in the case of closely held corporations; whereas financially embarrassed corporations, with widely scattered stockholders, will be unable to take advantage of the proposal.

Effective use of section 28 will require planning in advance to obtain "consents" from cooperative stockholders and paying off recalcitrant stockholders before the end of the year. As most organizations are not in a position to determine the amount of their net income until after the close of the taxable year, widely held corporations will not be able to make all the necessary preliminary arrangements incident to obtaining the "consent dividends credit." In practice, therefore, section 28 can be availed of only by closely held corporations.

A point that requires adjustment is involved in determining the holding period of the "consent" stock for the purpose of computing the recognized gain or loss in the event of a subsequent sale or taxable exchange. Will the holding period date from the original purchase of the stock, or will there be several holding periods, one for the original purchase of the stock and others for the amounts of the "consent" dividends added at various times to the cost of the stock?

As the proposal now reads, where a shareholder signs a "consent" the amount specified in the "consent" is taxable to him in its entirety, whether or not such amount, if distributed to him in cash, would have been in whole or in part a taxable dividend. Such amount is then added to the basis of the stock in the hands of the shareholder, but only in an amount which represents a taxable dividend (i. e., is out of earnings or profits) and is allowed as a "consent dividends credit" to the corporation. Thus, a holder of 1 share in a corporation "consents" to include $100 in his gross income as a dividend. It develops that for the taxable year the corporation has net income of $100

per share but at the end of the year has accumulated earnings or profits of only $50 per share. In this case, the "consent dividends credit" of the corporation would be limited to $50 per share, while the shareholder would be obliged to include the entire $100 in his gross income. Moreover, the shareholder would be allowed to increase the basis of his stock by only $50 (the amount allowed to the corporation as "consent dividends credit"), the remaining $50 apparently vanishing into thin air.

The foregoing situation will undoubtedly arise frequently, as in a great many instances corporate executives will find it difficult to estimate accurately the net earnings before the end of the year. In such cases, there will always be the danger to shareholders that they might sign "consents" in excess of the corporate net earnings and, therefore, will be taxed on amounts which do not represent earnings of the corporation. To avoid this inequitable condition and to encourage shareholders to cooperate with corporate executives where conditions warrant, it is recommended that shareholders be taxed only on such amounts of their "consents" as would represent taxable dividends if paid in cash. Alternatively, if shareholders are to be taxed on the full amount of their "consents," they should be permitted to add such amount in full to the basis of their stock, and not only the portion allowed as a "consent dividends credit" to the corporation.

The definition of "consent stock" (sec. 28 (a) (1) could be improved by being changed to read as follows:

"*Consent stock.*—The term 'consent stock' means the class or classes of stock entitled, after the payment of preferred dividends (as defined in par. (2)), to an unlimited proportionate share in the distribution (other than in complete or partial liquidation) within the taxable year of all the remaining earnings or profits."

(*l*) Expenses incurred in the production of taxable income should be allowed as deductions, even though such income does not arise from a trade or business.

Section 23 (a) of the proposed bill and the corresponding section of the present and prior laws provide for the deduction of all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. This provision should cover the deduction of expenses paid or incurred in the production of taxable income, even though such income does not arise from the taxpayer's trade or business. In some instances, the Commissioner has disallowed expenses of this character, and has attempted to place an unduly narrow interpretation on this section of the law.

The failure to allow such deductions is contrary to sound accounting concepts and the reasonable intent of the law, and results, in many cases, in the taxation of gross, instead of net income. Accordingly, it is recommended that section 23 (a) be amplified to permit the deduction of all ordinary and necessary expenses paid or incurred during the taxable year in the production of taxable income.

(*m*) This committee endorses the recognition of the "normal stock," and "last in, first out" or replacement methods of costing sales and determining inventories in pertinent cases.

Section 22 (c) of the Revenue Act of 1936 and of the proposed bill, provides that:

"Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income." General Counsel's Memorandum No. 17322 (reported on p. 151 of Cumulative Bulletin XV-2) wisely and fairly permits industries processing certain raw materials, principally wheat and cotton, to apply the results of hedging transactions, entered into for the purpose of eliminating gains or losses on raw materials, to their inventories without the application of the limitation imposed on capital gains or losses, although such limitations are applied generally to futures transactions in these commodities.

There are other industries producing, fabricating, or processing raw materials which are not permitted by the Commissioner to apply current costs to current sales under the "replacement" or "last-in, first-out" inventory method. These latter inventory methods are appropriate in industries in which (a) operating processes are continuous, (b) the period of processing is relatively long, (c) minimum inventories must be maintained constantly, and (d) raw materials represent a major part of the total cost of the products. Moreover, these

methods have substantial acceptance in industry, are endorsed by accounting authorities, and have been recognized as appropriate by the Securities and Exchange Commission.

During periods of rising prices the "first-in, first-out" method of pricing inventories results in taxing business income that is in part necessarily absorbed in increased inventories and working capital, and is unduly onerous in industries which entail long processing periods.

The "normal stock" and "last-in, first-out" or "replacement" methods clearly fall within "approved standard methods of accounting" and are "best suited to the needs of certain businesses." They should, accordingly, be granted recognition.

(*n*) We urge the repeal of section 802, requiring the filing of returns as to formation, etc., of foreign corporations. It imposes unnecessary burdens on accountants, inasmuch as such information can best be obtained from officers, directors, stockholders, and attorneys directly concerned.

Section 802 of the proposed bill provides for comprehensive returns of information in connection with the formation, organization, or reorganization of any foreign corporation. This section affects the accounting profession vitally.

The proposed bill, as well as the Revenue Act of 1937 and T. D. 4773 promulgated thereunder, impose an unreasonable burden upon accountants. Entirely apart from the principle of the matter, these provisions relating to information returns to be submitted by accountants and others are particularly objectionable due to their ambiguity and breadth.

The language of the law itself is ambiguous. Prior to the promulgation of the regulations under the 1937 act, there remained a doubt as to whether such information was required only if the foreign corporations were actually in existence or merely proposed. The regulations imply an extension of the requirements to include information relative to discussions of proposed foreign incorporations.

The regulations and Form 959 require answers to hypothetical questions, calling upon accountants to interpret the intent of clients. The Bureau itself refuses to answer hypothetical questions concerning tax matters. Is it not unreasonable to expect accountants to do so? Does the acceptance of an engagement on the part of an accountant to calculate the effect which the formation of a foreign corporation would have upon taxation involve "aid or counsel" in matters relating to the formation of foreign corporations? Such engagement does not necessarily warrant the conclusion that the formation of a foreign corporation is even proposed.

Decided doubt remains as to the meaning of "reorganizations" of foreign corporations. Does reorganization contemplate the statutory concept or the commonly accepted meaning of that term? Recent Supreme Court decisions have overthrown interpretations of that term which have prevailed for some years past. Does writing up the accounts of a foreign corporation constitute the character of "aid or counsel" contemplated by the act? Does advice to foreign clients through offices abroad, relative to the formation of córporations in the normal and legitimate conduct of affairs, come within the definition of "aid or counsel" under the act?

The foregoing examples are typical of many ambiguities which exist because the provisions of the law are not sufficiently limited. Where does mere conversation end and advice begin?

The relationship between the accountant and client is one of confidence. Assurance of sound procedure demands that this relationship be fostered for the good of all concerned. The provisions of section 802 stultify the accountant and rear a reluctance on the part of clients to confer with accountants respecting the formation of legitimate foreign business companies, and may have the further effect of driving taxpayers to seek the services of accountants and lawyers in foreign countries.

It would seem that provisions requiring such information to be filed by those directly concerned—i. e., officers, directors, stockholders, and attorneys—should suffice, without resorting to reports of indirect informants, who merely have casual acquaintance with the matter in hand.

Therefore the repeal of this provision is strongly urged.

(*o*) The time for filing Federal income-tax returns should be extended to the fifteenth day of the fourth month following the close of the taxable year.

Under section 53 of the proposed bill, income-tax returns are required to be filed, as heretofore, within 2½ months following the close of the taxable year. The Commissioner is empowered, by the same section, to grant reasonable extensions of time.

Experience has shown that large taxpayers, especially corporations, cannot gather the necessary data for the preparation of returns within the time specified by law. The audit of the accounts of such taxpayers is not generally completed until 1 or 2 months after the end of the year, and until then the work of collecting tax data cannot be effectively started. The technical complexities of our present income-tax structure make it imperative for many taxpayers to secure professional aid, so that it is rarely possible for returns to be prepared by the due date.

As a result a large number of taxpayers are forced each year to obtain extensions of either 1 or 2 months within which to file their returns. This is a source of expense, inconvenience, and uncertainty to both taxpayers and the Treasury Department.

This difficulty may be removed by amending section 53 (a) (1) of the proposed bill to read as follows:

"(1) General rule: Returns made on the basis of the calendar year shall be made on or before the 15th day of April following the close of the calendar year. Returns made on the basis of a fiscal year shall be made on or before the fifteenth day of the fourth month following the close of the fiscal year."

In respect of installment payments, section 56 could at the same time be amended to provide for the payment of one-quarter of the total tax on or before the 15th day of the fourth month following the close of the taxable year and one-fourth on the 15th day of the sixth, ninth, and twelfth months. This would not lessen the Government's revenue in any fiscal year and at the same time it would not be inequitable to taxpayers.

It is strongly urged that the changes recommended herein be incorporated in the tax bill now pending, in order that one unnecessary source of friction between the Treasury Department, taxpayers, and tax practitioners, be speedily removed.

* * * * * * *

We shall be pleased to lend our cooperation in further elucidation of the foregoing recommendations.

Respectfully submitted.

AMERICAN INSTITUTE OF ACCOUNTANTS,
VICTOR H. STEMPF, *Chairman, Committee on Federal Taxation.*

The CHAIRMAN. Mr. H. B. Spalding, New York City, representing the committee on Government finances, National Association of Manufacturers.

STATEMENT OF H. B. SPALDING, REPRESENTING COMMITTEE ON GOVERNMENT FINANCES, NATIONAL ASSOCIATION OF MANUFACTURERS

The CHAIRMAN. Have you a brief there, Mr. Spalding?

Mr. SPALDING. I do not have a brief prepared yet, Mr. Chairman, and I would like to ask leave to submit one before the close of these hearings.

The CHAIRMAN. These hearings are going to close pretty soon. If you want it to be printed in the hearings you will have to file it within a day or two.

Mr. SPALDING. We will have the brief filed within a day or two. I simply do not have it with me this morning.

In the time at my disposal this morning I can hardly undertake a complete general discussion of the tax law.

The CHAIRMAN. I wish you would give us the high points.

Mr. SPALDING. I will try to give you the high points and to keep fully within the time which you allowed me.

The exactions of the Government in the matter of taxation widely affect every business operation, not only in the rates, in the cost accounting, in the time of settlement, but also in the form of taxation,

the question whether the tax is intended purely as a revenue measure or is intended to have some regulatory effect, or even, as it has been suggested in some quarters, a redistribution of income.

Today you have the background of a business recession and the desirability of trying to change taxing laws to engender confidence to relieve the anxiety, whether it is a real anxiety or a psychological anxiety of businessmen as to the effect of existing laws on their operations.

The National Association of Manufacturers, in the position it has taken, has stood for these various points rather consistently. In the first place, we have believed in relief to corporations of small income, in the setting of lower rates on the first amount of income up to, say $25,000. We believe that if that relief is given it will be both from the point of fairness and also to simplify the administration, if those same rates were applied to all corporate incomes up to the limits that are provided for it; otherwise you are forced into a rather complicated tax computation for corporations which are just above the limit that is set.

We have consistently opposed and urge the repeal of the undistributed-profit tax in toto, that it is unsound in principle, and it is, I think, universally among business men, believed to be unfair. It creates in their minds a depressing effect and a retarding or reluctance on their part to invest capital in new productive enterprises.

We also have consistently opposed the inclusion in net income of capital gains and losses, believing that taxation of capital gains and losses has no place in an income tax; that if they are to be taxed at all, they should be taxed at a low rate, low enough so that the taxation of the capital gain or loss will not have a materially deterrent effect on the entering into the transaction which results in a capital gain or loss.

We urged in the report that we made 2 years ago that the Congress appoint an independent commission to study the whole tax problem, and in particular the relationship of Federal and State taxes, in the duplication that exists in those fields, and in the effect of various rates of taxation, both on revenue and on business and economic policy. That, of course, is a study that can be made only over a period of many months, perhaps a couple of years.

The CHAIRMAN. I may say that study is being made now, and one or two reports have been made by the joint committee on it, but this revenue business kind of fogs us up in carrying out what you would like to do with reference to it.

Mr. SPALDING. You have two problems to face. You have the problem of giving immediate relief for the year 1938, and then also the problem of the long range study, of trying to adopt a revenue system for the whole country which would be a reasonable, cohesive whole, both from the standpoint of the revenue, from the standpoint of fairness of taxes, and also from the standpoint of convenience of administration.

The present tax laws place a very heavy burden upon corporate profits, if you take into consideration the net profit for corporate taxes and then find out how much is left after the corporate tax has been paid, and after the individual has paid his taxes on the dividends received. Of course that varies with the different sizes of the individual incomes, but you find that in the incomes in the middle

bracket you have got a burden that is so heavy that I believe it would be a very strong discouraging influence on investment of new capital in productive enterprise.

That, gentlemen, is about all I have to say in the general remarks. I will discuss and elaborate them in the brief.

The CHAIRMAN. You believe that business would be helped materially if the capital-gains section should be modified as you have suggested, and if there was an elimination of the undistributed-profit tax?

Mr. SPALDING. That is the position that the association has consistently taken from the outset on all these taxes.

The CHAIRMAN. All right. Thank you, Mr. Spalding.

(Subsequently Mr. Spalding submitted the following appendix to his statement.)

No exaction of government more widely effects every business operation than the amount and character of Federal taxes. The importance and effect of Federal taxes on business lies not only in their rates but in the form, administrative features, and time of settlement provided in the law. Serious consequences arise out of forms of taxation which have a regulatory purpose rather than simply the raising of revenue. When the regulation aimed at is a partial redistribution of incomes, the economic and business effects are very substantial.

We do not at this time wish to argue the desirability from a social standpoint of using the tax laws to bring about a more equal distribution of incomes. Whether or not such a result in the long run is desirable if the means adopted to effect it have the immediate effect of retarding business recovery and reemployment we strongly urge the desirability of at least temporarily postponing a social reform in the interest of immediate business recovery and reemployment. It is from this standpoint and from this standpoint only that we urge that you consider the very heavy impact of Federal and State income taxes both corporate and individual in all of their several forms upon each dollar of net profit earned by the business corporation.

The following illustrations, although they do not include several of the taxes which, in their incidence, rests as a burden on business profits, do illustrate the tremendous burden imposed on business profit so great that we believe that it constitutes a major reason why there is today an almost total absence of demand for those forms of corporate issues upon which the first impact of business risk must fall. In these illustrations we have assumed in every case a corporation earning a net return of 10 percent on the value of its capital stock before taxes and which distributes in dividends all of its net income after taxes. Under the proposed House bill such a corporation would pay a tax of 16⅔ percent on its net income and distribute 83⅓ percent of its income. We have then assumed that the shares were owned by individuals resident in the State of New York with net taxable incomes before receipt of dividend of the following respective amounts: $10,000, $25,000, $50,000, and $75,000. In each case we have assumed their investment in the corporation to be an amount equal to double their annual income so that their pro rata share of the corporation's net profit before taxes would be equal to 20 percent of their other net taxable income. We then computed the total additional tax which such individuals would pay as a result of the receipt of the dividend and added that to the 16⅔ percent already paid by the corporation and computed the combined total as a percentage on the net profit before taxation of the corporation. The results of this computation show that the rates of taxation on such corporate profits are the folowing: In the case of of the $10,000-a-year man, 30.38 percent; $25,000-a-year man, 39 percent; $50,000-a-year man, 51.72 percent; $75,000-a-year man, 60.30 percent. These illustrations could, of course, be carried on into the still higher brackets and you would find that at the top surtax bracket of 75 percent there is taken in taxes computed as aforesaid almost 84 percent of the corporation's net profit.

It is, of course, obvious that the inducement to invest in any business enterprise is the prospect of profit, and the profit in which the investor is interested is the net which remains to him after all taxes which apply to the income from the investment if earned are paid. While the rate of earnings will vary from industry to industry, business to business, and from year to year, we believe

it would be generally conceded that a rate of 10 percent represents a reasonably successful enterprise and is considerably higher than the average rate of return over the past 20 years of business generally. When rates of taxation reach the amounts set forth in the above illustrations, it is rather obvious that the incentive to invest in productive capital which bears any real business risk is largely destroyed, especially when we consider that there remains available for investment tax-exempt securities substantially free from business risk and which, while they earn only a low rate of return, nevertheless their rate is very favorable as compared to that which remains to the investor of even a moderately large income when he invests it at a business risk the profits of which are subjected to tax rates such as those set forth above. By means therefore of these high surtax rates that have been applied within recent years our tax laws have tended to dry up one of the major sources of new industrial capital.

But that is not all. Another and a very large source of new industrial capital in this country has been the undistributed portion of business profits. The undistributed-profits tax imposed by the Revenue Act of 1936 not only took a large share of this source of new capital but since it is regarded by corporate directors as a penalty tax it has had the effect of at least temporarily eliminating substantially this source of new industrial capital. The psychological effect of this tax has been even more serious. It has been universally condemned by businessmen large and small and has created a fear on their part that the purpose of government through its tax laws is to make impossible the earning of a sufficient rate of return to induce investment of new capital in those forms of corporate securities which bear the first impact of business risk, so that today it is only the senior securities of the most seasoned and stable industries protected by large junior issues which have a market value equal to the investment costs of the assets which they represent. While such a condition exists, it is futile to expect the new investment and expansion of industrial enterprise necessary to absorb the present millions of unemployed.

Another feature of the income-tax laws that has received almost universal condemnation of businessmen is the inclusion of capital gains and losses in net income. Regardless of economic or legal theory, the average businessman considers a capital gain especially one which has accrued over a considerable period of time and which becomes taxable only as an incidence of his shifting of an investment or necessitous sale of the capital asset, as a capital levy and not a tax on his income. Moreover, it usually lies within his control whether or not to enter into the transaction which will give rise to the tax. The result of this has been to introduce through this tax a highly artificial influence on the purchase and sale of capital assets and in particular the purchase and sale of corporate stocks which, in turn, has an indirect and, we believe, a harmful effect on the capital market for new securities.

Moreover, if capital gains are included as part of net income, every consideration of fairness requires the deduction of capital losses, and and this was universally recognized in our income-tax laws until very recently. It was pointed out over and over again that while the Federal revenues might be somewhat increased during periods of prosperity that the inclusion of capital losses would result in a violent contraction of those revenues in a period of depression and this is exactly what happened and made it necessary, although the unfairness was largely conceded for recent tax laws to impose drastic restriction on deduction of capital losses. It may be granted that in the long run if capital gains and losses are not included in net income, or at least are not subjected to some form of special tax, that a somewhat higher burden must be placed upon other income. Business opinion, however, supports the belief that the tax structure would be improved by whatever higher rate of tax on other income was necessary to offset any loss of revenue resulting from the nontaxation of capital gains and losses.

One of the arguments which has been advanced in favor of some tax upon the undistributed profits of corporations has been that otherwise there is too great an inducement to use the corporation as a means of escaping individual surtaxes through nondistribution of earnings. In the case of personal holding companies where this motive is likely to be an important if not the dominant one, the National Association of Manufacturers sees no reason why they should not be treated separate and apart of other business corporations so as to close this avenue of escape. In the case of business corporations that might be availed of for this purpose we believe that an adequate remedy already exists in section 102. This section has been applied in a number of cases and in the ma-

jority of the cases that have reached the courts the Commissioner's decision has been sustained. If past or future experience indicates the desirability of strengthening this section it should be possible to so amend it as to cover all cases where the corporate organization has been availed of for the improper purpose of unreasonably withholding distribution of dividends.

We have had 25 years of the Federal income-tax law. During that time we have had 13 major revisions, 4 of which have occurred within the last 5 years. We are now considering the fourteenth change. The law today is very much of a patchwork of amendments on amendments and stands very much in need of restatement and if possible putting it in a form where the structure will be more or less permanent and the only necessary changes from time to time would be in the rates as the needs for revenue expand and contract. In addition, during the past 25 years there has been a very great increase in the recourse of the States to income-tax laws to supplement their revenues. This not only creates a duplication of taxation on the same sources but there is involved the serious threat to the Federal revenues from income tax should the States increase their reliance on this form of taxation. The fact that faces the country today is that the needs for revenue are so great that all existing and known sources of taxation have become or are rapidly becoming used to the point of diminishing returns. Extravagance and unnecessary Government expenditure is undesirable at all times and doubtless many savings can be effected at this point or that by careful and critical study of existing expenditures—Federal, State, and local. Resistance to pressure groups seeking legislation involving spending in their own interests can help materially but when all is said and done in this direction the costs of government and of those things which we look to government to provide call for the diversion through taxation to governmental purposes of a share of the total national income undreamed of 40 years ago. No tax law can be adequately considered by itself alone. It must be related not only to the general economic situation existing at the time but also to its place in the entire national tax structure. While there have been many individual studies of this problem by both private and public institutions, it would seem highly desirable that the Congress appoint a commission to restudy this whole problem, report not only as to those points where the tax laws are having an adverse economic effect but also to coordinate the whole tax structure—Federal, State, and local—into some semblance of a coordinated and interrelated whole.

A commission of this kind was urged by the National Association of Manufacturers at its annual meeting in December 1933. In urging the appointment of the commission we are not overlooking the very excellent studies that have been made by Mr. Parker, of the Joint Congressional Committee on Internal Revenue, and by the Treasury Department under the leadership of the Under Secretary, Mr. Magill. In the case of both, however, they are to a large extent limited to the consideration of Federal taxes and at least in the case of the Treasury Department they must of necessity be limited at least in their public expression by the economic and social views of the administration for the time being in office. A commission which is entirely nonpolitical in personnel, entirely relieved of the necessity of supporting any previously assumed position, would be free to adopt a purely factual and impartial approach to the tax problem with the time at its disposal to fully hear and sift the value of all shades of opinion and interests.

Mr. J. W. Hooper, Chamber of Commerce, Brooklyn.

STATEMENT OF J. W. HOOPER, CHAIRMAN OF THE FEDERAL TAX COMMITTEE OF THE BROOKLYN CHAMBER OF COMMERCE

Mr. Hooper. My name is J. W. Hooper. I am chairman of the Federal tax committee of the Brooklyn Chamber of Commerce. I have a very short statement to make, supported by a brief that has been filed.

A report is submitted under separate cover as to the results of a survey of Brooklyn industry by the Brooklyn Chamber of Commerce, covering the entire field of Federal taxation on corporation income. In this study, comprehensive factual information was secured by a

committee of the chamber aided by representative of the Brooklyn Chapter of the National Association of Cost Accountants. A copy of the findings was also submitted to the House Ways and Means Committee when that honorable body was discussing the proposal of its subcommittee for a revenue bill for 1938.

The survey disclosed that Brooklyn industry is emphatically of the opinion that the surtax on undistributed profits should be repealed; that the tax on capital gains should be repealed; that if the tax on capital gains is not repealed, then plant and equipment items used in the operation of business should not be considered as capital assets subject to the capital loss limitation of $2,000; that corporations again be allowed to file consolidated returns; that corporations again be allowed to carry forward losses, and if the provision is reenacted, it should be so stated that corporations would not be obliged to pay income taxes until they made up prior losses; that the taxation of capital stock and excess be repealed, and that taxation of intercompany dividends be repealed.

The CHAIRMAN. How are you going to get any revenue?

Mr. HOOPER. I have an answer for that, sir. The Brooklyn Chamber of Commerce, in the public interest, strongly supports this composite opinion of a representative cross section of industrial management.

If these foregoing recommendations are enacted into law, the chamber further advocates that the following steps be taken to make up for the lost revenue:

That the Federal Government reduce expenses by instituting a sound and sensible economy in its operation; that it balance its Budget as soon as possible.

Senator VANDENBERG. That will not be soon enough.

Mr. HOOPER. You are telling me. That it balance its Budget as soon as possible, with due regard to the country's economic structure, which has been so influenced by the free-spending nonrevenue-covered policies of the Government; that additional revenue, if required, be obtained from the following sources: An increase in the present normal rate of taxation of corporate and personal income; a broadened base from personal income taxation, by materially lowering present personal exemptions; taxation of exempt State and municipal employees; taxation of exempt interested from Federal, State, and municipal bonds hereafter issued.

The CHAIRMAN. Have you figured out the loss by virtue of the four propositions that you suggest should be repealed and the propositions that you have advanced?

Mr. HOOPER. Well, from the study that we have made of the information that we obtained from the Brooklyn industries it indicated that from the standpoint of the excess-profits tax and capital-stock tax, an increase of over 1 percent in the income tax would take care of that. As far as the undistributed-profits tax is concerned, we do not have sufficient data to go by.

The chamber further advocates that Congress do everything in its power to simplify the present tax laws; that greater responsibility be given to local tax offices in order to expedite tax settlement; that the representatives of the internal-revenue department be directed to adopt a more understanding and reasonable attitude in the interpretation of the tax-law provisions affecting corporation net income,

to the end that the taxpayer may feel that his particular case is being given the consideration it deserves by the field agent, and that the prevailing idea that a field agent must recommend an additional tax, regardless of the facts, in order to maintain a high merit rating in his local office, may be removed from the minds of the taxpayers; that Congress direct the Treasury Department to effect a speedier closing up of tax cases involving points subject to question; that the personnel standards of the Income Tax Bureau be improved and the personnel placed on a career basis, with the payment of salaries commensurate with corresponding work in private employment, promotion on the merit basis, and the top positions filled from the ranks; and that taxation legislation be enacted with a view only to the raising of revenue and not for punitive and regulatory purposes.

In order not to take up too much of the committee's valuable time, the underlying reasons for these recommendations are not now stated, but are shown clearly in the report referred to, copies of which are herewith made available to your honorable body.

The proposed Revenue Act of 1938, which is now being considered by the Finance Committee of the United States Senate, will, to a large extent, if enacted, reduce the burdens on industry imposed under existing tax legislation. However, the act does not go far enough, in that it still retains the principle of the surtax on undistributed profits. The retention of this principle will remain an ever-constant threat. The principle of taxation of undistributed profits should be removed once and for all, leaving no suggestion to succeeding legislative bodies to resurrect it from oblivion. One of the limitations of deductible loss on sales and exchange of plant and equipment used in business has been removed, and it is respectfully urged upon your honorable body that the limitation be not restored.

The changes proposed for the taxation of capital gains and the limitation of capital losses, and the use of such losses for deduction purposes in a subsequent year, do not go far enough, in that capital gain or loss items should be removed entirely from the field of items constituting taxable net income. Further, the provisions as to capital gains and losses in the present bill would be even more complicated and impractical in operation than those in the law now in force.

The proposed bill generally does not tend to simplify the tax structure, but, instead, tends to further complication. The proposed bill does not recognize the sound accounting principle that all elements of operating income and outgo of a business organization must be considered in determining the true net income and that consolidated returns should be permitted in order to give this recognition. The proposed bill continues to penalize corporations that are just commencing in business or whose operations do not show consistent profits, in that it does not permit the carry-forward of losses. The proposed bill does not eliminate the inequitable feature found in the present law in the duplication of taxation by way of taxing intercompany dividends. The proposed bill, as in all previous similar Federal legislation, continues to burden a corporation with the taxation of its net income, thus obliging business executives to consider such taxes as costs in order that they may be passed on to customers, so that at least a theoretical reasonable return on operations may be obtained for stockholders. This results from nonrecognition of the fundamental principle that income taxation should be levied on the ultimate

recipient rather than against an artificial entity created to collect the income for such ultimate recipient. In this connection your honorable body is respectfully referred to the form of income taxation employed in Great Britain.

(The brief submitted by Mr. Hooper is as follows:)

RECOMMENDATIONS RE REVISION OF THE FEDERAL CORPORATION TAX LAWS, SUBMITTED BY THE BROOKLYN CHAMBER OF COMMERCE, BROOKLYN, N. Y.

MARCH 18, 1938.

To the Members of the Senate Committee on Finance:

In anticipation of the revision of the Federal corporation tax law, the Brooklyn Chamber of Commerce has given intensive and thorough study to the entire Federal tax program as it affects corporations, and herewith submits its views in the form of 16 specific recommendations with respect to these taxes.

The chamber's findings are based, to a considerable extent, upon the experience data of 117 Brooklyn corporations widely diversified as to type and size. These concerns, which reflect a representative cross section of the borough's business life, submitted comprehensive information in response to questionnaires embracing more than 70 questions.

A committee comprised of the accounting officers of a number of sizable Brooklyn corporations, together with representatives of the Brooklyn Chapter of the National Association of Cost Accountants, secured the information and made the studies thereto.

These recommendations deal with the undistributed-profits tax, the corporation-income tax, the capital-stock and excess-profits taxes, and, finally, with certain general tax problems in the order named.

SURTAX OF UNDISTRIBUTED CORPORATION PROFITS

The chamber advocates the following actions in connection with the surtax on undistributed corporation profits.

Recommendation 1.—That the surtax on undistributed profits be repealed.

Reasons for recommendation: (*a*) The tax has proved exceedingly burdensome to corporations with debt structures requiring specified reductions in the debt for which credit cannot be claimed under the contractual debt provisions of the act.

(*b*) Corporations have had to pay the tax on undistributed profits earned within the year notwithstanding the existence of an unabsorbed deficit, because under State law they could not pay dividends while their capital was impaired.

(*c*) Corporations have had to borrow money to pay dividends and thereby weaken their financial structure.

(*d*) Corporations have had to pay interest rates on borrowed money ranging from 1½ to 6 percent, and averaging 4.14 percent, according to the reporting membership.

(*e*) Corporations have had to reduce inventories in order to pay back money borrowed for the payment of dividends.

(*f*) Weak corporations have been placed at a disadvantage with strong corporations in that they cannot obtain the dividend financing necessary to avoid the tax.

(*g*) Directors have been forced to authorize payment of dividends that ordinarily in the sound conduct of their business they would not have declared; more than half of the firms that replied to the question on the subject paid higher dividends than they would have paid in the normal conduct of their business.

(*h*) The business policy of building up reserves in profitable times to carry essential organization personnel through bad times has been largely discontinued. In this connection only a few of the reporting corporations have been able to take advantage of the payment of dividends in the form of capital stock to avoid payment of the tax and thereby conserve their cash position. Corporations have hesitated to issue such stock to pay dividends because of the expense incident thereto, particularly in complying with the registration requirements of the Securities Exchange Commission.

(*i*) It has compelled management of companies to take dividend action based on guesswork in estimating the income that would be available for dividends.

(j) The tax has had a distinctly deterrent effect on the normal course of business, a few specific examples of this being as follows:

(1) Cancelation of contracts by customers.

(2) Delay in acceptance of delivery and payment by customers.

(3) Rental of equipment by customers rather than buying.

(4) Increases in the proportion of installment sales to total sales.

(5) Purchases deferred by customers because of capital loss on exchanges arising out of traded-in machines which could not be taken as a reduction for income tax or undistributed-profits tax.

(6) Hesitancy in buying because customers cannot ascertain equipment costs until the end of the year, in cases where equipment is purchased out of profits as the cost of such purchase is increased to the user by the amount of tax paid on the profits withheld to pay for the equipment.

(7) A considerable number of reporting firms indicated they had not made the purchases of plant and equipment items because of the tax; that they had made expenditures for repairs which, except for the tax law, would have been replaced with new equipment; that they were placed at a competitive advantage due to the deferment of purchases of plant and equipment items because of the tax; that they reduced the amount of inventories they ordinarily would have carried; that the tax has added materially to their selling costs, particularly in business done with small customers who work on a small capital and grow out of profits; and that salesmen are now complaining about their commissions because of the additional calls required to close deals because of the tax.

In canvassing the membership, certain financial information was requested. In the smaller companies, surpluses built up in good years were in part used to maintain a level of dividends which otherwise would not have been possible if those companies had had to pay out their profits as they are now compelled to do to avoid the tax under the present law. A selected group of these smaller companies, in the years 1931–34, inclusive, paid out dividends substantially in excess of the net income they reported to their stockholders. The information they submitted indicates that over a period of time profits are not withheld from the field of personal income taxation as those profits find their way into the hands of stockholders in periods in which they otherwise would not be recipients of ordinary business income as well as during periods of good business. The figures submitted further indicated that, from the end of 1928 to the end of 1932, there was a reduction of 22 percent in the cash, accounts receivable, and inventories constituting the working assets of the reporting companies. This reduction no doubt was used for payment of dividends and innumerable other business requirements, which would not have been possible if the current assets of the company had been previously disbursed in the payment of dividends as would have been the case, of course, if the present law had been in effect prior to 1929.

FEDERAL INCOME TAX

The Chamber advocates the following actions in connection with the Federal income tax:

Recommendation 2.—The restoration, in the law, of permission to affiliated corporations (controlled by ownership of at least 75 percent of their voting stock by one of the affiliated corporations or controlled by like percentage through ownership by an individual) to file consolidated income-tax returns and to have their income tax determined on a consolidated basis at the same rate as would be applicable if the income were that of a single corporation.

Reasons for recommendation: (a) Lack of consolidation is burdensome and increases the tax. At least half of the reporting chamber members affected by the elimination of consolidated returns indicated that it increased their income tax; (b) it has increased the tax because all operating elements are not permitted to enter into the determination of true net income.

Recommendation 3.—That there be a redefinition of a capital asset subject to the limitation for the deduction of capital losses, now in section 117b of the revenue act, to the end that losses on the sale or exchange of plant equipment items used in the operation of the business will result in ordinary deductions in determining the taxable net income of the corporation.

Reasons for recommendation: (a) Plant and equipment items used in the every-day course of operation of a corporation's business are so obviously a

part of its regular, recognized activities that taxwise they should in equity be treated no differently than the inventories of the corporation.

Recommendation 4.—That in addition to the recommendation previously made in respect to plant and equipment items, it is further recommended that any limitations whatever be removed on the deductibility of corporation losses arising from ordinary sale or exchange of corporation assets.

Reasons for recommendation: (*a*) Reserves are accumulated for unforeseen contingencies and to protect the soundness of the corporation and any losses arising out of the investment of such reserves are as much a part of the operating loss of the business as an inventory loss; (*b*) the limitation of deduction for capital loss has hindered ordinary business operations causing hesitancy in the investment and disposal of reserve funds.

Recommendation 5.—That the income-tax law be revised to permit corporations to carry forward losses so that they will not have taxable income until prior years' losses have been recovered out of subsequent net income.

Reasons for recommendation: (*a*) A company having profits in some years and losses in others is placed at a disadvantage taxwise as compared with a corporation enjoying a steady taxable income creating in effect a higher percentage of tax on actual net income over a period of years; (*b*) a new corporation is now obliged to pay taxes on profits when made even though such profits are insufficient to absorb losses incurred in formative years; (*c*) payment of an income tax on the operations of an arbitrary period of 12 months often tends to impair the capital of the paying company.

Recommendation 6.—That depreciation rates used by corporations recognize all factors of wear, tear, and obsolescence as are consistent with good business policy, and that the burden of proof be placed upon the Government rather than the taxpayer where the rates used by the field representatives for general application to industry are at variance with the rates used by the specific taxpayer.

CAPITAL-STOCK AND EXCESS-PROFITS TAXES

The chamber advocates the following actions in connection with the capital-stock and excess-profits taxes:

Recommendation 7.—That the Federal taxes on capital stock and on excess profits be repealed.

Reasons for recommendations: (*a*) Corporations must pay the capital-stock tax in years in which they have no taxable net income; (*b*) the basis of the capital-stock tax is one of guesswork in that management is required to estimate its profits for an unknown future period in order to avoid payment of excess-profits taxes; (*c*) in time of irregular profits, there is an innate inequity in determining the particular value of capital stock. If the amount is set too low and the year is profitable, a corporation is penalized by the amount of excess-profits tax resulting from its low estimate. On the contrary, if a high estimate is set to avoid the excess-profits tax, the firm is heavily penalized in years when there is no profit. Thus there is the continual tendency to evade what seems to be a punitive tax rather than one designed to produce revenue. The returns from the membership show that capital-stock taxes have been made greatly in excess of what was necessary to avoid paying the excess-profits tax, due to overestimation of future income; (*d*) any tax that is not based on actual income as the tax on capital stock is unfair and unsound, and may result in partial or total confiscation of capital.

GENERAL

In considering these specific taxes, the chamber, of course, has given much attention to the many problems of a general character emanating from corporation taxation. The canvass of the membership also included a series of questions related to the whole scheme of Federal corporation taxation and many interesting replies were received. Based upon our studies thereto, the chamber wishes to submit the following additional recommendations:

Recommendation 8.—That representatives of the Internal Revenue Department be directed to adopt a more understanding and reasonable attitude in the interpretation of the tax law provisions affecting corporation net income. A large percentage of the reporting membership indicated they have found the revenue agents arbitrary, and from the experiences of many, it would appear that the prevalent idea in the field agent's mind is that he must recommend an additional tax regardless of the facts in order to maintain a high merit rating in his local office.

Recommendation 9.—That there be a speedier closing up of tax cases involving points subject to question. Data submitted shows that an unduly large percentage of tax cases, dating back from 1934 to 1920, are still open.

Recommendation 10.—In order to better effectuate the foregoing, the chamber advocates the delegation of much greater responsibility to local tax offices in order to expedite tax settlements; and that the personnel standards of the Income Tax Bureau be improved and the personnel placed on a career basis in which salaries commensurate with corresponding work in private employment will be paid, with promotion on a merit basis and top positions filled from the ranks.

Recommendation 11.—The chamber advocates greater simplicity in the tax laws. For the most part the reporting corporations, both large and small, require professional asistance in the preparation of tax returns.

Recommendation 12.—The chamber advocates repeal of the tax on the sale or exchange of capital assets in the hands of individuals. This tax has unquestionably been a particular hindrance to persons investing in business. Also, statements submitted by the reporting membership would indicate that the high surtax on individual incomes has deterred persons from investing in business in many cases.

Recommendation 13.—The chamber advocates repeal of taxation of intercompany dividends as being duplicate taxation and intended for purpose of regulation rather than revenue.

In the event of the repeal of the surtax on undistributed profits and the tax on capital stock and excess profits, the resultant loss in revenue must obviously be met by either reduced Government expenditures or revenue from other sources. The chamber's membership, in its replies, recognizes this, and we therefore recommend the following courses of action:

Recommendation 14.—That the Federal Government reduce expenditures by instituting sound and sensible economy in its operation.

Recommendation 15.—That the Federal Government balance its Budget as soon as possible, with due regard, of course, for the country's economic structure, which has been so influenced by the free spending nonrevenue covered policies of the Government.

Recommendation 16.—That if additional revenue is required in event of repeal of the undistributed-profits, capital-stock, and excess-profits taxes, the following sources be considered for that purpose: (*a*) Increase in the present normal rate of taxation on corporate and personal income. (In this connection the membership indicated its willingness to accept an increase in the normal rate on corporation income to replace the revenues that would be lost through repeal of the tax on capital stock and excess profits); (*b*) a broadened base for personal-income taxation; (*c*) taxation of exempt State and municipal employees; (*d*) taxation of exempt interest from Federal, State, and municipal bonds hereafter issued.

We ask your careful consideration of these recommendations.

Respectfully submitted.

Cary D. Waters, president, Committee on Federal Taxation on Corporation Income; J. W. Hooper, chairman, comptroller, American Machine & Foundry Co.; William H. Bowne, comptroller, Sperry Gyroscope Co.; Harry A. Grube, treasurer, Intertype Corporation; Louis Klein, comptroller, American Safety Razor Co.; W. C. Hogue, comptroller, Eberhard Faber Pencil Co.; C. E. Hicks, vice president and secretary, New York Dock Co.; R. A. P. Walker, vice president, Bush Terminal Buildings Co.; Charles H. Towns, Loomis, Suffern & Fernald; J. D. Scholfield, assistant treasurer, the Pilgrim Laundry, Inc.; Robert Behlen, treasurer, the Motor Haulage Co., Inc., representing Brooklyn chapter of National Association of Cost Accountants.

The CHAIRMAN. Mr. Tumulty.

STATEMENT OF JOSEPH P. TUMULTY, WASHINGTON, D. C.

Mr. TUMULTY. I realize that you are very busy men upon whom rests a great responsibility. I am encouraged to believe, from statements made by your chairman and the members of your committee that in your deliberations you are to be governed by facts and that

where it can be shown that any tax works a hardship, that you will supply the remedy. May I say to you very frankly that if this were the only matter pending before your committee and you had the time to read the brief I am submitting to you, I believe you could easily be persuaded that the tax whose elimination I ask, wrongly imposes a great hardship.

I have brought with me, Mr. Chairman, one of the pit traders in Chicago, who is willing to submit himself to the most scrutinizing questioning at the hands of your committee.

I tried to embrace in this brief which I am submitting to your committee a history of this unusual piece of legislation and strong reasons for the elimination of this tax. While I have no pride of authorship, may I say to you that while this brief deals with the cold facts of this situation, it is none the less a human document. Logic, figures, statistics sometimes are poor servants, stringless instruments, where we strive to reach conclusions in matters like this tax. In discussing this matter with the Secretary of Agriculture, I stated that this was not a tax; it is a penalty, a lash put upon the backs of men who render a real public service in the great grain markets of the United States.

In 1932, the Finance Committee of the Senate, under the leadership of Senator Smoot, recommended the elimination of this tax. In 1934, the Finance Committee, headed by Senator Harrison, recommended its reduction to 1 cent in these words:

> The tax on produce futures should be reduced from the present rate of 5 cents per $100 to the old rate of 1 cent per $100. The present high rate of tax is detrimental to the establishment of a stable market price for produce. This reduction will not cost more than $3,300,000 for 1935.

In expressing my views to the Ways and Means Committee, I stated that there had been no fair discussion of this matter either on the floor of the House or the Senate; and, gentlemen, I say this reluctantly, but it seemed to me that the smallness of prejudice and passion and hatred had prevented a fair discussion. This statement of mine was not a figment of my own imagination. It found confirmation in a discussion on the House floor to which I shall briefly call your attention.

Let me refer to what Mr. Oliver and Mr. Hart said:

> Mr. Oliver of New York. Mr. Chairman, I am opposed to the amendment. I do not believe we should vote in revenge or in retaliation in the matter of taxation. New York is not here to destroy anybody. We were built by America. We tear ourselves down if we injure any part of the country.
>
> Mr. Hart of Michigan. Mr. Chairman and members of the committee, I not only represent an agricultural district, but I am perhaps the largest grower of wheat in my district. In addition to that I have had 30 years' experience in the marketing of grain. I do not mean on the exchange, but marketing cash grain. I say to you that the grain exchanges are as necessary to trade as the lifeblood of an individual is to his welfare. They cannot operate without it.

In a letter addressed by Secretary Wallace, the father of the present Secretary of Agriculture, to Senator Norris under date of January 25, 1924, he said:

> Dear Senator Norris: During the past 50 years many bills have been introduced in Congress which would prohibit the sale or purchase of contracts for the future delivery of grain or cotton not providing for the actual delivery thereof. None of these drastic bills passed, because evidently Congress reached the conclusion that such legislation would substantially impair, if it would not actually destroy, the valuable hedging facility which is furnished by the making

of vast number of contracts on and through the exchanges in which deliveries are contemplated rather than actually assured. In rejecting these bills, it seems that Congress wisely refused to deprive the producers, the merchants and the manufacturers of these farm products of the benefit of this insurance against price fluctuations. * * *

I am convinced that the insurance facility is of greater value and is largely dependent for its existence upon public speculation in grain and cotton contracts and this hedging privilege should not be destroyed until these industries find some better way to insure themselves against price fluctuations. * * *

Sincerely yours,

HENRY C. WALLACE, *Secretary.*

Mr. Chairman, during the Senate debate the question was asked: What is the view of the Department of Agriculture? That question was asked at the time that Senator Harrison's committee recommended a reduction of a cent.

The CHAIRMAN. What was it formerly? Three cents or five cents?

Mr. TUMULTY. It was 3 cents. It was 5 cents at one time and then it was reduced. It was begun in the days of the Spanish-American War as an emergency tax.

As I stated, in the debate in the Senate there was the question asked: What is the view of the Department of Agriculture? Silence was the answer.

The view of Mr. Duvel was called to the attention of the Senate. Mr. Duvel was and is now head of the Commodity Exchange Administration of the Department of Agriculture. He said:

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.

Senator CAPPER. What is the date of that statement, do you remember?

Mr. TUMULTY. That was at the time that Senator Harrison made his report.

The CHAIRMAN. That was in 1934, was it not?

Mr. TUMULTY. That was in 1934, Senator Capper.

Now, I have been pouring over many ancient tomes of the Department of Agriculture and I find a quotation from Dr. Hoffman, economist of the Department of Agriculture, who said at a public hearing before the Commodity Exchange Administration, December 3, 1937, in answer to the following question:

Dr. Hoffman, in your approach to the study of grain marketing, you have, so far, presented facts and figures which were undoubtedly, indisputably, they would show the detrimental effect of trading by large traders, and some of a smaller type. I would like to ask you this, if it is a fair question: Have you given any thought, or have you written any articles, bulletins, or papers that might show the benefit derived from speculative activities?

Mr. HOFFMAN. Mr. Chairman, I think I am accurate in saying that I have written a good deal on the subject of the benefits of speculation and speculative activities.

In my introductory comments, reviewing my writings on this subject, I did cite some of these references:

There is a distinction to be drawn—or, put it this way, one needs, in writing on the benefits or the adverse effect of speculative trading, to be very careful in so doing that he points out the varieties of speculative trading. It is not all of precisely the same character and, therefore, in dealing with the subject at any length, it is necessary to break up the types of trading found on grain markets such as this and separately characterize each type.

I am willing to go on record that, after weighing the different types of speculative trading, the relative merits of each, that judged in their combined effect, I view speculative trading as a whole, taking due account of those aspects which are not desirable with those which are desirable, as being an excellent means of marketing grain in this country.

One will read the record in vain to find an expression of view from any expert, in or out of the Government, which will not hold that this tax places a deadly burden on the farmer, that the farmer's market would benefit by its elimination: That pit traders are essential to the futures market and that more important than anything else by reason of the trading which these pit traders engage in, the price to the producer of wheat is enhanced. That is not my own opinion. That is the opinion of Mr. Hoffman, of the Department of Agriculture. That is the opinion of Dr. Duvel, of the Department of Agriculture.

Gentlemen, I have here, I merely wish to present it, the evidence, or the proceedings of the Commission to inquire into trade and grain futures, conducted by that great British economist, Sir Josiah Stamp. That commission was the most dignified commission ever to look into a matter of this kind. Associated with Sir Josiah Stamp was the Chief Justice of Canada. They had meetings all over the United States, from the Atlantic to the Pacific, and I found in this report, in examining it, the testimony of Dr. Duvel, who wrote a letter to the chairman of the Ways and Means Committee urging the elimination of this tax. I have excerpts from his testimony showing that this kind of trading is the cheapest form and that it enhances the value of farm product.

I had a conference with the Secretary of Agriculture. I said, "I think that you are a Christian gentleman, and I am asking you just what do you think of a tax imposed on men that will result in a balance sheet like this"?

Here is the one that I called his attention to: For 10 floor traders active in all pits:

Tax payments and clearing-corporation results for the crop year 1937

	Tax paid	Clearing corporation	
		Pay	Collects
July	$3,647.21		$19,618.75
August	3,189.07	$26,606.25	
September	2,015.61		9,753.75
October	1,293.57		5,256.25
November	1,282.41	4,253.75	
December	1,086.00		4,170.25
Total	12,514.37	30,860.00	38,804.00
			30,860.00
Profit			7,945.00
Tax			12,514.37
Loss before computing office expense, salaries, dues, etc			4,569.37

In my brief I have collected balance sheets from these pit traders showing just what the effect of that is upon the lives and fortunes of these unfortunate men.

Gentlemen, I say that speculation is not always to be anathematized. I know I play an unpopular role when I stand before this com-

mittee and say a kind word for anything that even indirectly concerns an exchange, but, gentlemen, this thing, this kind of trading, has a stabilizing influence on the great grain markets of the United States. In the debate in the Senate all kinds of anathemas were hurled. "Get rid of this kind of business." That was the cry in 1932 and 1934. There was not any fair discussion. I am never interested in cold figures that lie on cold parchments. I am interested in the stumbling, staggering mass of human beings that are the victims of cruel legislation.

Gentlemen, I do not want to impose on you, I only beg of you to see that this great wrong is righted.

I feel in very respectable company this morning when I quote from one of the greatest liberal leaders in all this world, Justice Holmes. What did he say about speculation in grain and the Chicago Board of Trade? He said:

> As has appeared, the plaintiff's chamber of commerce is, in the first place, a great market, where, through its 1,800 members, is transacted a large part of the grain and provision business of the world. Of course, in a modern market contracts are not confined to sales for immediate delivery. People will endeavor to forecast the future, and to make agreements according to their prophecy. Speculation of this kind by competent men is the self-adjustment of society to the probable. Its value is well-known as a means of avoiding or mitigating catastrophes, equalizing prices, and providing for periods of want. It is true that the success of the strong induces imitation by the weak, and that incompetent persons bring themselves to ruin by undertaking to speculate in their turn. But legislatures and courts generally have recognized that the natural evolutions of a complex society are to be touched only with a very cautious hand, and that such coarse attempts at a remedy for the waste incident to every social function as a simple prohibition, and laws to stop its being are harmful and vain.

Frankly, I do not represent the Chicago Board of Trade, I do not represent anybody wearing diadems. I represent a few of the unfortunate victims.

I said to the Secretary of Agriculture that this was not a tax, it was a penalty. These men stand in the midst of that market, buying and selling, stabilizing influences, and the result of their activities is the enhancement of the price. And what is the reward? He receives a lash and a kick.

I said to the Secretary of Agriculture that this kind of legislation would bring a blush of shame to the cheeks of Attila the barbarian.

I am a lonely traveler along the way, gentlemen. I never had the great privilege of appearing before a great committee like this. I talk to the common, average man on the streets. My great chief once said that the man who can judge of the things of life is not the man who stands on the banks of life looking on; it is the man who stands in the midst of the melee of life, who knows the blows that are being struck and the blood that is being drawn. It is by that man that I wish my judgment to be guided.

The ordinary man in the United States of America is just worried. The sword of fear constantly hangs over him, and, gentlemen, you have the great responsibility of striking the rock and releasing the energies of the people of the United States. I know that if you will be a little more tender in your treatment of these lonely men that perhaps from their hearts will come influence that will bring out the gushing waters of prosperity for the people of the United States.

They reduced the tax in the House from 3 cents to 1 cent, then they put a tax on scratch sales. It is like the Irishman who said, "They gave us a pair of pants, but they cut the buttons off."

I venture to suggest that no human institution could have endured so long and been so constantly availed of and relied upon by the great agricultural and industrial interests of the Nation unless it had abundantly justified its existence and rendered a service of unquestionable value to the commerce of the country.

The day may come when the weather will be so effectively controlled or unerringly predicted; when knowledge will be so universally and instantaneously known around the world; when the mysterious cycles of fertility secreted in the bosom of the soil will be solved and all the fluctuating factors of finance and industrial productivity that affect the capacity of man to consume will be understood; when the free wills of men will be so thoroughly comprehended or so completely suppressed that the future will no longer be uncertain and prices no longer a matter of caprice, but subject to exact and scientific and official prescription by society. But none of us will see that day.

A stultifying chaos would afflict the business of the world were there not some focal mirror to reflect a crystalized image of all price factors everywhere, and some pivotal group, honest enough and courageous enough and prosperous enough to underwrite the inevitable vicissitudes of nature and the indefinite vagaries of man. Such a group must be made up of intelligent and diligent students of all the facts or they will go broke. Their compensation is on a contingent basis which puts them constantly on their toes and those of lesser industry or poorer judgment are perpetually weeded out. The intelligence and the industry of those who succeed as well as their courage and their capital render a service entitled to compensation. They become the skilled and automatic funnels and filters by which all facts are brought to bear promptly and accurately in the fixing of prices. They constitute the focus where knowledge gathered elaborately and at great expense over a network of wires reaching throughout the world and necessarily otherwise unavailable to any individual farmer or manufacturer or trader is constantly made available and instantly marshalled, assessed, and evaluated by the composite opinion of experts who devote their lives and their fortunes to this work. Even Government crop reports must be analyzed and appraised, and it is well known that the price of wheat is affected more year in and year out by production outside the United States than in it.

Thus there constantly exists upon the board of trade the closest possible approximation of true value at any given time.

The first rules governing trading in futures were passed by the Chicago Board of Trade in 1865. The present highly organized form of rules is a natural growth evolving through years of trial and error. Few organizations on earth have more detailed and drastic and rigorous rules. There is no room for the crook or the shyster or the high-pressure salesman, or even for the diplomat. The covenants of the Board of Trade are all open covenants, openly arrived at in the full light of day in what used to be the freest

competitive market in the world. It is obvious that it can serve its high purpose only insofar as it is free, and all its complicated rules are designed to promote that freedom.

But now the heavy thumb of government has pressed down upon a vital spot in that freedom, the small trader. This tax does not daunt the big long-term speculator or the occasional gambler. He can take it in his stride, but it is the little fellow who is hit—the small operator who is constantly trading. His precarious profits are devoured by this deadly tax which he must pay, win or lose, and it throttles and tends to extinguish his willingness and his capacity to bear the thousand little risks that are the lifeblood of the fairness, the fluidity, and the freedom of the market place.

This tax does harm all out of proportion to its usefulness as a producer of revenue, because it touches a delicate and vital spot in the process of distribution. A man can endure to be lashed on the back or even to have a quantity of blood drawn from his body and still go on working, but put a cinder in his eye or the slightest pressure on his brain and he becomes powerless to function. The group of little men operating upon the board of trade is an alert and multiplex will, incessantly engaged in registering instantly the composite judgment of society on prices. Insofar as their services are discouraged or repressed, the liquidity and the stability of the price structure is undermined.

But even more important and vital than the board of trade's functions as a focal mirror of price factors and a promoter of price stability is its function as an insurer against future price changes.

There is no Lloyd's of London to insure the processor of wheat against future fluctuations in its value, except as to restricted groups and under very limited circumstances; and even if there were such an insurance available, its premium would be prohibitive. Hedging on the board of trade is the ancient and recognized and universal substitute for such insurance. Other types of insurance are not taxed; why should this type be?

A price hazard is automatically created the moment a crop is planted. Hedging insures the voyage of the crop from the farmer who produces it to the miller who grinds it. Banks can and will loan more on wheat when its true market price is available and liquid and steady. It is estimated that about 56 percent of farmers hedge at one time or another upon the board of trade, and practically 100 percent of the middlemen between the farmer and the baker hedge upon the board of trade. Even though a farmer never hedges, he benefits, of course, by being able to know the fair price at any moment. When a miller, for example, takes an order for flour, he buys a hedge of wheat upon the board of trade. Then if a drought in Argentina should put up the price of wheat, the speculator takes the loss, and the dealer or miller is protected even though wheat may double in price. When a miller can thus hedge, less capital is required in his business and therefore his costs are lower. This saving has long since been passed on by virtue of keen competition to the benefit of the farmer on the one hand and the consumer on the other. It is clear that the ability to insure a house against fire makes the house a more valuable asset and yet makes the rent cheaper.

The risk of destruction by fire would depress the value of the house and inflate the rent that the owner would be obliged to demand if he were his own insurer or ran the risk of a disastrous loss by virtue of his ownership of the house. Hedging enables the miller to pay more to the farmer for wheat and to charge less to the consumer for flour. The board of trade, therefore, constitutes a price-insurance agency, and no other form of insurance has ever been evolved that is nearly so cheap or so practicable. Other systems of moving grain have been tried in Winnipeg, but the conclusion was clear that no other method now known returns to the farmer such a high percentage of the price paid by world markets. There is no similar tax in Canada or in Amsterdam or Liverpool or the Argentine, and thus this tax puts American farmers at a disadvantage against those with whom they must compete for the world market. It is a tax that tends either to hamper the freedom and efficiency of the functioning of the exchange or to raise the price of bread to the consumer or to lower the price of wheat to the farmer. It probably does all three. It is, in any event, inevitably a tax on a foodstuff levied on its passage from the field of the farmer to the table of the consumer.

In Lloyd's of London a large group divide among many the infinite variety of hazards that attend human transactions, thus facilitating commerce and making possible the initiation of far-flung projects so adventurous as to terrify the boldest investor, and yet frequently so vitalizing and so salutary that they are the very stuff and essence of business progress. The board of trade is an institution of similarly great social and economic value. Just as the Gulf Stream washes the shores of far-away continents and tempers their wintry winds with the warmth gathered under blazing tropic suns, so the stream of liquidity and price assurance that rises up out of the blazing light and highly informed rivalry, the hot excitement and seeming chaos of the trader's pit, carries to far-away farmers and factories and mills a beneficent security against the havoc and disaster of violent and unpredictable revolutions in value. This institution cannot exist without a large and vigorous and tolerably prosperous group of speculators willing and able to take the risks involved, and this institution cannot be destroyed without immeasurable disaster to the agriculture and commerce of the Nation.

Gentlemen, I have Mr. Ryan here. He wishes to present a statement. I do not want to take up your time any further.

(The brief submitted by Mr. Tumulty is as follows:)

MEMORANDUM IN SUPPORT OF THE REPEAL OF THE TAX ON SALES OF COMMODITY FUTURES, BY JOSEPH P. TUMULTY, ATTORNEY FOR COMMITTEE REPRESENTING THE FLOOR TRADERS OF THE CHICAGO BOARD OF TRADE

It is hoped that the Finance Committee will give its approval to the elimination of the 3-cent tax on the sales of commodity futures. From the books of a floor trader in Chicago, may I give at the onset a most glaring example of the injustice of this tax:

Clearing members handling daily trades for 10 floor traders active in all pits; employs 4 clerks.

Tax payments and clearing corporation results for the crop year 1937.

	Tax paid	Clearing corporation	
		Pay	Collects
July	$3, 647. 21		$19, 618. 75
August	3, 188. 07	$26, 606. 25	
September	2, 015. 61		9, 753. 75
October	1, 293. 57		5, 256. 25
November	1, 282. 41	4, 253. 75	
December	1, 080. 60		4, 170. 25
Total	12, 514. 37	30, 860. 00	38, 805. 00

Pay	$30, 860. 00
Profit	7, 945. 00
Tax	12, 514. 37
Loss before computing office expenses, salaries, dues, etc	4, 569. 37

Senator Smoot, in 1932, recommended the elimination of this tax; the Finance Committee, presided over by Senator Harrison in 1934, recommended the reduction of the tax to 1 cent. When the recommendation of Senator Harrison's committee was placed before the Senate, as a result of unfair attacks, which permitted no calm discussion on this vital matter, the tax was finally fixed at 3 cents.

The statement made in my brief and at the hearing before the Ways and Means Committee that prejudice and not a fair consideration of this tax dominated the discussion both in the Senate and the House is confirmed by the reply of Representative Oliver of New York to a suggested amendment of a 25-cent tax. (See Congressional Record, 72d Con., 1st sess., vol. 75, pt. 7, p. 7229.)

Here are interesting excerpts from the speeches of Representative Oliver and Representative Hart, of Michigan, as follows:

"Mr. OLIVER of New York. Mr. Chairman, I am opposed to the amendment. I do not believe we should vote in revenge or in retaliation in the matter of taxation. New York is not here to destroy anybody. We were built by America. We tear ourselves down if we injure any part of the country.

"I shall not vote a tax as a penalty or as a retaliatory measure. The amendment proposing an increased tax on the trade in commodities is unsound."

Then again there appears in the Record a speech by Mr. Hart denouncing the retaliatory character of the legislation:

"Mr. HART. Mr. Chairman and members of the committee, I not only represent an agricultural district, but I am perhaps the largest grower of wheat in my district. In addition to that I have had 30 years' experience in the marketing of grain. I do not mean on the exchange, but marketing cash grain. I say to you that the grain exchanges are as necessary to trade as the lifeblood of an individual is to his welfare. They cannot operate without it."

In the Senate debates in 1932 and 1934, much was made of the point that after the imposition of the 5-cent tax, revenues in the Illinois district increased from $556,000 in 1932 to $2,216,000 in 1933, and to $4,000,000 in 1934. The very business atmosphere of 1933-34, which was the boom period, following the Roosevelt election, gives the explanation for this increase in revenue by reason of this tax in 1933 and 1934. During this period we had the devaluation of the dollar, which brought with it, as a necessary accompaniment, the threat of inflation, which threat economists agree drove people onto the various markets to aquire commodities and equities which it was felt would show the greatest appreciation in value. In addition, during those 2 years, there was the liquidation of the Farm Board's large holdings of wheat which had hung, like Damocles' sword over the market. During this time the Government agencies were engaged in attempting to fix prices higher than the world level. "Hedging," "spreading," and "scratch sales" are not the devices of diabolical minds "in the pit" to catch the unwary. They are the necessary instrumentalities

invoked to preserve stability and liquidity in the market. One has only to consider what would happen if ever hedging were declared unlawful and traders were not allowed to maintain hedging positions. Ex-Secretary Wallace, in his letter to Senator Norris in 1924, aptly described "hedging" as a form of insurance.

Hedging stripped of the mean, sinister implications hurled at it is a mere counterbalancing sale or purchase of one commodity by making a purchase or sale of another. Answering the question of "What would happen if over night 'hedging' should be declared illegal," a miller or merchant deprived of the price insurance afforded by hedging would in self defense have to widen his profit item to protect himself from a decline in the market or a rush of supplies greater than the immediate demands. At the present time, purchases of cash grain by a miller or merchant can be hedged on the Chicago futures market at 95 cents. Without that market, caution would dictate a price of probably 80 cents a bushel, with a consequent loss to the farmer in his price.

Secretary Wallace, referring to legislative attempts to abolish trading in futures sales said, "such legislation would substantially impair, if it would not actually destroy the valuable hedging facility which is furnished by the marketing of vast numbers of contracts on and through the exchanges in which deliveries are contemplated rather than actually assured."

In chapter X of Professor Cherington's book, The Elements of Marketing (The MacMillan Co., 1921), the author, in discussing the question of insurance against unusual commercial hazards which cannot be insured against through insurance companies because of the high cost of such insurance, devotes several pages to a discussion of the use of future trading by means of future contracts as a device for insuring against hazards caused by price fluctuations. In this connection he states (pp. 118-125, inclusive):

"The purchase and sale of future contracts has been subjected to much criticism because of certain speculative abuses which sometimes accompany it. The producers of agricultural products in particular have sometimes suffered from these abuses because of their general inability or disinclination to study or master the principles of market fluctuations. Much has been written about the question whether speculative trading of this kind does or does not materially affect price levels. On the whole it seems to be demonstrated that except in times of abnormal shortage or in rare cases of deliberate 'rigging' of the market by large operators who create real or artificial corners the effect of future trading is rather wholesome than otherwise. It tends in normal conditions to make the market more even. It serves to iron out seasonal fluctuations, and to make the open-market price at any one time reflect world conditions more accurately than would be possible in a spot market alone. But perhaps more important than any of these effects is the opportunity which future trading gives for securing at a low price practically complete assumption of speculative risks by means of the 'hedge.'"

Speaking of wheat, Professor Cherington says:

"Wheat is in many respects the best example of a commodity sold the world over in highly organized markets where spot and future transactions are carried on side by side and with beneficial effects on both. A miller, or a wheat merchant, need never speculate in his wheat purchases and sales. He can always insure his mill profit or his merchant profit by means of a hedge as securely as he could by insurance, and this can be done at a trifling cost."

An interesting excerpt from a pamphlet entitled "Searle Grain Company, Ltd.," dated Wednesday, January 19, 1938, discusses the value of commodity exchanges and the systems of future marketing. It is as follows:

"During the course of its long life many criticisms have been made of the exchange and the system of futures marketing. No less than seventeen formal inquiries have been made but so far every Commission has remarked upon the important services to the producers performed by the exchange.

"Students of grain marketing unanimously agree that no product in the world is handled, processed, and marketed with such a small spread between producer and consumer as are the grains bought and sold on the open futures market through the facilities provided by the exchange."

The report of the Canadian Commission to inquire into trading in grain futures, presided over by Sir Josiah Stamp, contains the following:

"*Price fluctuations.*—The general effect of future trading on price fluctuations is to 'put on brake.' Instead of prices falling violently, the fall is

cushioned; it comes gradually in a series of small steps. Or conversely, instead of prices rising rapidly, the rise is stepped up gradually. The total effect is that the market range—the spread between high and low prices—is reduced. Thus under future trading the daily, weekly, monthly, and yearly ranges in price are smaller than these ranges, would be without future trading. (A careful study of the graphs will clearly show the truth of this statement.)

"*Does short selling depress prices?*—An opinion held by many is that the selling of a large volume of wheat for future delivery by the speculator—(i. e., wheat contracts when he does not have the real wheat—has the effect of depressing prices. Short selling, as this process is called, is indulged in by the speculator who thinks prices are too high and are now ready to fall. The short seller, in order to make any profit at all from a change in price, must of course buy back the contracts at a lower price. That is, he becomes a buyer to the same extent that he has been a seller. Evidently, therefore, his total effect on the market is not to depress prices. It takes some deeper cause than 'short selling' to depress prices for any length of time or to any perceptible extent" (p. 14).

"We took general evidence from two men of long experience in Winnipeg extending over many years before 1904 and after, and we obtained their impressions in general terms. One of them said that after the introduction of the futures market the farmer got an absolutely better price because the buyer previously always required a margin of 10 cents to 15 cents a bushel which never gave an 'unreasonable profit,' whereas afterwards he never expected to make more than a cent and a half. The other witness, as an 'old-timer,' agreed with the above and was also emphatic that a better price to the farmers resulted from hedging." (pp. 14-15).

"FINAL SUMMARY

"All the foregoing may seem very involved and elaborate to the man in the streets who likes a plain 'yes' or 'no' to what seems to him 'a plain question.

"Unfortunately, however, no short statement on an economic matter is ever strictly and absolutely true, and this very natural desire for a plain answer can only be met by statements which are true generally, but leave room for times and cases where qualifications are essential.

"However, in brief, our answer to the question submitted is that in addition to the benefits reflected to the producer in furnishing a system of insurance for the handling of his grain, and in providing an ever-ready and convenient means for marketing the same, futures trading, even with its disadvantages of numerous minor price fluctuations, is of distinct benefit to the producer in the price which he receives" (p. 72).

Attention is called to the fact that the further destruction by unjust taxation of this traders group will ruin the liquidity of the farmers' market. Most marketing students will agree that this group's elimination would result in considerable reduction in the average price of wheat and corn. Figured at only 1 cent per bushel this would result in over $36,000,000 loss to the Nation's farmers, which is many times the tax collected. It would probably be of sufficient proportions to make necessary some kind of Federal subsidy. The proponents of placing this transactional tax upon trading state that the revenue to the Government is unimportant. The farmer's market is important and the Department of Agriculture says this tax is a burden on the men responsible for furnishing a market to the farmer. Canada placed a similar tax on their market and after 1 year canceled it and refunded all the money collected. Today because of this tax and other restrictions and the effect of both on the market, foreign buying which used to come into American markets is now placed in Winnipeg. It is difficult to determine the loss to American merchants and industry and to the Government itself occasioned by the building up of a competing nation at the expense of our own people; that Winnipeg May wheat is selling 31 cents over Chicago is very significant.

The terms "speculative gambling" was rather loosely used in the Senate and House debate where efforts were made to "end the deep agony" of this tax. Of course, in 1934, the thunder of debate in the Senate permitted no fair appraisal of the value of orderly buying and selling of grain, commonly known as trading in futures. It would seem from the attacks made that this form of trading was the devil's device to outwit the purchasers of all commodities. The critics of

grain exchange had forgotten that trading in grain futures had its inception during the Civil War. At that critical time in our Nation's life the Government wanted to erase all doubt as to definite supplies at certain future dates, and thus the Government itself began making contracts for future delivery of grain.

"Merchants," as Mr. Thomas Y. Wickham, vice president of the Chicago Board of Trade, said, "with weeks and months in which to provide for their contracts, entered them more readily than they had dared to do for immediate delivery. These were the first short sales and thus arose the practice of short selling. Interior merchants quickly took advantage of the opportunity to sell for future delivery grain that was not available for immediate delivery. These were the first hedging sales and thus arose the practice of hedging."

Does this form of buying and selling commodities add to the cost of the commodity? The answer is found in the following from the speech of Mr. Wickham:

"It is a broad statement, but a true one, that no other commodity is distributed at so little cost as grain. The farmer receives a larger share of the dollar the consumer pays for grain than does the producer of any other commodity. That he does so is due almost entirely to future contracts and to speculation in future contracts. Through these contracts the miller may eliminate all risk of price decline; because of such contracts he must buy in competition with the highest bidder in the world. And in this competition only the speculator is willing to purchase in anticipation of less plentiful supplies in the future. Without him, the harvest market must become a glut in which consuming buyers would temper bids to great risk and plentiful supplies."

Taxation is ordinarily based on ability to pay, and this is the only tax we know that ignores this relationship. Since it is devitalizing a group of earnest citizens, destroying a farmer's market and reducing their income, diverting trade and revenue to a foreign country, causing unemployment, and is unimportant in Federal revenue we think it would be constructive action to eliminate this unjust imposition.

No one can read the Brook Ballard letter mentioned in this brief without gaining the impression that here is the outpouring of a man's heart whose little business was the victim of this outrageous piece of legislative legerdemain. One is going far afield to characterize this form of exaction by calling it a governmental tax. It is not a tax. It is the bitterest kind of a penalty; a sort of reprisal that not only taxes the body but takes the very flesh and soul of a man and treats him rather as a slave than as a citizen.

This tax was first imposed as an emergency war measure in the days of the Spanish-American War. Since that time this particular tax has frequently been availed of by the United States Congress in its endeavor to provide revenue.

In 1932, after a full hearing, the Committee on Finance of the Senate reported as follows (see Rept. No. 665):

"Under the House bill the stamp tax on sales of produce for future delivery, imposed by subdivision 4 of schedule A of title VIII of the Revenue Act of 1926, is increased from 1 cent to 5 cents. Your committee has stricken out of the bill the proposed increase."

A report of Senator Harrison, of the Committee on Finance, March 28, 1934, contained the following (Rept. No. 558):

"The tax on produce futures should be reduced from the present rate of 5 cents per $100 to the old rate of 1 cent per $100. (See sec. 611.) The present high rate of tax is detrimental to the establishment of a stable market price for produce."

The last expression of opinions in the matter of this tax came from the Finance Committee of the Senate in 1932 which recommended its total elimination and the opinion of the Finance Committee in 1934 recommending a reduction of the tax from 3 cents to 1 cent. And these opinions were expressed by these two great committees of the Senate only after extensive hearings before these committees covering this subject.

During the Senate debates in 1932-34, when this matter was considered, the question was frequently asked by the opposition Senators: Why have not the views of the Agriculture Department been sought? Indeed, if the records of the hearings before the Finance Committee were accessible to the Senate at that time they would have disclosed the fact that several committees of Congress and the former Secretary of Agriculture, Mr. Wallace, father of the present Secretary, had opposed legislation that sought to abolish commodity exchanges.

In the hearings before the Committee on Finance, United States Senate, on H. R. 7835, March 12 to 15, 1924, there appears the following statement of the former Secretary Wallace:

DEPARTMENT OF AGRICULTURE,
Washington, D. C., January 25, 1924.

Hon. G. W. NORRIS,
Chairman, Committee on Agriculture and Forestry,
United States Senate.

DEAR SENATOR NORRIS: During the past 50 years many bills have been introduced in Congress which would prohibit the sale or purchase of contracts for the future delivery of grain or cotton not providing for the actual delivery thereof. None of these drastic bills passed, because evidently Congress reached the conclusion that such legislation would substantially impair, if it would not actually destroy, the valuable hedging facility which is furnished by the making of vast number of contracts on and through the exchanges in which deliveries are contemplated rather than actually assured. In rejecting these bills it seems that Congress wisely refused to deprive the producers, the merchants, and the manufacturers of these farm products of the benefit of this insurance against price fluctuations * * *.

I am convinced that the insurance facility is of great value and is largely dependent for its existence upon public speculation in grain and cotton contracts, and this hedging privilege should not be destroyed until these industries find some better way to insure themselves against price fluctuations. * * *

Sincerely yours,

HENRY A. WALLACE, *Secretary.*

That there is a need that some exchange medium shall be utilized for the sale of cotton and grain in futures markets was acknowledged by experts appearing at the hearing on the Cotton Futures Act, Senate Committee on Agriculture, 1922.

"Perhaps the nature of these transactions and the necessity for their great number in the aggregate as compared with the size of the crop was never more forcibly illustrated than by Mr. Sidney Y. West, a prominent cotton merchant of Little Rock, Ark., in appearing before the Committee on Agriculture and Forestry of the Senate in the Sixty-seventh Congress. The committee had under consideraton of the bill, S. 390, to prevent the sale of cotton and grain in future markets, known as the Caraway bill, and Mr. West, in the course of his testimony in defense of the exchanges (p. 43), said:

" 'We are attacked about this 100,000,000 bales traded in when only 10,000,000 bales are raised. You take the matter of fire insurance on that same number of bales and you will find it relatively about the same number as the 100,000,000 bales they speak of being traded in on the future exchanges, because every time I move a bale of cotton from one warehouse to another—buy it, for instance—when it is moved out of the warehouse, that insurance policy is canceled out, and when it gets to my warehouse my policy covers it. On being moved, when it gets to the depot, my policy is canceled out, and another one takes effect when it gets on the railroad. Then when it arrives at the compress at Little Rock the railroad policy is canceled out and another policy takes effect at Little Rock. Then when I sell that cotton, if it goes on the railroad again, I cancel my Little Rock insurance, and another policy takes it up, and so on; and it is carried right through. Each bale is insured on an average against fire about six different times. There are 10,000,000 bales of cotton and 60,000,000 bales insured against fire.' "

Reference is made also to the Report of the Commissioner of Corporations (Doc. No. 949, 60th Cong., 1st sess.) on page 590, Revenue Act of 1934, hearings before the Committee on Finance, United States Senate, on H. R. 7835:

Importance of purely speculative operations.—While hedging transactions are thus a very important feature of future dealings in cotton, they constitute only a portion of such dealings. In addition to hedging operations, there are, as already stated, a vast number of purely speculative transactions. Such speculative operations have frequently been condemned by both the cotton grower and the merchant and also by the spinner, on the ground that they seriously interfere with their business. It is not intended in this report to enter into a general discussion of the merits or evils of speculation. It may, however, be stated that it is the normal business of speculators, as a class, to anticipate conditions which may effect the price of a commodity, and to bring about a readjustment of the price to such conditions.

* * * * * * *

"The justification of speculation is that it performs an actual service to trade. The facilitation of hedging in part illustrates the service which purely speculative operations can thus render. In order that such service be properly rendered, however, it is imperative that speculative operations deal with conditions arising as the result of natural causes. If, instead, speculation is concerned with artificial and arbitrarily created conditions which tend to complicate the interpretation of natural conditions, its proper function becomes perverted."

Here we have from the legislative branch and from a member of the Cabinet a frank statement of opposition to legislation seeking to abolish trading on exchanges which would, in Secretary Wallace's own words in 1924, "substantially impair, if it would not actually destroy, the valuable hedging facility which is furnished by the making of the vast number of contracts on and through the exchanges in which deliveries are contemplated rather than actually assured." Secretary Wallace said that in rejecting these bills it seemed that Congress wisely refused to deprive the producers, the merchants, and the manufacturers of these farm products of the benefit of this insurance against price fluctuations.

A committee of the House, in discussing the abolition of cotton exchanges, said:

"Any legislation, therefore, which eliminates from the cotton trade the element of legitimate speculation and legitimate speculators must, in the opinion of the committee, result disastrously to the producer, especially at that season of the year when the bulk of the crop is moving from him into the channels of commerce. Cotton exchanges properly regulated in their operations in that they afford opportunities for legitimate speculation, may be made to be of real benefit to farmers, merchants, and spinners. The legitimate speculator, operating through the exchanges, is the only buffer standing between the helpless producer and the powerful buyer of his product. It is the presence in the future market for cotton of this class that is always ready to buy and to deliver at the market price that has served to relieve the trade of the risk of violently fluctuating values" (hearing before the Committee on Finance, p. 591).

The attacks upon this kind of trading on the exchanges were answered by Mr. Justice Holmes in an opinion by him (198 U. S. 236) in the case of *Board of Trade of the City of Chicago* v. *Christie Grain and Stock Co.*, wherein Justice Holmes said:

"As has appeared, the plaintiff's chamber of commerce is, in the first place, a great market, where, through its 1,800 members, is transacted a large part of the grain and provision business of the world. Of course, in a modern market, contracts are not confined to sales for immediate delivery. People will endeavor to forecast the future, and to make agreements according to their prophecy. Speculation of this kind by competent men is the self-adjustment of society to the probable. Its value is well known as a means of avoiding or mitigating catastrophes, equalizing prices, and providing for periods of want. It is true that the success of the strong induces imitation by the weak, and that incompetent persons bring themselves to ruin by undertaking to speculate in their turn. But legislatures and courts generally have recognized that the natural evolutions of a complex society are to be touched only with a very cautious hand, and that such coarse attempts at a remedy for the waste incident to every social function as a simple prohibition and laws to stop its being are harmful and vain. This court has upheld sales of stock for future delivery and the substitution of parties, provided for by the rules of the Chicago stock exchanges. * * * The contracts made in the pits are contracts between members. We must suppose that, from the beginning as now, if a member had a contract with another member to buy a certain amount of wheat at a certain time, and another to sell the same amount at the same time, it would be deemed necessary to exchange warehouse receipts.

"We must suppose that, then as now, a settlement would be made by the payment of differences, after the analogy of a clearing house. This naturally would take place no less that the contracts were made in good faith for actual delivery, since the result of actual delivery would be to leave the parties just where they were before * * *. The fact that contracts are satisfied in this way by set-off and the payment of differences detracts in no degree from the good faith of the parties, and if the parties know when they make such contract that they are very likely to have a chance to satisfy them in that way, and intend to make use of it, that fact is perfectly consistent with a serious business purpose and an intent that the contract shall mean what it says * * *

(p. 249). It is none the less a serious business contract for a legitimate and useful purpose that it may be offset before the time of delivery in case delivery should not be needed or desired * * *. It seems to us an extraordinary and unlikely proposition that the dealings which give its character to the great market for future sales in this country are to be regarded as mere wagers or as 'pretended' buying or selling, without any intention of receiving and paying for the property bought ,or of delivering the property sold, within the meaning of the Illinois act * * *. The sales in the pits are not pretended, but, as we have said, are meant and supposed to be binding. A set-off is, in legal effect, a delivery."

If it is the purpose of tax legislation to procure revenue and not to inject into tax legislation sociological reforms that seek to destroy legitimate industry, then attention is called to the alarming results of this legislation. The effect of the tax on particular types of operations, such as hedging and spreading, which are essential to the successful operation of the marketing machinery, is demonstrably bad. To take only a few of many specific examples available: A, who in the past has been a very active and expert trader, and during August and September of this year was particularly active in "spreading," an operation everywhere acknowledged to be important to the hedging trade, had a gross profit for 2 months of approximately $3,000, and his tax was $2,800. Consequently, he has quit "spreading." Another firm of important expert traders had, over a period of 2 months, a gross profit of $4,350, and, after deducting expense (including salaries of five clerks), had a gross profit of $2,110. Its tax was $2,830, with the result that the firm has a net debit for this period of $717. Case after case could be cited where, although a small profit is shown it is so small as not to constitute a source of livelihood, even on a very low standard.

It must be remembered that the Chicago Board of Trade is the principal grain market of the world and that it is in every sense a world market. The prices and the price opinion emanating from this market determine the actions of producers, millers, merchandisers, and others throughout this country and the course of prices and price trends in other markets. As must be apparent from the above, if this tax is to continue, it can only result in the elimination of the professional trader from the floor of the exchange. Should this result, our present marketing machinery would be crippled so that it could no longer function in a proper and orderly manner. As pointed out above, this cannot be permitted without bringing about evils that all agree should be avoided.

THE REVENUE PRODUCED BY THE TAX IS INCONSEQUENTIAL

The revenue which is produced by this tax is so small that it is inconsequential and certainly cannot be considered as in any sense important. As observed by the former chairman of the Subcommittee on Taxation of the House Ways and Means Committee, it would not operate our Government 40 minutes.

Exhibit B shows the proceeds of the tax from 1918 down through the fiscal year 1936. The figures are shown both for the first Illinois collection district and the United States. The figures for the first Illinois collection district represent, of course, almost entirely taxes paid by members of the Chicago Board of Trade and usually constitute about 60 percent of the total amount of tax paid on all commodity futures in the United States.

The total tax paid during the entire fiscal year ending July 1, 1936, was $1,758,560.06 for the first Illinois district and $2,943,512.37 for the entire United States. It can safely be said, therefore, that the amount of tax involved is not an important item in the Budget of the United States. It is difficult to draw any definite conclusions from the earlier history of the tax as shown in exhibit B. It is significant, however, that immediately after the reduction of the tax from 2 cents to 1 cent in 1924, the total paid in the first Illinois district increased from $1,446,407.76 to $2,804,045.13.

For the reasons hereinabove pointed out, it is believed that the repeal of the tax will not result in an appreciable reduction in revenue. On the contrary, it is believed that an increased revenue will result. The actual stifling effect of the tax is effectively putting out of business the major source of this revenue, namely, the professional traders, and thus reducing the volume of business subject to the tax. The revenue lost to the Treasury will, it is believed, be more than made up by the new business stimulated, through income and other taxes, and through the ultimate effect on agricultural prices. With respect to the latter, the abolition of the tax will unquestionably be a positive constructive factor.

The tax has been condemned by the Department of Agriculture, through the Chief of the Commodity Exchange Administration. A copy of the latter's official testimony before the House Committee on Appropriations is as follows:

During public hearings recently held by the House Appropriations Committee on the Agricultural Department Appropriation Bill for 1935, Dr. Duvel, Chief of the Grain Futures Administration, testified as follows:

"Dr. DUVEL. We believe in the futures market; we think it should be maintained, but that it should be on the basis where everyone who finds it necessary to use it for hedging or who desires to use it for speculative purposes should have a fair chance. Whenever a single individual can control 10 or 15 percent of the open contracts or can do 10 percent of the day's trading, that is not a free and open market; it is anything else but that. * * * Based on information accumulated during the past 10 years we believe the system of futures trading should be maintained, but it does need to be improved in many respects.

"Representative HART of Michigan. They have had pretty lean years.

"Dr. DUVEL. As far as the business is concerned?

"Mr. HART. Yes.

"Dr. DUVEL. Yes; business right now is not paying overhead; they also have the burden of a heavy tax on sales of futures, and the tax is too high.

"Mr. HART. You think it is too high?

"Dr. DUVEL. The tax burden comes on the man who is in the pit. The higher the price, the greater the burden.

"Mr. HART. Where does the tax go on this hedging operation? It goes into the cost of flour, doesn't it?

"Dr. DUVEL. As far as futures tax is concerned, on the actual transaction, it is so small it does not amount to anything when applied to a single lot of actual wheat.

"Mr. HART. Supposing that wheat turns over, hedges on the actual cash grain, and turns over five or six times; it amounts up doesn't it?

"Dr. DUVEL. It is about one-twentieth of a cent a bushel when the price of wheat is $1 a bushel.

"Mr. HART. It isn't a large amount.

"Dr. DUVEL. If it turned over five times, you would have only a quarter of a cent.

"Mr. HART. It hampers the small trader.

"Dr. DUVEL. It hampers the scalper, the man that gives liquidity to the market."

When the statement was made in the Senate debate that it was quite strange that the Finance Committee did not call anyone or listen to testimony from anyone except "the grain and cotton gamblers" (Congressional Record, vol. 75, pt. 10, p. 11649, 72d Cong., 1st sess., Senate) Senator Harrison called attention to the appearance before the Finance Committee of a representative from the Department of Agriculture, who represented the Grain Futures Administration and whose opinion was sought. (From Congressional Record, Senate, vol. 78, pt. 6, p. 6543.) The statement of Senator Harrison was as follows:

"In the hearings before the Senate Finance Committee Dr. J. W. T. Duvel submitted the views of the Grain Futures Administration of the Department of Agriculture. He said he represented the Grain Futures Administration, and continued:

"'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.'"

Answering further the question as to what the attitude of the Chief of the Commodity Exchange Administration was toward matters of this kind, I am attaching hereto (exhibit D) certain excerpts from a report of the Chief of the Commodity Exchange Administration, contained in a letter addressed to the present Secretary of Agriculture, dated September 18, 1937. In this report Dr. Duvel says:

"Futures trading on properly conducted exchanges is commercially useful in several ways. The three principal functions are: (1) Providing a continuous market, (2) aiding in price determination, and (3) making hedging possible. By continuously evaluating known and expected price-making factors in terms of quotations for near and distant deliveries it develops what may be termed "the general price level" of the commodity. And it makes hedging (protection

against price hazards) practicable. All trading in commodity futures consists either in assuming price risks by speculation or shifting price risks by hedging.

"A futures market in action resembles an auction. Exchange members gather in pits or rings on the trading floor to negotiate, by competitive outcry of bids and offers, agreements to buy and sell a specified commodity. These agreements are contracts of the peculiar type called 'futures'."

Again, answering the question appearing in the Senate debate, why was not the Department of Agriculture consulted regarding this matter, I beg leave to call attention to the opinion of the highest expert authority in the Department of Agriculture. That authority is Dr. Hoffman, economist of the Department of Agriculture, at a public hearing before the Commodity Exchange Administration December 3, 1937, Docket No. 3, pages 403-405.

The following question was addressed to Dr. Hoffman:

"Mr. Chairman, I would like to ask just a couple of more questions. I have been here for 4 days listening to everybody else—in fact, I haven't slept for 4 nights because, with my limited education, it takes me hours what it might take these other fellows minutes.

"Dr. Hoffman, in your approach to the study of grain marketing, you have, so far, presented, the facts and figures which were undoubtedly, indisputably—they would show the detrimental effect of trading by large traders, and some of a smaller type. I would like to ask you this, if it is a fair question: Have you given any thought, or have you written any articles, bulletins, or papers that might show the benefit derived from speculative activities.

"Mr. HOFFMAN. Mr. Chairman, I think I am accurate in saying that I have written a good deal on the subject of the benefits of speculation and speculative activities.

"In my introductory comments, reviewing my writings on this subject, I did cite some of these references.

"There is a distinction to be drawn or, put it this way: One needs, in writing on the benefits or the adverse effect of speculative trading, to be very careful in so doing that he points out the varieties of speculative trading. It is not all of precisely the same character, and therefore, in dealing with the subject at any length, it is necessary to break up the types of trading found in grain markets such as this and separately characterize each type.

"I am willing to go on record that, after weighing the different types of speculative trading, the relative merits of each, that judged in their combined effect, I view speculative trading as a whole, taking due account of those aspects which are not desirable with those which are desirable, as being an excellent means of marketing grain in this country.

"Mr. KORTH. Thank you, Dr. Hoffman. That is certainly a very intelligent answer to my question."

With reference to the professional trader, the tax is occupational and in a sense is the only tax of its kind levied by the Federal Government. These traders also must pay every other form of regular and special tax paid by other businessmen. The unjustness of the tax is obvious, when one considers that it must be paid on a loss as well as on a profit. In practical effect it is a capital levy on this particular group and, with respect to them, as will be hereinafter pointed out, is confiscatory.

Another peculiarity of the tax is that it increases with the price of the commodity and its effects become proportionately more disastrous to the broker, who still must trade on the basis of one-eighth-cent profit or less. We have already demonstrated the effect of the tax on transactions in wheat when wheat is selling at $1.20 a bushel. If the price of wheat rises to $1.80, the tax on a sale of 10,000 bushels rises from $3.80 to $5.40, and if the day should come when wheat rises to $2.40 a bushel, then the tax on the same sale would be $7.20. When the price of wheat is $1.80, the loss on one such transaction will wipe out the gains of almost five profitable transactions. When wheat is at $2.40, the loss of one transaction will wipe out the gains from eight profitable transactions.

In a word, during the rising market, when liquidity is exceedingly important to prevent abrupt interruptions of a steady price trend upward, the hardships that this tax works upon the professional trader can be readily demonstrated by a practical example from the wheat market. As above pointed out, a professional trader seeks and ordinarily obtains no greater profit in the case of wheat—the same is true with respect to other commodities—than the minimum price unit in which the commodity can be dealt. Suppose, as stated in a previous brief, that trader A sells 10,000 bushels of wheat at the present prevailing price of $1.20 per bushel. Assume that this transaction results in a profit and not a

loss and that he makes the regular one-eighth cent per bushel. He would realize a gross profit of $12.50. In order to have the transaction cleared, he must pay a commission of $2.50 and a tax—3 cents for each $100 of value—of $3.60. Thus his profit on the transaction is $6.40. Now, let us assume that in the next transaction he suffers a loss. Computed on the basis of one-eighth cent, he would suffer a loss of $12.50 on the transaction. Add to this loss the commission of $2.50 and the tax of $3.60 and his actual loss is increased to $18.60, over three times the profit which he makes when the transaction results in a profit.

In other words, the loss on one transaction will entirely wipe out what he realized from three profitable transactions. Thus, if two-thirds of the trader's transactions result in a profit, he still suffers a loss on his day's work. Unless the trader carrying the risk is right more than 70 percent of the time, he must do business at a loss, and because of this tax.

The following is a striking illustration of the effect of this tax upon the business of the ordinary trader:

EXHIBIT A

C. L. Thompson & Co.: A firm of long standing, composed of two member partners who clear trades for themselves and a number of others. These men operate mostly in corn futures, on which the tax is smaller because of the cheaper price.

Net results of all trading for this concern for the entire period of the new tax rate:

	Net profit before tax	Tax paid	Percent of profit		Net profit before tax	Tax paid	Percent of profit
July 1932	$1,565.55	$937.85	60	December	1,050.00	553.65	52
August	2,082.35	1,714.50	82	January 1933	1,062.10	580.20	54
September	1,582.60	1,149.20	73	February	854.35	410.25	48
October	1,828.60	751.70	41	March	1,617.80	638.15	39
November	1,359.35	801.65	59	April	7,852.65	1,835.50	21

Edward H. Bagley: He has been a member for over 20 years and has been in the business from messenger boy up.

Net results of his trading for 2 months:

September 1932:

Net debit before tax	$613.55
Tax added to debit	877.70
Total net debit	1,491.25

October 1932:

Net credit before tax	976.15
Tax paid	697.26
Net credit	278.89

Without tax he would have made in the 2-months trading $362.50 but the payment of the tax left him with a net debit of $1,212.36, once again proving that the tax actually conscripts capital.

Frank L. Schreiner: This man has been a grain man all his life, is very active trader, has been a success for many years and as an individual belongs to a class that is very essential to the liquidity of the market.

His entire family has been engaged in the grain business for many years. He is a clearing member and is a perfect example of a victim of the present tax.

All personal trading for his account from July 1, 1932, to May 1933, show the following:

Net debit before taxes	$1,005.37
Tax paid	22,967.58
Total debit	23,972.95

How long can this continue?

C. J. Lucy: He has been a member since 1915, an active spreader in the center of wheat.

His operations for 1937 resulted:

Profit	$23,623.41
Tax	16,190.08
Net profit	7,433.33

Tax 69 percent of profit.

Milton Kirschbaum: He has been an active wheat trader since 1932.

His operation for 1937 follows:

Loss July	$5,662.46
Loss August	10,000.33
Profit for year before tax	7,054.84
Tax	6,325.01
Net profit	729.83

Tax absorbed almost 90 percent of his profit.

Vilas C. Kuhlman: He has been a member since 1930 and devotes all his time to rye trading.

His operations for 1937 resulted as follows:

Profit	124.73
Tax	1,810.67
Debit for year	1,685.94

Tax over 1,400 percent of profit.

Herman Gordon: He is a very active trader in wheat the last few years.

His operations for the year of 1937 resulted as follows:

Profit	$4,062.07
Tax	1,253.05
Net profit	2,809.02

Tax is 30 percent of his income.

Herbert McNamee: He has been a member since 1903. He is an oat trader and has been active in the grain trade the greater part of his life.

His operations for 1937 resulted as follows:

Profit	$3,774.78
Tax	704.03
Net profit	3,070.75

Tax amounted to 18.7 percent. Tax on oats figures approximately one-third that of wheat.

Fred C. Spinney: Member since 1914. Daily active trader, center of wheat pit.

Operations for 1937:

Profit	$2,270.58
Tax	1,903.28
Net profit	367.30

Tax exceeds 84 percent of profit.

T. F. Molyneaux: Member since 1910, daily active trader, clearing own trades and those of other floor traders.

Operations for 1937:

Profit	$13,313.94
Tax	6,842.61
Net profit	6,471.33

Tax over 51 percent of profit.

George F. Diehl & Co.: Mr. Diehl is a clearing member since 1902, handling a large volume of floor trades, employing five or more clerks.

Income statement of floor traders clearing through George F. Diehl & Co., calendar year of 1937.

Account	Profit	Loss	Tax	Net profit	Loss	Percent of profit
100	$7,793.83		$3,081.30	$4,712.80		40
101		$237.50	578.37		$815.87	
102		185.45	676.24		861.69	
103	840.21		1,208.96		468.75	163
104	6,210.95		2,532.93	3,678.02		40
105	14,663.46		14,540.11	123.35		99.16

Note account 105: The Government income from the year's work of this man was 11,800 percent of his own.

Lawrence J. Ryan, office: Clearing member handling daily trades for 10 floor traders active in all pits. Employs four clerks.

Tax payments and Clearing Corporation results for the crop year 1937.

	Tax paid	Clearing Corporation	
		Pay	Collects
July	$3,617.21		$19,618.75
August	3,188.97	$26,606.25	
September	2,015.61		9,753.75
October	1,293.57		5,258.25
November	1,282.41	4,253.75	
December	1,086.60		4,176.25
Total	12,514.37	30,860.00	38,805.00
Pay			30,860.00
Profit			7,945.00
Tax			12,514.37
Loss before computing office expenses, salaries, dues, etc			4,569.37

Alvin Anderson: Member since 1928. An active wheat trader. His operations for 1937 resulted as follows:

Profit	$5,824.72
Tax	1,840.32
Net profit	3,984.40

Tax amounted to approximately 32 percent.

Edw. W. Byrne: Member since 1927. Wheat trader. His operations for 1937 resulted as follows:

Profit	$135.84
Tax	1,188.77
Net loss	1,052.43

Tax amounted to 880 percent.

Frank M. Day: Member since 1916. Active wheat trader. His operations for 1937 resulted as follows:

Profit	$5,562.41
Tax	1,516.50
Net profit	4,045.91

Tax amounted to 38 percent of profit.

The necessity of a large active trading body has been proved by many hearings and investigations by Government departments and agencies as vital to the farmer's interest. If the farmers' market is to be maintained, this body must be enabled to perform its function or the farmers' welfare will be seriously jeopardized.

There has been an annual reduction in the number of floor traders for the past several years. The records of the Board of Trade Clearing Corporation show five firms or individuals whose business was practically wholly floor trade, retired during 1937 and were not replaced.

Practically any line of business gives opportunity of advancement to the industrious and it is significant that no floor trader improved his position sufficiently to become a clearing house member during 1937.

Also, no new firms became clearing house members.

Clearing house members for this type of trader act more as a collecting agency for the Government than as a business firm. They receive less for their service than the taxes they collect for the Government.

Were there laws imposing a severe tax on the uncollectible fees of physicians, lawyers, and other professional men, a tax on credit losses of merchants, a tax on the withering and wilting of flowers in florists' hands, a tax on breakage of art works in a dealer's hands, or a tax on a decline of value on highly perishable items in a transportation company's possession, it would be analogous to the position of the grain trader.

It must not be assumed that the elimination of this tax would result in depriving the Treasury of 100 percent of the revenue as the grain trader would be restored to the ranks of the prosperous, resume his normal expenditures for the labor and product of others, and still contribute to support his Government through income tax.

In the continued imposition of this unjust tax one cannot read the record of hearings without being convinced that the action of the Government is inequitable and harassing to a legitimate business. If one is free to assume, as in this case, that the present system of marketing agricultural commodities through the functioning of organized exchanges is an essential factor in our economic fabric and that to use the words in Senator Harrison's report in 1934, "that the present high rate of tax is detrimental to the establishment of a stable market price for produce," then the tax originally imposed as an emergency measure should, like other nuisance taxes, be lifted and repealed.

The foregoing leaves but one conclusion, that the tax is driving the expert traders out of the exchange. The tax can be justified only on the grounds that the floor traders can perform no function important in the distribution of produce and hence should be taxed to the point of destruction.

We do not believe that Congress wishes the abolition of a system of exchange which is the recognized method of all civilized nations that deal with similar problems. Ex-Secretary Wallace set his face against any legislation that would prohibit the sale or purchase of contracts for future delivery and was not afraid to say this in his letter to Senator Norris.

Unfortunately, when this tax was last under discussion in 1932 and 1934, the business skies were clouded with attack and counterattack upon all kinds of speculation. To these attacks one finds a comforting assurance in the opinion of that great philosopher, statesman, and jurist, Justice Holmes (*Board of Trade of City of Chicago* v. *Christie Grain and Stock Co.*, 198 U. S. 236). His vision was far-flung. He not only comprehended the present, but he faced the future with a realism that was all-compelling. He saw the evils of speculation but recognized, as he said, "that people will endeavor to forecast the future and to make agreements according to their prophecy." Said Justice Holmes in *Board of Trade* v. *Christie Grain and Stock Co.*, "Speculation of this kind by competent men is the self-adjustment of society to the probable. Its value is well known as a means of avoiding or mitigating catastrophes, equalizing prices, and providing for periods of want. It is true that the success of the strong induces imitation by the weak, and that incompetent persons bring themselves to ruin by undertaking to speculate in their turn. But legislatures and courts generally have recognized that the natural evolutions of a complex society are to be touched only with a very cautious hand, and that such coarse attempts at a remedy for the waste incident to every social function as a simple prohibition and laws to stop its being are harmful and vain. The Court has upheld sales of stock for future delivery and the substitution of parties.

Here is the finest expression of a solemn judgment by a sage and philosopher who never allowed a great object to be obscured through the mist of misunderstanding or prejudice.

I can think of no better, at least, no more human way of closing this discussion than by quoting from a personal letter received from one of the victims of this unjust tax. The letter is as follows:

"We are a loyal group of Americans appealing to our Government to right a wrong. We will be better citizens when that wrong is corrected and we cling to our chosen business, in the knowledge that a gross injustice such as this must be corrected. If we were seeking special favors against our fellow citizens, we should be send home with a scolding. We are not, and ask only that we be put on the same basis as our next-door neighbor. Give us the breathing

spell that this whole program professes to feel for the small semisuccessful businessman and the Government will not lose revenue but will take a major step in the rehabilitation of a group of right-thinking but discouraged citizens.

"Respectfully submitted.

"JOSEPH P. TUMULTY,
"Attorney for Committee Representing the
"Floor Traders of the Chicago Board of Trade."

EXHIBIT B

Internal revenue collections from the sale of future delivery stamps in the first Illinois collection district and in the entire United States.

Fiscal years ended June 30—	First Illinois collection district	Entire United States
1918 [1]	$992,804.22	$2,353,858.98
1919	3,836,165.26	7,263,571.00
1920	3,433,292.64	8,171,870.[illegible]
1921	4,576,186.90	7,521,075.44
1922	3,107,766.12	5,558,580.08
1923	2,250,194.04	7,015,881.68
1924	1,446,407.76	7,557,576.74
1925	2,804,015.13	5,397,147.98
1926	2,425,993.29	4,183,217.87
1927	1,647,882.49	2,884,534.45
1928	1,950,736.23	4,018,498.60
1929	1,816,557.66	3,333,427.14
1930	2,189,041.67	3,590,875.58
1931	1,050,171.49	1,682,680.56
1932	556,270.83	959,310.64
1933	2,216,375.06	4,206,597.74
1934	4,136,935.54	7,817,743.08
1935	2,260,909.17	3,950,544.00
1936	1,758,560.08	2,913,542.37

[1] Collections for the fiscal year 1918 cover the last 6 months only. Prior to January 1 1918, Bureau records do not indicate the tax derived from future trading in produce as a separate item.

NOTE.—The rates of taxation on sales of produce for future delivery at or under the rules or usages of any exchange, for each $100 in value or fraction thereof, were as follows:

Act of October 22, 1914 (effective December 1, 1914), 1 cent.
Act of October 3, 1917 (effective December 1, 1917), 2 cents.
Revenue Act of 1924 (effective July 3, 1924), 1 cent.
Revenue Act of 1932 (effective June 21, 1932), 5 cents.
Revenue Act of 1934 (effective May 10, 1934), 3 cents.

EXHIBIT C

EXTRACT FROM OPINION OF MR. JUSTICE HOLMES IN BOARD OF TRADE OF THE CITY OF CHICAGO V. CHRISTIE GRAIN AND STOCK CO. (198 U. S. 236)

Mr. Justice Holmes, in the course of his opinion, points out that the Chicago Board of Trade was incorporated by special chapter of the State of Illinois on February 18, 1859, and that (p. 245):

"The main feature of its management is that it maintains an exchange hall for the exclusive use of its members, which now has become one of the great grain and provision markets of the world. Three separate portions of this hall are known respectively as the wheat pit, the corn pit, and the provision pit. In these pits the members make sales and purchases exclusively for future delivery, the members dealing always as principals between themselves, and being bound practically, at least, as principals to those who employ them when they are not acting on their own behalf * * * (p. 246). It appears that in not less than three-quarters of the transactions in the grain pit there is no physical handing over of any grain, but that there is a settlement, either by the direct method, so-called, or by what is known as ringing up. The direct method consists simply in setting off contracts to buy wheat of a certain amount at a

certain time, against contracts to sell a like amount at the same time, and paying the difference of price in cash, at the end of the business day * * * (p. 247). As has appeared, the plaintiff's chamber of commerce is, in the first place, a great market where, through its eighteen hundred members, is transacted a large part of the grain and provision business of the world. Of course, in a modern market, contracts are not confined to sales for immediate delivery.

"People will endeavor to forecast the future, and to make agreements according to their prophecy. Speculation of this kind by competent men is the self-adjustment of society to the probable. Its value is well known as a means of avoiding or mitigating catastrophes, equalizing prices, and providing for periods of want. It is true that the success of the strong induces imitation by the weak, and that incompetent persons bring themselves to ruin by undertaking to speculate in their turn. But legislatures and courts generally have recognized that the natural evolutions of a complex society are to be touched only with a very cautious hand, and that such coarse attempts at a remedy for the waste incident to every social function as a simple prohibition and laws to stop its being are harmful and vain. This Court has upheld sales of stock for future delivery and the substitution of parties, provided for by the rules of the Chicago Stock Exchange * * *. The contracts made in the pits are contracts between the members. We must suppose that, from the beginning as now, if a member had a contract with another member to buy a certain amount of wheat at a certain time, and another to sell the same amount at the same time, it would be deemed unnecessary to exchange warehouse receipts. We must suppose that, then as now, a settlement would be made by the payment of differences, after the analogy of a clearing house. This naturally would take place no less that the contracts were made in good faith for actual delivery, since the result of actual delivery would be to leave the parties just where they were before * * *. The fact that contracts are satisfied in this way by set-off and the payment of differences detracts in no degree from the good faith of the parties, and if the parties know when they make such contracts that they are very likely to have a chance to satisfy them in that way, and intend to make use of it, that fact is perfectly consistent with a serious business purpose, and an intent that the contract shall mean what it says * * * (p. 249). It is none the less a serious business contract for a legitimate and useful purpose that it may be offset before the time of delivery in case delivery should not be needed or desired * * *. It seems to us an extraordinary and unlikely proposition that the dealings which give its character to the great market for future sales in this country are to be regarded as mere wagers or as 'pretended' buying or selling, without any intention of receiving and paying for the property bought, or of delivering the property sold within the meaning of the Illinois act * * *. The sales in the pits are not pretended, but as we have said, are meant and supposed to be binding. A set-off is, in legal effect, a delivery."

Exhibit D

REPORT OF THE CHIEF OF THE COMMODITY EXCHANGE ADMINISTRATION, 1937

Futures trading on properly conducted exchanges is commercially useful in several ways. The three principal functions are: (1) Providing a continuous market, (2) aiding in price determination, and (3) making hedging possible. By continuously evaluating known and expe[illegible] price-making factors in terms of quotations for near and distant deliveries it develops what may be termed the general price level of the commodity. And it makes hedging (protection against price hazards) practicable. All trading in commodity futures consists either in assuming price risks by speculation or shifting price risks by hedging.

A futures market in action resembles an auction. Exchange members gather in pits or rings on the trading floor to negotiate, by competitive outcry of bids and offers, agreements to buy and sell a specific commodity. These agreements are contracts of the peculiar type called futures.

EXHIBIT E

GENERAL MILLS, INC.,
EXECUTIVE OFFICES, CHAMBER OF COMMERCE BUILDING,
Minneapolis, Minn., February 5, 1938.

Mr. LAWRENCE J. RYAN,
Board of Trade Building,
Chicago, Ill.

DEAR MR. RYAN: Referring to your letter of January 27 regarding the tax on trading in grain futures:

We have been aware of the great burden that has been created through this tax on floor traders, which is having the effect of reducing their activities. This, in our judgment, is automatically reducing the liquidity of our grain future markets. As has often been stated, this tax is a burden on all grain operations where future trades are concerned, and while it affects smaller trades to a lesser extent it does prove extremely burdensome in the operations of the floor traders who in the performance of their economic functions make a large number of trades daily. Recognizing this fact, we have been increasingly disturbed as, in our opinion, any obstacle placed in the way of a free, active, liquid market would be harmful to all grain activities.

We were further disturbed because of our own hedging operations. In the conduct of our grain and milling activities, we operate a total of approximately 50 million bushels of grain storage space, of which about 10 million is country elevator and warehouse space consisting of nearly 235 country stations. This storage space is scattered from Buffalo, N. Y., west to the Pacific coast, and from Montana to Texas—in fact, in all active grain territories. Where possible, we depend upon the futures grain market for hedging purposes and, with the volume necessarily handled, under these widespread operations, we need a liquid-futures market in order to service the producer as well as the consumer in the most economical way.

The price determining the value of grain and flour is based very largely upon the prices established in the grain-futures market, which indicates the necessity of a sound and liquid market. It has been our opinion that the large floor-trading group assisted very materially in creating this liquid market, and therefore, that if the tax on grain futures could be eliminated it would have the effect of promoting greater activity on the part of these floor traders and promote a more efficient futures-trading operation, which would automatically create greater liquidity for the benefit of the producer and consumer alike through the reduction of the spread between buyer and seller.

As we view it at the present time, without relief from this burdensome tax as it affects the floor traders, we are quite fearful that it will have the further effect of reducing their activities to a minimum, which may have the effect of further widening the spread between producer and consumer. We are of the opinion, therefore, that the tax should be removed on grain-futures trades, and we hope that you will be successful in obtaining the necessary relief through Congress at this session.

Very truly yours,

L. N. PERRIN, *Vice President.*

EXHIBIT F

CONTINENTAL GRAIN CO.,
332 South La Salle Street, Chicago, February 2, 1938.

Mr. LAWRENCE J. RYAN,
Board of Trade Building, Chicago, Ill.

DEAR MR. RYAN: By reason of operating elevators at the most important primary markets and purchasing facilities in the important grain-producing territories throughout the country, we make very large use of the hedging facilities furnished by the Chicago Board of Trade.

Our business is dependent on a free, open, and liquid futures market in Chicago, where most of our hedges are placed when grain purchases are made, and these hedges have to be removed against export sales, or sales to domestic processors. When making offers on export inquiries, we have to compete against offers from other countries, and it is very important that our prices should be competitive. This we are enabled to do, due to our being able to buy in our hedges without disturbing the futures market to any large extent,

and the reason for our being able to do this is, that the futures-market liquidity is furnished by a group of active pit traders. This group so essential to our operations, is slowly being decimated through the levy of taxes on all its operations. Any lessening of their participation in the market diminishes the market's value to ourselves and the producer. Our affiliates engaged in grain handling in European countries, in former years used the Chicago futures market very extensively; they are, however, reluctant to pay this tax and all other things being equal, will use the Winnipeg or other foreign markets.

We earnestly wish to call your attention to the serious situation that would develop by any further impairment of the liquidity of the futures markets, as this would entail larger margin requirements when making purchases from the producer and also we would have to add larger margins when making offers on export inquiries.

Very truly yours,

CONTINENTAL GRAIN CO.
S. MAYER.

EXHIBIT G

ROSENBAUM BROS.,
Chicago, February 4, 1938.

Mr. LAWRENCE RYAN,
Chairman of Committee on Tax Elimination,
Chicago, Ill.

DEAR MR. RYAN: The matter of eliminating the tax on trading in grain futures is of great importance. We operate grain elevators in Chicago and Savanna, Ill., Winona, Minn., and Omaha, Nebr., and during the course of the year merchandise all grains, both in domestic and export channels. In addition to this, our subsidiary Vitality Mills, Inc., whose plant is located in Chicago, does an extensive business in commercial mixed feeds.

We maintain a full hedge position in connection not only with our grain operations, but our feed operations as well, at no time having any position whatsoever in the markets.

In view of the size of our operations, the question of tax on futures trades is a sizable factor in the expense of doing our business. For example, when the wheat crop starts to move, our hedges will go into the July future. These are subsequently switched to September, then to December, and finally to the May, so that altogether a big share of our wheat hedges are transferred a minimum of four times during the course of the crop year, adding a sizable visible cost to the handling of grain.

Inasmuch as futures markets afford us hedging facilities at all times, it is possible to handle grain without the necessity of adding to our selling price an item which compensates for business potential inventory shrinkage such as obtains in other industries.

As a general thing, we are enabled to make purchases of cash grain by "spotting" the board, knowing that we can get our hedge off at virtually that figure. The same thing is likewise true with respect to sales. However, in view of the fact that the cost of operations has been so greatly increased, insofar as the floor trader is concerned, danger to futures' liquidity has been brought into existence.

In the event that floor traders are compelled to decrease their operations, a condition which can indeed be brought about by apparent excessiveness of the tax in comparison to returns, it would not be possible to "spot" the board to the extent that obtains at the present time and as a result cash grain will have to be discounted sufficiently in purchasing same to allow for this. It is self-evident that this discount would perforce have to be passed on to the producer through a lowered buying price. On the other hand, a slightly greater margin would be necessary from the selling standpoint when hedges are removed, which of course, would be paid by the ultimate consumer.

A careful analysis of the situation leads us to believe that a continuation of this tax will, through curtailment of pit traders' activities, have a depressing effect upon producers' prices generally. The fact that this market, even at the present time, is carrying in excess of 150,000,000 bushels of hedges, clearly indicates that this is not a local but rather a national situation.

Yours very truly,

ROSENBAUM BROTHERS,
(Sgd.) H. S. AUSTRIAN,
President.

EXHIBIT H

BOARD OF TRADE BUILDING,
Chicago, Ill., November 10, 1937.

Hon. ROSWELL W. MAGILL,
Under Secretary of the Treasury,
Washington, D. C.

DEAR ROS: I have been a member of the Chicago Board of Trade for over 16 years, during the last 12 of which I have been engaged in personal trading in the wheat pit. In this capacity, there has been ample opportunity to study and appraise our trading mechanism, and, in a broader sense, to analyze the position and function of the board of trade in the whole economic structure of grain marketing. Honestly and confidently, I believe in our institution as a vital and necessary force for good in the distribution and financing of agricultural products. Otherwise, I should long since have turned elsewhere for my lifetime business interest.

Ros, you are aware that under the revenue act, there is a tax on all trades in grain futures amounting to 3 cents per $100 or fraction thereof of the value of the sale. In my personal experience as a result of this tax, I was compelled to pay a monthly tax for the privilege of conducting a legitimate business averaging around $200 when, during the depression years, there was little more than that to be made. It meant that at the end of every month, however lean in profits, $200 had first to be paid in Federal tax before a cent of my earnings became available for the primary needs of my family. If there was no residue or if the net result was a loss, there was no adjustment or compensation possible. I did as many another, turning to selling insurance afternoons and evenings to supplement the meager income from my regular business.

Please consider these facts: I do not review my experience to enlist sympathy. I do rather intend to fight for what I believe to be my right—and that of others—to earn a fair living from my chosen profession protected from blanket measures instituted through misinformation or purposes of punitive discipline. My experience is doubtless typical of that of the four hundred or five hundred-odd men engaged in personal trading in the pits of the Chicago Board of Trade. These men are as alert, honest, capable, subject to strict rules and discipline as any other group of busines men you will find anywhere. Their influence, politically, is wholly insignificant because of lack of numerical strength. Therefore they depend for their protection upon the fairness of the tax laws. There should be no more omniscient, omnipotent judge than justice.

I portest more earnestly that this tax is severely unjust, working so great hardship among our membership that decent living standards are maintained only with greatest difficulty. The tax is not, I believe, defensible from the standard of revenue production. If I am correct, less than $3,000,000 are obtained during the year ending July 1936, the last period for which I have any information. I firmly believe it could be shown where this sum or more could be raised from taxes under the income-tax law from those who have been unable to pay taxes, or whose payments fell below the surtax brackets, because of this tax on sales of grain futures.

I know the Board of Trade has, at one time or another, tried to enlist the aid of administrative agencies in removing this tax which seems only punitive in its effect. What is being done now, if anything, I do not know. Because no results have been forthcoming to date, I am asking this personal appeal as a citizen for the protection of his government. I feel that you will listen to such an appeal. I am ready and willing to take whatever steps may gain a fair presentation of my case.

The importance—to me and to many others—of this matter is submitted as my excuse for taking so much of your time.

Sincerely and fraternally yours,

BROOK B. BALLARD.

EXHIBIT I

VICTOR E. HERTER & CO.,
Dayton, Ohio, February 8, 1938.

Mr. L. J. RYAN,
Chicago, Ill.

DEAR SIR: We certainly are pleased to learn that someone is taking the initiative to eliminate the unfair tax on grain futures and are therefore moved to express our thoughts pertaining thereto.

We, as operators of country elevators and feed-mixing plants, buy from and sell to farmers direct as well as wholesalers and brokers. The continued imposition of this confiscatory tax will, we have no doubt, result in the curtailment of trade on the exchange floor which in turn can only result in lessening the liquidity of the grain market. The final result will be reflected in the price paid by us to the farmer for his grain because with a restricted market and its attendant wild fluctuations we will have no other alternative but to make a corresponding reduction in our bids to protect ourselves against potential losses.

Please feel free to call upon us at any time to help you in this worthwhile undertaking.

Yours truly,

V. E. HERTER & CO.,
J. M. CAMPBELL.

EXHIBIT J

SCHULTZ BAUJAN & CO.,
Beardstown, Ill., February 9, 1938.

Mr. VILAS C. KUHLMAN,
1232 Board of Trade, Chicago, Ill.:

Replying to your letter of the 5th, we can gladly join in all efforts for repeal of the excise tax on grain-futures transactions.

Our business consists of milling and merchandising of grain, flour, and commercial feeds. Fifty percent of our business is done direct with the farmers, especially during harvest time and during the time when the big movement of wheat is on. In order to pay the farmer a maximum price for his grain, of course we have to place hedges immediately, either in Chicago or St. Louis. If it were not for the tax on grain futures, we, of course, could pay the farmer a little more for his grain. We always have thought that this tax was uncalled for and works directly against the farmer and inconsistent with the trend of the day to help the farmer.

We feel that the tax has interfered materially with the functioning of the market, and, no doubt, we would have a better market without it, and we are very anxious to cooperate in every way to urge its repeal.

Yours very truly,

SCHULTZ BAUJAN & CO.,
By A. G. SCHULTZ.

EXHIBIT K

THE HUNTER MILLING CO.,
Wellington, Kans., February 3, 1938.

Mr. LAWRENCE J. RYAN,
1215 Board of Trade Building, Chicago, Ill.

DEAR SIR: Replying to your letter, we gladly subscribe to all efforts for repeal of the excise tax on grain-futures transactions.

Our business consists of milling and merchandising of grain, chiefly wheat, and the manufacture and sale of feed. We constitute a close bond between the farmer and the grain exchanges. At the time of heavy movement of grain we buy grain from the farmer at prevailing market prices far in excess of our immediate needs because we know that we can place hedges immediately either in Chicago or Kansas City. Similarly, through ready access to this hedging medium, we can book forward sales of flour in excess of our immediate supply of cash wheat. Because these markets possess liquidity, absorptive power, and move in minimum, orderly price ranges, we are enabled to pay maximum prices to the farmer for wheat, to provide flour to consumers at low cost, and to reduce our own operating risk.

We believe that the professional traders form an integral and necessary part of this marketing machinery and that their operations should not be restricted, and, indeed, their very existence as a group jeopardized, by the levying of this tax on grain-futures sales.

We feel that the tax interferes with the natural functioning of the market and will gladly cooperate in every way possible to urge its repeal.

Very truly yours,

J. H. CARR, *Secretary-Treasurer.*

The CHAIRMAN. Mr. Lawrence J. Ryan, also a member of the committee representing floor traders of the Chicago Board of Trade.

STATEMENT OF LAWRENCE J. RYAN, COMMITTEE REPRESENTING FLOOR TRADERS OF THE CHICAGO BOARD OF TRADE

Mr. RYAN. I am here in behalf of 300 pit traders of the Chicago Board of Trade to ask the elimination of a tax which bears no relationship to income or ability to pay. Under this tax, if we make a profit, we pay a tax. If we suffer a loss, we pay a tax; and under the change proposed by the Ways and Means Committee regarding scratch sales, when we trade with neither a profit or a loss, we pay a tax. This form of taxation is so unjust, so unduly burdensome and so uneconomic that it should not be part of our taxation structure. It seems illogical to appropriate $150,000,000 to force farm prices to a parity and at the same time insist upon a continuance of a tax of approximately $4,000,000 which nullifies to a great extent the benefits intended by the expenditure of this huge sum. We, like other citizens, are willing and anxious to share the burdens of taxation with our fellow citizens but we believe that the basis of all taxation should be ability to pay. We take pride in our achievements in moving farm products from the field to the consumer's homes. We ask nothing more than that we shall be permitted to pursue our business and not be unjustly taxed. Since my appearance before the House Ways and Means Committee, conditions in our trade have become progressively worse. Six firms have ceased to do business since January 1. On January 31 our clearing house had 714 shares outstanding. They have now been reduced to 558. The lay-off of men on March 1 was distressing, indeed. Men connected with firms over 15 years were released. Some of those were phone men holding membership, who undoubtedly will be forced to dispose of them and further depress the price.

Expert testimony shows that the average prices of farm products have been elevated by the operation of the futures market. The liquidity of the futures market is sustained by the floor traders and their destruction by this character of confiscatory taxation would mean a great injury to the farmers.

Scratch sales, like hedging, form an integral part of the functions of the futures market and contribute to its liquidity, serving as a stabilizing influence and facilitate the handling of orders. In connection with the amendment found in the House bill imposing a tax of 1 cent on scratch sales, which sales up to this time had been free of tax, attention is called to the fact that this tax suggested to be imposed by the Ways and Means Committee, would impose upon the commission house considerable bookkeeping and clerical expense which would be passed on to the floor trader in the form of increased commissions. Let us consider the plight of a pit spreader who at pres-

ent scratches 75 percent of his trade. Based on daily volume of 100,000 bushels, at $1:

Total	100,000
Scratch	75,000
Net trade subject to charges	25,000
Commission	$6.25
Tax	7.50
Total	13.75

If 25,000 bushels cleared has a profit of one-eighth, or $31.25, he nets $17.50. If the result should be a loss of one-eighth, his debit would be $45. Under the House recommendation of eliminating the scratch exemption, and reducing the rate to 1 cent, the result of one-eighth profit on the same transaction would be—

Tax	$10
Commission	25
Total	[1] 35

[1] Or a loss of $3.75.

Thus the House proposal becomes an increase in tax rather than a reduction.

The CHAIRMAN. There was no tax on scratch sales before the House recommended it?

Mr. RYAN. No, sir; there was not.

The CHAIRMAN. Well, do you judge the action of the House helped your situation, by the inclusion of scratch sales, where there was no tax on scratch sales?

Mr. RYAN. We have been hurt. Naturally, a large part of our trading has to scratch. It frequently happens that we have to commit ourselves beyond our capacity, because of the volume at which stuff is offered and bid for. Ours is a competitive market and offers to buy or sell are subject to first acceptance. A trader long 10,000 bushels of wheat at one-fourth, which is the bid price, strives to sell same at three-eighths, at which price there are several offers. A broker receiving a substantial buying order bids three-eighths for 25,000 or 50,000, and the long trader sells it to insure a profit on his holdings, even though this momentarily commits him beyond his capacity. He immediately buys in the surplus, scratching the amount beyond his long position.

The CHAIRMAN. It is the idea that the more transactions there are on the board of trade in grain, the more market there is it helps the price of the grain?

Mr. RYAN. Yes. The greater the volume the greater the liquidity and the closer the merchant can bring the market to the farmer, knowing it is a liquid market. Canada had this tax at one time. They not only eliminated it, but refunded all that they collected.

The CHAIRMAN. It was 3 cents?

Mr. RYAN. Yes.

The CHAIRMAN. And it was to go out of existence in 1939?

Mr. RYAN. Yes.

The CHAIRMAN. The House reduced the tax from 3 cents to 1 cent, and brought the date up, so it goes out now a year ahead of that time on the proposed law?

Mr. RYAN. Yes.

The CHAIRMAN. In addition to that they put a tax on scratch sales?

Mr. RYAN. Yes, sir.

The CHAIRMAN. Is that tax permanent, on scratch sales, or does that go out at the same time as the other tax?

Mr. RYAN. Well, this tax on scratch sales would become permanent under the reduction of one cent.

Senator BROWN. How much revenue is involved?

Mr. RYAN. Well, for the period of the last 15 years, excepting 1932, when it was less than one million in the entire United States, it varied from $1,700,000 to $8,000,000, and the first district of Illinois—that is, Chicago—pays about 60 percent of this.

To our knowledge this tax situation accounts for the only time we have appeared before Congress seeking relief, and we believe it was the intent to help. The proposed change would benefit merchandisers, processors, and speculators, and the only ones not aided are the floor traders, who sought aid and brought this matter to legislative attention. We do not feel our pleas fell on unsympathetic ears, and were probably remiss in not explaining the technology of scratching. We were deeply grateful for the opportunity of appearing before the Ways and Means Committee, and were loathe to burden its members with too much detail, and did not foresee a tax on scratch sales arising.

Hedging sales normally remain in the market for considerable periods, and must be carried by some buyer until removed. The ultimate buyer is not always instantaneously available for each hedge, and it frequently passes through several hands during the same day. We do not feel it was ever the intent to tax the same bushel of wheat several times.

As Mr. O'Connor, of New York, said when the bill was up for discussion in the House:

> In spite of the general opinion, supported by the Department of Agriculture and other governmental agencies, that the tax of 3 percent on commodity sales on our produce exchanges should be entirely repealed, this bill merely reduces the tax to 1 percent; but although the Department of Agriculture agreed that the tax should be entirely repealed, in addition to only reducing the tax to 1 percent, this bill places a new tax on what are known as "scratch sales" on the commodity exchanges, where a certain amount of a commodity is sold at one time in a day, and the same amount of the same commodity is bought during the same day, or vice versa, all at the same price so that there is no gain or loss in price on the commodity. This is what is sometimes called a "wash sale." But, mark you, this bill now puts a 1-percent tax on that kind of a transaction, which will many times increase the burden on our citizens dealing in commodities rather than relieve them to any extent. That innovation by itself is typical of the present attitude toward our taxpayers. In all the instances just recited, it is the best opinion of experts on taxation and economics that more revenue would be received by the Government if such taxes were repealed rather than by their continuance or modification.

These men, human beings like you, are being destroyed financially, physically, and in spirit by the viciousness of this tax. Any successful effort is reduced by the tax, and the grief of unsuccessful effort is increased by the tax. Some have found it necessary to augment their

income by part-time jobs after exchange hours, many who in former days found their amusement in golf have been compelled to give it up, some have disposed of their cars, others have given up their homes, and some lacked money to bury the dead in their immediate family.

Suspensions due to nonpayment of dues are numerous, and others were forced to sell their membership to satisfy claims. The strain of trying to trade profitably under this tax burden has broken the health of many, and since men of sufficient caliber are not available, they are not being replaced. This has resulted in decreased employment and hundreds of former workers are today without jobs, and this number will be increased presently as I know of two firms who are retiring from business.

The further destruction of this group will ruin the liquidity of the farmers' market, and I think most marketing students will agree this group's elimination would result in a considerable reduction in the average price of wheat and corn. Figured at only 1 cent per bushel, this would result in over $36,000,000 loss to the Nation's farmers, which is many times the tax collected. It would probably be of sufficient proportions to make necessary some kind of Federal subsidy. The proponents of placing an impoverishing tax upon us state that the revenue to the Government is unimportant, but the farmers' market is important, and the Department of Agriculture says this tax is a burden on the men responsible for furnishing a market to the farmer. Canada placed a similar tax on their market, and after 1 year canceled it and refunded all the money collected.

Today, because of the tax and restrictions and the effect of both on the market, foreign buying which used to come into American markets is now placed in Winnipeg. It is difficult to determine the loss to American merchants and industry and to the Government itself occasioned by the building up of a competing nation at the expense of our own people, and I think the spectacle of Winnipeg May wheat selling 31 cents over Chicago is very significant.

Since this tax is devitalizing a group of earnest citizens, destroying a farmers' market and reducing their income, diverting trade and revenue to a foreign country, causing unemployment, and is unimportant in Federal revenue, we think it would be constructive action to eliminate this unjust law.

The CHAIRMAN. Thank you very much.

Dr. Henderson, professor of applied physiology, Yale University. He will talk on subjects most novel and interesting. Doctor, be as brief as possible. We have your brief, and the matter will be considered fully by the committee.

STATEMENT OF YANDELL HENDERSON, NEW HAVEN, CONN., PROFESSOR OF APPLIED PHYSIOLOGY, YALE UNIVERSITY

Mr. HENDERSON. I handed in a statement that is not very long. I shall only read one or two paragraphs from it.

The CHAIRMAN. I wish you would just point out the high spots, so we will understand it.

Mr. HENDERSON. I should like to submit, before Monday, an addition containing some figures that I did not have time to include.

The bill, as it comes from the House to the Senate, is for a 25-cent increase on a gallon of liquor. That is from $2 to $2.25. It is my belief that that figure ought to be $1 more; that is, that the tax instead of being $2 ought to be $3.

I spent a great deal of time in studying our liquor situation here and in other countries, and it is my firm belief that the bootlegger today is a bogeyman to scare Congress. There is ample profit and profiteering—taking the distilled-spirits industry as a whole—ample profiteering to pay an extra dollar per gallon.

Now, when Congress sets the tax at $2 or $2.25, or any other figure, it merely establishes the apparent tax. The real tax is determined by another figure, that may be called the dilution allowance, and that figure is set under another law, namely, the Federal Alcohol Administration Act. This act authorizes the Alcohol Administrator to set the amount by which spirits may be diluted and yet be legally labeled and sold as whisky or other forms of spirits. At present the lowest figure to which we can go is 80 proof. I am suggesting that it should be allowed to go down to 60 proof, but merely as a sort of a sop to this bogeyman, the bootlegger.

Concretely, my suggestion is that the nominal tax—that is, the tax on each gallon of 100-proof spirits—should be raised to $3, and also that the Alcohol Administration Act should be amended so as to permit the bottling, labeling, and sale of spirits down to 60 proof. If these two steps were combined, the Government would obtain an increased revenue, not merely of thirty or thirty-five millions that the $2.25 tax is expected to produce, but certainly more than $100,000,000, and without promoting bootlegging.

The CHAIRMAN. What is the nominal now?

Mr. HENDERSON. Eighty. The lowest that is on the market, I think, is 87. Most of the whisky is sold at 87 and 88.

Senator HERRING. Why don't they go down to 80?

Mr. HENDERSON. There isn't any pressure. Whisky costs so little that they could as well put water in bottles as whisky.

Senator HERRING. Would you like to sell water instead of liquor?

Mr. HENDERSON. I would like the Government to get a good deal more money on it, and a little pressure on the industry to dilute spirits would also result in killing fewer people with automobiles. I do not want to go into that, but we are killing 100 a day, and 10 to 15 of those are due to alcohol. I am trying to help on the matter of finances now, which is properly not my business, perhaps.

I do not mean that all bootlegging would stop. There will probably always be small amounts of illicit distilling in out-of-the-way places. But there would be no stronger motive for the making of illicit liquor than at present, for the cheapest legal liquor would not cost the consumer any more than now. I have learned from the officials of the Treasury Department that among thousands of seizures of illicit spirits very few have run higher than 70 proof, and many are of even lower proof. To require legal spirits to be stronger than illicit spirits is to give aid, comfort, and support to the bootlegger. That is one reason, and there are several other very good reasons why the Alcohol Administration should be authorized to lower the allowable dilution from the present figure of 80 proof to 60 proof.

Whisky or any other form of distilled spirits at 60 proof is milder than at 80 proof and much milder than 100 proof. But it is not a

weak drink; it is a very strong drink. One of the standard drinks now is the dry Martini cocktail. I analyzed a Martini from my club a short time ago. It was not by any means a weak cocktail, and yet it was only 58 proof. That is as strong as can be swallowed without burning the throat. It is true that a few men become addicted to drinking straight 88- to 100-proof whisky without diluting it. But that process soon destroys the lining of the stomach and results ultimately in serious alcoholic addiction.

The proposal to permit whisky down to 60 proof to be labeled and sold as whisky is one to which by itself the distilling industry cannot, and I believe will not, offer any serious objection. Indeed, I know that some of the leaders of that industry have seriously considered the introduction of 80-proof whisky, the lowest that would now be legal. The introduction on the market of even lower-proof whiskies would tend to head off the movement toward a return to prohibition that the liquor trade now greatly fears.

With a tax of $3 on a gallon of 100 proof, the real tax on 60 proof would be $1.80 a gallon, which is nearly the same as the real tax on the mildest whisky now on the market, namely, 87 proof, with a real tax of $1.74. With a basic tax of $3, the real tax on 80 proof would be $2.40; on 90 proof, $2.70, and on the 100-proof bottled-in-bond whisky, both the nominal tax and the real tax would be $3. Why anyone should insist on buying and drinking such fiery stuff as 100-proof spirits, I do not know. But I do know that nearly every other civilized country has taxed 100 proof off its market. In England and Sweden and elsewhere no spirits are now sold above 80 proof. The British distillers send us 87 proof but they offer nothing above 80 on their own home market. If some people in this country want 100 proof there is no reason why they should not pay more for it.

The suggestion of lower concentration and higher tax is not a new idea. It was adopted by Lloyd George in England early in the war and has been in effect ever since. The dilution allowance is 30-off proof; that is, 70 percent of the British proof. The basic tax is £3 12s. 6d., or $18, but as their gallon is larger and their proof higher than ours, this amounts to a basic tax of $14.50 on an American proof-gallon. It is about five times the sum of our Federal and State taxes. The standard price of a bottle of 30-off-proof whisky in England is 12 shillings and 6 pence, or $3.12. And under these conditions of tax, dilution, and price, the distilling industry makes a good profit.

The distillers in England, some of them, are among the richest men in England, and some of them sit in the House of Lords.

The CHAIRMAN. The average fellow who drinks dilutes his liquor, does he not?

Mr. HENDERSON. Yes; I think he does; but if you look along the roads today you see a large number of bottles thrown out of cars, and that liquor is drunk without dilution. That again is not a financial question, it is a social question, and I am trying to point out that with such a combination of arrangements you can well afford to raise the tax to $3 a proof gallon and thereby promote dilution.

Now, let me give you these figures as they compare between England and America. I had a long conference a few months ago with Mr. C. E. Collins, chief inspector of the port of London. The tax over there, on an imperial gallon of their proof--that is, our 80

proof—is $12.60. On their gallon at 70 proof, and 5 bottles—of course, there are 5 bottles in their gallon—comes to $15.60. The whole British industry is run on a spread between tax and ultimate sales price of $3.

Now you compare that with our situation. Our taxes are $2 Federal, and as a maximum, $1 State, or $3. We sell a gallon of four bottles for $2 apiece, or $3 apiece. That is $8 to $12. That makes a spread of from $5 to $9 as against the spread of $3 in England, and I submit that a spread of $3 in this country should cover all of the manufacturing costs and leave a good profit of $1 or $2, and out of that the Government should take in taxes, and the industry can perfectly well afford, to pay an extra dollar a gallon Federal tax.

As I figure it, on 122,000,000 gallons the American people today pay $1,162,000,000. The taxes, Federal and State, are $366,000,000. A reasonable cost of manufacture and merchandising, at $3 a gallon, would be $366,000,000. They are profiteering to the extent, then, of $430,000,000, and out of that they can well afford to pay a dollar a gallon more, and out of that the Government would get well over $100,000,000.

Now, I am puzzled to know as to just where this enormous profit or profiteering goes, and I suggest that a lot of it goes into advertisements, and I would make an additional suggestion that you put a 10-percent tax on liquor advertisements.

The CHAIRMAN. You elaborated on the proposition in your brief?

Mr. HENDERSON. Yes, sir. These figures I want to have typewritten and send in as supplementary figures. I got them rather late. I have accepted the figures offered by the Distilled Spirits Institute.

COMPARISON OF AMERICAN AND BRITISH LIQUOR TAXES AND COSTS TO SHOW THAT THE DISTILLED SPIRITS INDUSTRY HERE IS PROFITEERING TO THE EXTENT OF $2 TO $6 A GALLON OVER AND ABOVE ALL REASONABLE COSTS OF MANUFACTURE AND MERCHANDISING, OR A TOTAL APPROXIMATING $430,000,000 A YEAR

The British tax on an imperial gallon 100 British proof is $18. (British proof = 57 percent alcohol, American proof = 50 percent alcohol.)

All British spirits are diluted to 70 percent British proof making the tax per gallon ($18 by $0.70), $12.60.

The imperial gallon equals 1.25 American gallons and fills 5 quart bottles which are sold at retail for $3.12 each, or $15.60 per gallon.

The spread between tax and receipts is therefore $3 per gallon, which covers all costs of manufacture, merchandising, and profits. And the profits are sufficient to pay liberal returns on the capitalization. It is a prosperous industry.

In comparison the American Federal tax per gallon, 100 proof, is $2, to which the States generally add $1; total tax, $3.

The American gallon fills only 4 quart bottles, of which 70 percent are sold at $2 a bottle, or $8 a gallon; and 30 percent at $3 a bottle, or $12 a gallon. Spread between taxes and receipts, $8—$3=$5; $12—$3=$9.

The Distilled Spirits Institute reports that the "naked production cost" of a gallon of whisky in America now is 50 to 60 cents, or at most, 15 cents a quart.

It is fair to assume that $3 per gallon would be a liberal estimate of the cost of manufacture and merchandising for American whisky. If so, the industry here is profiteering to the extent of at least $2 a gallon on the cheaper priced whiskies and $6 a gallon on the higher-priced whiskies.

Undoubtedly a considerable part of the funds thus obtained are spent on extravagant advertising, which itself might well be taxed. The organization of the trade through which spirits pass after leaving the distilleries and before reaching the consumers is complicated and extravagant.

The total paid by the American public for its whisky (122,000,000 gallons) annually is $1,162,000,000. The taxes on 122,000,000 gallons are $366,000,000. The cost of manufacturing and merchandising at $3 a gallon would be $366,000,000.

The inevitable conclusion is that the industry as a whole is profiteering to the extent of $430,000,000. From this sum the Government may fairly ask for $100,000,000 additional in taxes.

Herewith is a draft of the amendments to the tax bill that I would suggest.

Now, I would like to have this amendment appear in the record.

The CHAIRMAN. Very well.

(The amendment is as follows:)

AMENDMENT TO THE TAX BILL SUGGESTED BY PROF. YANDELL HENDERSON AND DRAFTED BY PROF. GEORGE H. DESSION, TO INCREASE THE REVENUE FROM DISTILLED SPIRITS BY (A) RAISING THE TAX PER PROOF GALLON, AND (B) LOWERING THE REQUIRED DEGREE OF PROOF

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. This Act may be cited as the "Liquor Taxing Act of 1938."

SEC. 2. Paragraph 4 of subdivision (a) of section 600 of the Revenue Act of 1918, as amended (relating to the tax on distilled spirits generally and the tax on distilled spirits diverted for beverage purposes), is amended to read as follows:

"(4) On and after the effective date of title I of the Liquor Taxing Act of 1934, and until the effective date of the Liquor Taxing Act of 1938, $2 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon and on the effective date of the Liquor Taxing Act of 1938, $3 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon."

SEC. 3. Subdivision (e) (2) of section 5 (dealing with labeling) of the Federal Alcohol Administration Act, approved August 29, 1935, is amended to read as follows:

"(2) As will provide the consumer with adequate information as to the identity and quality of the products, the alcoholic content thereof (except that the Administration may at any time authorize the labeling of distilled spirits of not less than sixty degrees of proof as whisky, brandy, rum, or gin; except further that statement of, or statements likely to be considered as statements of, alcoholic content of malt beverages are hereby prohibited unless required by State law; and except further that, in case of wines, statements of alcoholic content shall be required only for wines containing more than 14 per centum of alcohol by volume), the net contents of the package, and the manufacturer or bottler or importer of the product; * * *."

SEC. 4. Subdivision (f) of section 5 (dealing with advertising) of the Federal Alocohol Administration Act, approved August 29, 1935, is amended to read as follows:

"(2) As will provide the consumer with adequate information as to the identity and quality of the products advertised, the alcoholic contents thereof (except that the Administration may at any time authorize the advertising of distilled spirits of not less than sixty degrees of proof as whisky, brandy, rum, or gin; except further that statements of, or statements likely to be considered as statements of, alcoholic content of malt beverages are prohibited; and except further that, in case of wines, statements of alcoholic content shall be required only for wines containing more than 14 per centum of alcohol by volume), and the person responsible for the advertisement; * * *."

SEC. 5. This Act shall take effect on the day following its enactment.

The CHAIRMAN. Mr. W. L. Finger, of New York City, representing the Rubber Manufacturers' Association, Inc. He desires to talk on the tax on tires and tubes.

STATEMENT OF W. L. FINGER, REPRESENTING THE RUBBER MANUFACTURERS' ASSOCIATION, INC.

Mr. FINGER. Mr. Chairman and gentlemen of the committee, my name is William L. Finger. I am assistant to the general manager of the Rubber Manufacturers' Association, 444 Madison Avenue, New York City, and am chairman of the tire manufacturers' division of this association.

I want to talk very briefly about the excise tax on tires and tubes. In this matter the Rubber Manufacturers' Association is authorized to speak for all manufacturers of tires and tubes in the country.

In principle we believe that all excise taxes should be abolished. We recognize, however, that this is not practicable at the present time, but we suggest that the existing rate of excise tax on tires and tubes should be reduced.

The excise tax on tires and tubes, which yielded $40,000,000 in 1937, is based on weight and amounts to about 8 percent ad valorem on tires and about 12 percent on tubes. These percentages are supported by official statistics which, with your permission, I will insert in the record but will not take time to read.

Excise tax on tires and inner tubes, 1936–1937

TIRES

Year	Excise tax paid	Wholesale value	Percent of wholesale value represented by excise tax
1936	$31,837,510	$374,044,000	8.5
1937	33,300,197	411,331,444	8.1
INNER TUBES			
1936	$6,401,012	$49,900,000	12.8
1937	6,587,305	53,037,032	12.4

Tires and tubes are nothing but automobile parts and accessories. Paragraph (c) of section 606 of the act, covering automobile parts and accessories, admits that tires and tubes are classified in this category, but excludes them from the regular rate fixed for such parts and accessories. This rate is 2 percent, and we submit that in logic and in fairness the rate on tires and tubes should not be appreciably higher than the regular rate of 2 percent for parts and accessories.

The excise tax on other necessities, and even on several luxuries, is only 2 or 3 percent. In no case where the tax is on a percentage basis does it exceed 10 percent, and that rate is conditioned to strictly luxury products.

Tires and tubes are not luxury products in any sense but are necessities used by all classes, including large numbers of workers and farmers.

In this connection, it is worth pointing out that perhaps the most significant development now taking place in the tire industry is the

rapid growth in the use of rubber tires for tractors and other farm implements. It is significant that the tractors and other farm implements themselves are not subject to the excise tax at all. The sale of farm-implement tires has been advancing by leaps and bounds for the past 3 or 4 years, and it is predicted that the day is not far distant when the majority of all such implements will be equipped with rubber tires. This year 75 percent of the farm tractors sold will be on rubber tires. We do not believe that the tires which a farmer uses to plow his ground, to harvest his crop, or haul it to market, or which the laborer uses to go to his work, should be subject to any higher tax than that which is levied on similar products.

The House bill proposes to eliminate the excise tax on a number of products, the total yield from which amounts to about $25,000,000 a year. Most of the products on which the repeal of the tax is recommended are luxuries, such as furs, sporting goods, cameras and lenses, chewing gum, phonograph records, cosmetics, brewer's wort and malt.

Would it not be much more beneficial to the great mass of people to reduce the excessively high excise tax on tires and tubes which are necessities used by all classes of people, than to repeal the tax on luxuries such as those mentioned?

It would be fair, theoretically, to reduce the tax on tires and tubes to the equivalent of 2 percent. We recognize that such a reduction would entail the lost of more revenue than the amount set by experts and by the House bill. We suggest, however, that the amount of the tax could be reduced by 12 or 13 million dollars a year, or by a third, instead of repealing it on some of the items mentioned above.

Furthermore, it may be possible for the tax experts to discover other products not now subject to an excise tax, on which such a tax could be placed without injury, to compensate for the reduction that might be made in the tax on tires and tubes.

The present method of assessing the tax on a pound basis has proved to be convenient from an administrative standpoint and we recommend the retention of this method, but a reduction in the rate on tires from 2¼ to 1½ cents a pound and on tubes from 4 cents to 2½ cents a pound.

This would still leave the rate of our tax or three times as high as the rate on similar products, but would be at least a step in the right direction.

Mr. Chairman, we have explained this problem several times to congressional committees and to Treasury officials. Not once have the justice and reasonableness of our position been challenged. The only explanations given for failure to make a correction are, the Government needs the money, this tax is lucrative, and is very easy to collect. It is true that the Government needs the money, but is that a valid reason for saddling any commodity, especially a necessity, with an unjustifiably high and discriminatory tax? Moreover, this tax will not make or break the fiscal position of the Government. It is true that the tax is lucrative, because it is four times as high as it ought to be in fairness and in logic. It is true that the tax is easy to collect, because the Rubber Manufacturers Association, with the approval and supervision of the Treasury, organized and helps to operate the machinery that makes the collection of this tax very simple and easy. Should we be penalized by making it easy to collect this tax?

We respectfully ask for at least a partial correction of this inequity which has already stood for 6 years.

Now, tires and tubes are nothing but automobile parts and accessories.

The CHAIRMAN. Well, they were so taxed at one time, as I recall it.

Mr. FINGER. I do not believe so; no, sir.

The CHAIRMAN. They were not?

Mr. FINGER. No, sir. Since these excise taxes were placed into effect as an emergency measure in 1932, tires and tubes have always been taxed separately from other automobile parts and accessories.

The CHAIRMAN. But we made a change in the law. When was that?

Mr. FINGER. I do not believe that any change has been made, sir.

The CHAIRMAN. We took the entire question up. I think it was about 4 years ago, or 6 years ago, I have forgotten. I cannot remember these dates.

Mr. FINGER. The tax was first placed, sir, in 1932, and the rate fixed then was 2¼ cents a pound on the total weight of tires, 4 cents a pound on the total weight of tubes, and that rate, to the best of my knowledge, and I believe I am correct, has not been altered.

The CHAIRMAN. What was the weight before that?

Mr. FINGER. There was no tax before that. It was one of the emergency excise taxes.

The CHAIRMAN. But they were taxing automobile parts, were they not?

Mr. FINGER. Not to my knowledge.

The CHAIRMAN. There was no tax on automobile tires and tubes then prior to 1932?

Mr. FINGER. To the best of my knowledge there was not.

Senator BROWN. Is there any double taxation in the case of a new car sold by the manufacturer to the dealer? Do you again pay the tax on the entire purchase price, or is the tax on tires and tubes deducted before it is put on the entire purchase price of the car?

Mr. FINGER. I believe the tax on tires and tubes is deducted, so there is no double taxation in that respect. I will be glad to verify that.

Senator BROWN. I wish you would check on that.

The CHAIRMAN. Why did the tires and tubes escape taxation before 1932? Was it because they were made from imported rubber? Before 1932 there was no tax on tires and tubes, but there was a tax on automobile parts. That is true, is it not?

Mr. FINGER. I am not prepared to speak on that.

The CHAIRMAN. We always had a tax on automobile parts. I was just trying to reason why there had never been a tax on tires. I presume it was because we had to import all the rubber from which the tires were made.

Senator VANDENBERG. As a matter of fact there was a tax on tires and tubes as long ago as the act of 1918.

The CHAIRMAN. What were they taxed?

Senator VANDENBERG. 5 percent.

The CHAIRMAN. Coming back to your tractors, if a tractor has got a rubber tire on it now it would be taxed, would it not, as far as the rubber tire is concerned?

Mr. FINGER. The tire is taxed. The tractor itself and the other farm implements are not taxed.

Senator BARKLEY. The baby carriage would be taxed for the tires?

Mr. FINGER. I believe this tax applies to any vehicle which is capable of sustaining a person. [Laughter.]

This year over 75 percent of all the new tractors sold will be equipped with rubber tires.

Now, we do not believe that the tires which the farmer uses to plow his ground or harvest his crops, or the tire on which he goes to the market, or the tire that the laborer uses to go to his work should be subject to a tax that is any higher than the tax that is levied on similar products.

Senator BROWN. Before you go off on another line there, have you the figures or statistics, Mr. Finger, that show the percentage of automobile accidents that are due to blowouts?

Mr. FINGER. The State of Connecticut in 1936 compiled some figures on accidents, and those figures show that today 1½ percent of all the highway accidents are due to blowouts, and about 7 percent of all highway accidents are due to skidding. Now, most of the blowout accidents are definitely attributable to tires that have been run too long, and a large number of the skidding accidents are due to tires that have been run so long that their tread has been run smooth.

Senator BULKLEY. What would you say is the proper and reasonable life or mileage of tires?

Mr. FINGER. Today a rubber tire—the average tire can reasonably be expected to run 20,000 to 25,000 miles, sir, and give satisfactory service with very little tire trouble. I would like to add, if I may, that 25 years ago the average expectancy from a tire was about 2,000 miles, and a considerable amount of tire trouble. So that, in effect, in the last 25 years your tire life has been increased tenfold.

The CHAIRMAN. I would like to inquire about the proportionate price increase for tires.

Mr. FINGER. In that same period, sir, during which the life of tires has been increased tenfold the price of tires has been reduced, so that tires today cost about one-fourth as much as they did 25 years ago. In other words, the tire buyer gets 40 times as many miles for his money today as he did 25 years ago, and infinitely more comfortable transportation, with infinitely less tire trouble.

Senator BULKLEY. You mean that now the regular standard tire ought to run 25,000 miles before it is so worn as to be dangerous?

Mr. FINGER. 20,000, sir.

Senator BULKLEY. 20,000 miles?

Mr. FINGER. Yes, sir.

Senator BROWN. Do you think that this tax is any material factor in preventing, or in decreasing—I will put it that way—safety on the highway, in causing an increase in highway accidents?

Mr. FINGER. There is no question but what it is, sir. This is really a sales tax of 8 percent and 12 percent, and I do not believe I submit any argument to this committee to prove that a sales tax of that amount on any commodity will retard the sale of that commodity. There is no doubt but that this tax keeps on the road a great many tires far beyond the time when they should have been changed, for safety, and thereby it hampers the development of the very important highway safety movement, which, as you know, has been one of the leading developments in highway transportation.

Senator BROWN. In round figures it puts a $22 price in a $20 tire?

Mr. FINGER. Yes, sir.

Senator JOHNSON. Is it also true that the revenue from this tax is used to improve the highways?

Mr. FINGER. This revenue goes into the general revenue fund.

Senator JOHNSON. Yes; but they take the money out of the general revenue fund and pay it for highway improvement.

Mr. FINGER. I would have to ask for expert opinion on that. I do not know how these funds are allocated, but it is my impression that the money from this tax goes into the general revenue fund. Highway users pay a considerably larger amount of taxes than are used in the maintenance or construction of highways. That statement is subject to check, but I believe that it is correct.

Senator BULKLEY. Can you give us an idea of what part of the cost of operating an automobile would be the cost of tires?

Mr. FINGER. The Bureau of Agricultural Economics recently made a study on that subject and indicated that in their opinion about 15 percent of the total operating costs of an automobile is the tire cost. That is the over-all average.

Senator BULKLEY. That includes depreciation and repair of tires?

Mr. FINGER. Yes. In connection with your question, sir, about retarding the sale of tires, it is rather interesting that this also retards the use of cotton, because the tire industry last year consumed 240,000,000 pounds of cotton, about 120,000 bales.

Senator JOHNSON. American cotton or Egyptian cotton?

Mr. FINGER. American cotton, insofar as America supplies the type of cotton that is necessary in the tire industry. Most of it is American cotton. The tire industry requires some long-staple cotton. A small amount of it is produced in this country, but some of it is imported from Egypt.

It would be fair, theoretically, to reduce the tax on tires and tubes to the equivalent of 2 percent. We recognize that such a reduction would entail the loss of more revenue than the amount set by experts and by the House bill.

Senator BULKLEY. How much would that be a pound?

Mr. FINGER. I would suggest a reduction of about one-third, which would be on tires, from 2¼ cents a pound to 1½ cents a pound, and on tubes from 4 cents a pound to 2½ cents a pound. That would not be a reduction to the place that we feel we are entitled to. Our tax, even on those figures, would still be two or three times as high as the tax on similar commodities, but in view of the revenue needs of the Government, we are not at this time asking for much greater adjustment than that.

The CHAIRMAN. How much would we lose in money if that plan is adopted, would you estimate?

Mr. FINGER. About $12,000,000 or $13,000,000.

Mr. BULKLEY. That is presuming that there is not any increased sale of tires.

Mr. FINGER. That is not assuming that there is an increased sale of tires; that is on the present sales, if they continue.

Senator BULKLEY. But you contend that there would be more tires sold if the tax were decreased?

Mr. FINGER. That is right.

The CHAIRMAN. Mr. Finger, did you and your committee talk with the experts of the Treasury with reference to this matter?

Mr. FINGER. We did, sir.

The CHAIRMAN. Did you ever get together on a fair proposition that they might recommend?

Mr. FINGER. They indicated that the suggestion that we made of a reduction of about one-third of these rates that I have named seemed to be fair and reasonable to them.

The CHAIRMAN. Is there anything else you desire to say?

Mr. FINGER. I have just one final word. We have brought this subject to the attention of numerous governmental agencies, Mr. Chairman, and not once has the justice and reasonableness of our position been questioned. The only explanations that they have given for failing to make the correction was the Government need of money. The tax is very lucrative and it is extremely easy to collect. The Government does need the money, but we do not believe that that is a reason for saddling on any commodity, particularly a necessity, an unjustifiably high and discriminatory tax rate. Moreover, this tax is not going to make or break the fiscal position of the Government. The tax is lucrative, it is easy to collect, because the tire manufacturers help the Government to collect it.

The CHAIRMAN. It seemed to these men, I presume, that they ought to be taxed like other automobile parts. We were stretching out to get some revenue, it was very difficult to work this proposition out, but after some time we finally worked it out and adopted that plan that is now on the statute. If the Treasury can stand a loss I think you have made a very fine argument for your proposition.

Mr. FINGER. Thank you for the privilege of being heard by your committee.

The CHAIRMAN. Mr. Linker, of New York City.

STATEMENT OF KAHLMAN LINKER, NEW YORK CITY

Mr. LINKER. Gentlemen, I am editor and publisher of the Monthly Stock Digest, which is a statistical and analytical service dealing with investments.

The CHAIRMAN. You have filed your brief?

Mr. LINKER. No; I haven't, but I will, sir.

The CHAIRMAN. All right.

Mr. LINKER. I could level major objections against the various provisions in the proposed Revenue Act of 1938. I could direct considerable criticism against the undistributed-profits tax and against the capital-gains tax, the latter of which I think is particularly atrocious. However, it seems idle to consider either of these items when, unless certain moves are made, both profits and gains are matters of considerable conjecture. Those two items are not the major items to be considered now, except in terms of a broad program. There would appear to be time for them later.

The major consideration is much more distressing and urgent. I believe that if something is not soon done to operate against the causes of our present difficulties, conditions could rapidly get much worse, possibly to a degree few can visualize.

I believe and feel that I can show that the present depression had its beginning with and was largely caused by the operation of the Revenue Act of 1937 against a set of circumstances which were not appreciated or taken into account at the time that the revenue measure was passed, and, judging from the provisions of the proposed Revenue Act of 1938, it seems highly improbable that the real causes for our present deplorable conditions are yet nearly appreciated, and, therefore, being taken into account.

In other words, I believe I can convincingly show that the present depression was launched by the operation of the Revenue Act of 1937, which drastically eliminated tax avoidance. In so suddenly eliminating tax avoidance, which had been practiced at progressively greater rates over a period of years, it in effect, made operative, in one sharp move, an income-tax structure which was many times more oppressive to those who had been the major holders and purchasers of equity securities than that applicable prior to the enactment of the Revenue Act of 1937. The resultant effect on security markets and business has distressingly proved beyond a question of doubt that, under a condition of complete elimination of tax avoidance, the present income-tax structure is far too onerous certainly for the economic good of the country. Thus, the method of attack proposed by the House of Representatives and, preliminarily voiced in other quarters, falls far short of getting to the root of the difficulties.

Please bear with me while I briefly build the background necessary for an understanding of the true state of affairs. You will note, in building the background, I have referred to securities, because, as it has happened in this particular case, the security markets do reflect, more than any other medium, the actual condition of affairs.

Now, gentlemen, a very peculiar thing happened last fall. It seems quite unusual that the Revenue Act of 1937, in unamended form, was passed by the House on Monday, August 16, which, by the way, was preceded, on August 13, by the ratification of a tax convention between the United States and Canada, created to enable the interchange of individual tax-report data and thus eliminate tax avoidance, while the stock market recorded its highest levels for the movement on Saturday, August 14, and began to decline sharply thereafter.

The close correlation of dates, that is August 14 and August 16, may not be a proof of anything. It may merely be a coincidence, but it is believed it is much more than a coincidence for the circumstances leading up to the enactment of the Revenue Act of 1937, culminating in that measure, were such as to make it one of the most destructive documents of all time. You will recall that there was not then, certainly as indicated from the record of hearings and floor debates, any consideration given to the repercussions which would be evidenced when, suddenly, personal-holding companies, doubtless employed on a wide scale by most taxpayers, were rendered useless even to the degree of being major liabilities.

You will recall that there was never any consideration given to the effect of totally eliminating in one drastic move a habit which had been practiced on such widespread scale. For example, you may recall that, in the hearings prior to the passage of the 1937 act, the Treasury estimated the loss of tax resulting from tax avoidance to be about $100,000,000 to $110,000,000.

Now, the income-tax receipts currently coming in are much greater than estimates made by the Treasury. For example, the figures I received would indicate that they will be about $170,000,000 greater than was estimated in January by the Treasury Department. And one must realize that, in addition, there were very little capital gains registered in 1937. I mean whatever income came in may be directly attributable to reported income as dividends and the other sources of revenue.

Now, if you were only, for example, to show that there was $100,000,000 in lost revenue over and above the estimate of the Treasury, and then take that $100,000,000 estimated as lost by tax avoidance, that is $200,000,000, and if you would allocate a tax of 40 percent on that, that would give you a net income of approximately $500,000,000 represented by tax avoidance. Now, you capitalize that 16 times, and you have, representing tax avoidance alone, $8,000,000,000 worth of assets. Now, that only represents tax avoidance, that does not have reference to the total amount of securities, or the total amount of capital assets which were affected by the drastic elimination of tax avoidance.

Senator CONNALLY. You keep on talking about the elimination of tax avoidance. What do you mean?

Mr. LINKER. I mean this, sir: First of all my figures show that for 1936 36.4 percent of the dividends by domestic and foreign corporations were paid to individuals reporting a net income for that year in excess of $25,000. Now, that was under a condition of tax avoidance, so that one could say that 55 percent, at the minimum, of equities of domestic corporations were held by people who reported income in excess of $25,000 a year.

In addition, I believe that an investigation will substantiate the fact that people of large income in practically every case used domestic or foreign personal holding companies. So that when you, in one move, eliminate tax avoidance, you will agree that, by the operation of the Revenue Act of 1937, domestic and foreign personal holding companies became worse than useless. A user of a domestic or foreign personal holding company in one stroke found that he was operating at a disadvantage, and that, as a result, he has had to pay a tax larger than as an individual. That now, coming in one move as it did, created a terrific amount as a result of securities to be sold.

My contention is this: I believe that as a result of the Revenue Act of 1937 you automatically made effective a tax structure which was probably equivalent to that which was assessed in 1930.

Senator WALSH. You mean to say that the act of 1937 did not materially change the evils that you have been speaking of before that time?

Mr. LINKER. Did not materially change the evils?

Senator WALSH. I mean the evil of avoidance.

Mr. LINKER. The act of 1937 completely eliminated avoidance.

Senator WALSH. Is it satisfactory to you now?

Mr. LINKER. My thought is this: That now that you have determined a method for completely eliminating tax avoidance you must then inquire into the economic position of your present tax structure under a condition of eliminated tax avoidance.

My thought is this: Your tax structure was raised in 1932, but at the time it was raised your capital-gains provisions permitted an off-set

of losses against income, which, in itself, reduced the revenue to the Government and reduced the pressure of the increased tax structure of the tax bill, particularly on those in high-income brackets.

Senator WALSH. Cannot you give us a specific case of some holding company or taxpayer, and tell us just what you propose to change in the present law?

Mr. LINKER. Yes; I can do that.

Senator CONNALLY. Before you do that I will ask you this: Is it your theory that we can wipe out the act of 1937 and put ourselves back as we were before, and that that would benefit the situation?

Mr. LINKER. No, sir; I am very much in favor of the act of 1937.

Senator CONNALLY. That is just what I am getting at. I misunderstood you. I thought you were complaining about the act of 1937. You now want to retain it?

Mr. LINKER. Yes.

Senator CONNALLY. In view of stopping up the cracks you think the tax structure ought to be liberalized, is that it?

Mr. LINKER. Yes. In 1932 the surtaxes were raised; they did not bring any additional revenue to the Government because of the operation of the capital-gains provision. In 1934 the surtaxes were raised considerably more, but when they were, according to what I would calculate as substantiating evidence, the domestic personal holding company came in to offset the impact of that raised tax structure. So that even though the law made it necessary that the taxes be higher, that the taxpayer pay a higher amount, a taxpayer who was utilizing the domestic personal holding company really was paying no increase in taxes.

Then taxes were raised again in 1936, and when you did, I believe, according to Mr. Magill's statement, the foreign personal holding company came in, and that was utilized in such fashion as to avoid taxes, and the impact of that tax in 1936 was not felt on our economy. That is, a man of large income, not having to pay the tax and having been sheltered under his domestic or foreign personal holding company, did not feel that increase in tax.

So now, when you come into 1937, particularly after your undistributed-profits tax, the actual effect on the taxpayer is that even though there had been step-ups in the tax structure, the avoidance had reduced the impact of that to a taxpayer who had been utilizing a domestic or foreign personal holding company.

The Revenue Act of 1937 made one big jump. We had been moving along under a condition which did not necessitate inquiry into the economic propriety of a level of taxes. We have found, as conditions have since shown, that we moved the tax structure in one sudden move to a point where it could not be absorbed.

Senator WALSH. So your point is that the act of 1937 was so drastic and so sudden, that those persons who had been using the personal holding companies were economically affected, to the disadvantage of the economic welfare of the country. Is that your point?

Mr. LINKER. I say this, that when that act was passed it automatically created tremendous selling of securities on the part of people who had been utilizing domestic and foreign personal holding companies, and at the same time it made it undesirable for a man of large wealth to purchase.

Senator WALSH. Do you want the rates of 1937 lessened? You either want them repealed or you do not approve them. Just what do you want?

Mr. LINKER. I say this: Conditions are at such a state that you have got to amend, I believe, the Revenue Act of 1937.

Senator WALSH. How about surtaxes? Do you want them retained?

Mr. LINKER. They must be retained, but reduced substantially.

Senator WALSH. You want some reduction in the surtax rates?

Mr. LINKER. They must be drastically reduced.

Senator WALSH. How much reduction do you want?

Mr. LINKER. In determining the amount of the reduction, you must place yourself in the position of a man of large wealth.

Senator CONNALLY. I would be very glad to do it for myself. [Laughter.]

Mr. LINKER. I will say this, sir: Under a condition of tax avoidance, if a man of considerable income were to come to me and say, "What should I buy? Should I buy equity securities today?" I would tell him he were unwise, that the tax disadvantage under present surtax structures is so tremendous that it would be most inadvisable to buy equities. Your present tax structure is so high that a man of wealth is much better off by converting all his assets into cash and living off his principal.

Senator CONNALLY. Let me just ask you a question.

Mr. LINKER. Yes.

Senator CONNALLY. He does not pay any tax unless he makes a profit, does he?

Mr. LINKER. That is on gains; yes.

Senator CONNALLY. He does not pay any tax unless he makes a profit. Your theory is, if he pays us 65 percent total tax on his profit, a man of great wealth, he is in the 65-percent bracket, your theory is he better put that money into cash and not make anything, he is better off making nothing than he would be in making 35 percent, is that correct?

Mr. LINKER. I do believe that, because there is one thing that you do not take account of, and that is the risk involved of losing all or part of his principal.

Senator CONNALLY. He is not going to buy it unless he thinks he is going to make a profit.

Mr. LINKER. Certainly, but there is the element of doubt. If you were, for example, to invest $100,000 in any kind of enterprise and you would pay, say, 65 percent tax on the gain, and suppose, for example, as happened this last fall, where your market toppled so that your values dropped to such a degree that terrific losses were shown, the Government gives you nothing back for it, so why should he take the chance?

Senator CONNALLY. That is what we want you to tell us about.

Mr. LINKER. What has happened has been this: The use of tax avoidance has grown over a period of years, as was determined in testimony before the Revenue Act of 1937, to the point where most wealthy individuals, comprising the major markets for equity securities, have been utilizing tax avoidance. The result has been that we have built up a tax structure over a period of years which was economically too high under a condition of eliminated avoidance. A

man, put under the condition of eliminated tax avoidance, cannot possibly justify the purchase of equity securities. He hasn't a chance.

Senator WALSH. There are some members on this committee who agree with you. What is your remedy?

Mr. LINKER. The remedy is an inquiry into the whole surtax structure, to the point where surtaxes are so levied that men of wealth can purchase, and find it desirable to purchase and hold securities in which there is any risk whatsoever.

Senator WALSH. Mr. Chairman, that is one of the very problems that we have been discussing, thinking of and working on.

The CHAIRMAN. Yes.

Mr. LINKER. I feel it is important to recognize that by far the greater number of American securities today are risk securities, and further, I believe, in setting up the tax structure we must also give adequate consideration to the gains provision, because under present circumstances a man finds himself in the ridiculous position of not justifying the taking of any risk whatsoever. In inquiring into this we must forget what our present surtax rates are and make an independent inquiry from the aspect of merely placing ourselves behind the desk of that man whose investment in American capital, in American industry we must have. Now, I can give a pretty concrete example here.

Senator WALSH. I really do not think it is necessary.

The CHAIRMAN. Have you a prepared brief?

Mr. LINKER. Yes; but I would like to say one thing further, because I think I can substantiate something which is quite important, if I may.

The CHAIRMAN. All right, proceed.

Mr. LINKER. You will note that there has not been a recovery in real estate, certainly to any major degree. We are attempting to stimulate the revival of residential- and office-building construction. It is my theory that what has happened in real estate is a definite indication of what will happen in manufacturing and trade under the present tax structure, without tax avoidance. Real estate, by its very nature, does not lend itself to tax avoidance. It is too tangible, it is too difficult to transfer, it is too unliquid, and as a result men of large wealth have constantly been making effort to divest themselves of real estate and go into liquid securities which lend themselves more to tax avoidance. As a result, we have seen that there has been no major stimulation in real estate activity. No man will commit himself over a period of years under a condition of declining values. You, for example, would not commit yourself on a mortgage if you knew that at the end of the period your price is going to be less than what you had paid for it.

If the present tax structure is maintained on the statute books, you will find that all securities will be condemned to a decline in values over a period. You cannot stop it, because it will force a definite liquidation of securities over a period at the same time that it prevents the purchase of securities.

I say to you that the drop in the market, in the fashion in which it came, put fear in the hearts of the people, because they could not understand at that time what was the impelling force behind it. It was a mystery then, as it is a mystery today.

Senator CONNALLY. You could not have a sale unless there was a purchase also. You say it would force a lot of sales and yet not encourage any purchases. I should think if there is a sale there must be a purchase, must there not?

Mr. LINKER. That is true, sir.

Senator CONNALLY. What you mean to say is that by discouraging the purchasers it has had an effect of reducing the price of the security further down?

Mr. LINKER. Definitely.

Senator CONNALLY. It does not stop sales.

Mr. LINKER. That is true.

The CHAIRMAN. Thank you very much.

(The brief submitted by Mr. Linker is as follows:)

BRIEF OF KAHLMAN LINKER, NEW YORK CITY

One may level major objections against the various provisions in the proposed Revenue Act of 1938. Considerable criticism could be directed against the undistributed-profits tax and against the capital-gains tax, the latter of which I think is particularly atrocious. However, it seems idle to consider either of these items when, unless certain moves are made, both profits and gains are matters of considerable conjecture. Those two items are not the major items to be considered now, except in terms of a broad program. There would appear to be time for them later.

The major consideration is much more distressing and urgent. I believe that if something is not soon done to operate against the causes of our present difficulties, conditions could rapidly get much worse—possibly to a degree few can visualize.

I believe and feel that I can show that the present depression had its beginning with and was largely caused by the operation of the Revenue Act of 1937 against a set of circumstances which were not appreciated or taken into account at the time that revenue measure was passed—and, judging from the provisions of the proposed Revenue Act of 1938, it seems highly improbable that the real causes for our present deplorable conditions are yet nearly appreciated and, therefore, being taken into account.

In other words, I believe I can convincingly show that the present depression was launched by the operation of the Revenue Act of 1937 which drastically eliminated tax avoidance. In so suddenly eliminating tax avoidance, which had been practiced at progressively greater rates over a period of years, it in effect made operative, in one sharp move, an income-tax structure which was many times more oppressive to those who have been the major holders and purchasers of equity securities than that applicable prior to the enactment of the Revenue Act of 1937. The resultant effect on security markets and business has distressingly proved beyond a question or doubt that, under a condition of complete elimination of tax avoidance, the present income tax structure is far too onerous certainly for the economic good of the country. Thus, the method of attack proposed by the House of Representatives and, preliminarily voiced in other quarters, falls far short of going to the root of the difficulties.

Please bear with me while I briefly build the background necessary for an understanding of the true state of affairs. Please note as well that my discussion is built mainly around the securities markets. That is done for no reason other than that I believe the cause and origin of the present depression are involved in factors largely affecting the purchase, sale, and ownership of securities. In any event, certainly, the action of security markets would have naturally reflected, better than any other medium, the operation of these factors.

A very peculiar thing happened last fall. Doesn't it seem a bit unusual that the Revenue Act of 1937, in unamended form, was passed by the House on Monday, August 15 (which, by the way, was preceded, on August 13, by the ratification of a tax convention between the United States and Canada, created to enable the interchange of individual tax report data and thus eliminate tax avoidance) while the stock market recorded its highest levels for the movement on Saturday, August 14, and began to decline sharply thereafter? If you will recall the conditions under which the Revenue Act of 1937 was enacted, you will

be given reason to believe that interested security holders certainly could have felt, by August 14, that it was a foregone conclusion that tax avoidance would be eliminated in essentially the form originally proposed.

The close correlation of dates (August 13, 14, and 16) may be merely a coincidence and proof of nothing, but it is believed, they are much more than a coincidence, for the circumstances leading up to the enactment of the Revenue Act of 1937, culminating in that measure, were such as to make it one of the most destructive documents of all time. You will recall that there was not then, certainly as indicated from the record or hearings and floor debate, any consideration given to the repercussions which would be evidenced when, suddenly, personal holding companies, doubtlessly employed on a wide scale by most large taxpayers, were rendered useless even to the degree of being major liabilities. It is true that the extent of use and ramifications of these personal holding companies could not then be fully appreciated—but, certainly, no consideration was accorded the known delicateness of financial machinery, the major importance of keeping it in balance, and the utter necessity, if financial adjustments were to be made, of accomplishing them with gradual, subtle treatment.

In one fell swoop this legislation forced the holders as a group, of the great majority of American equity securities to liquidate tremendous blocks of these securities at the same time that it made the purchase of these equities completely undesirable to the individuals who had formerly comprised by far the major market.

In one sudden move, the Revenue Act of 1937 in effect placed into operation an income-tax structuree which was many times higher and more burdensome than that, which through use of tax-avoiding devices, was operative directly before its enactment.

The decline in the stock market last fall was as precipitous as that of 1929, even though the volume of transactions was far smaller, even though the drop began from a much lower level, even though there had been relatively little credit apparently utilized for the carrying of securities, even though margin requirements were much more stringent, even though the Securities and Exchange Commission had eliminated practices which formerly may have been responsible for inordinately high stock prices, even though the underlying position of business and finance was then far sounder and not overextended nearly to the degree witnessed in 1929.

It is difficult to believe that the uncovering of a temporarily top-heavy inventory situation and the then apparent prospects for declining corporate profits could have, then, of themselves, been so drastically reflected in the security price decline which was witnessed. The real major causes of the current depression and the drastic securities markets' decline today seem as much a mystery, to almost everybody, as they ever were.

The situation not yet being understood, one would question the possibilities of constructing rectifying measures. Thus, there seems good basis for believing that, ultimately, and it can be very soon, there can be another slaughter of security values, this time the like of which one has never witnessed. Quite conceivably it could carry down, in a short time, to such levels as to make equity securities merely "scraps of paper" for which there was no market at all—ultimately working terrible and irreparable havoc to the financial and industrial machinery of the country.

One cannot realize how hazardous the security markets are today. There really are no markets for equity securities. The major reason why, to this time, there has not been considerably more selling—the market having given some appearance of price steadiness—has been that those desiring to liquidate large blocks on the exchanges realize that to offer stocks in any but a "caressing" fashion would immediately remove what weak "floor" still remains from under the bids. If one is skeptical, let him offer for sale on the exchange merely a moderate-sized block of even a low-priced stock and observe the sacrifice of price he has to take in order to move it off. It would be a truly awful sight to behold if there were any signs of a growing "competition" simultaneously to liquidate equity securities—and that can develop at any moment.

Such a "competition" simultaneously to liquidate equity securities could quite easily arise if the Revenue Act of 1938 were enacted in its presently proposed form without having offered vital relief to this pressing situation. Then those who feel they must liquidate their securities will have been given notice that the last shred of hope for relief were exhausted—so that, in self preservation,

the thing to do will have been to sell and sell as quickly as possible without regard for the price bid. In addition, too, there will doubtlessly be others, unethical in practice, who will take advantage of this distress condition.

I need not portray for you what economic effects another wave of security liquidation would have.

Thus, one can feel that the Revenue Act of 1938 might well be the crisis.

In order to grasp the picture, let me briefly summarize the important circumstances leading up to the passage of the Revenue Act of 1937. Some of this is, of course, already known to you though possibly not fully appreciated from an aspect of cause and effect.

Primarily, one must admit that our present Federal income-tax structure has not developed out of definite, long-range policies. It is largely the result of alternating efforts to raise revenue in good and bad times and the consequence of a persistently changing set of provisions designed largely to provide relief, prevent avoidance, or "soak the rich." Surtax rates were raised, deductions limited, new taxes imposed, and attempts made at preventing avoidance either during depression years or during those when ill-advised provisions or tax avoidance had yielded less revenue than the Government felt it needed and should collect.

As time passed, particularly since 1932, when substantially higher tax rates were levied against large incomes, wealthy individuals moved increasingly to seek ways for utilizing the provisions of the laws to pay as little taxes as possible. One might say that this conflict began almost to assume the form of a game, with individuals of large income, when the simple means of tax-saving were eliminated, taking to complex devices which greatly reduced the impact of the progressively increased tax rates and successively reduced deductions. As a matter of fact, the development of circumstances was such that most wealthy people gradually came to consider tax avoidance to be completely legitimate and embraced it through personal holding companies.

The considerable increases of income surtaxes and other taxes, such as those levied on estates and gifts, and the more onerous provisions relating to capital gains and losses did not too greatly operate against the investment of funds in a fashion largely different from that pursued by individuals of much lower income, for tax-saving devices were found and utilized to counterbalance them.

While there is no evidence available to me which would prove this view, there seems good probability that a greatly intensified use of domestic personal holding companies came into being in 1934, though such vehicles apparently had been utilized in one form or another for 25 years.

Then, having its inception with 1935 and 1936, according to the Treasury Department, the foreign personal holding company was discovered and probably adopted on a particularly broad scale by some wealthy individuals, a scale which, despite the testimony offered, was far greater than was either then or now appreciated. This would appear substantially true because, not only did the foreign personal holding company provide additional facilities for apparently more secure tax avoidance, it also offered the added important features, if the taxpayer were so inclined, of purchasing and carrying securities on foreign borrowed capital without detriment of the high Federal Reserve Board margin requirements, of trading in securities in a manner not permitted by Securities Exchange Commission regulations, and in evading inheritance and estate taxes, in that, it was felt, the transactions could not be traced.

I believe that most wealthy individuals who employed foreign personal holding companies did not take recourse to the trading infractions or tax evasion mentioned above—yet it seems highly probably that the aggregate volume of securities so involved was most considerable. Certainly, presumptions which appear to be based on logic would tend to substantiate such view. You must appreciate that, in making my analysis, it is a case largely of conjecture and opinion, based mainly on correlations with other factors which appear logically substantiating. Even the Treasury Department, prior to the Revenue Act of 1937, had no means of obtaining definite information concerning the degree to which personal holding companies were employed if they were incorporated and operated from abroad.

In that connection I might state that there seems good chance that the actual amount of tax avoidance resorted to was probably far above even the figure one would visualize from the estimates of receipts short of those anticipated, made by the Treasury Department in the hearings. I think the forthcoming 1937 income-tax returns will substantiate that in part, though there seem to be reasons why all the facts will not be embodied therein.

While to attempt to make definite estimates would be idle, there are grounds for believing that the volume of securities held in domestic and foreign personal holding companies, at the time the Revenue Act of 1937 was passed, had reached a tremendous figure, aggregating many billions of dollars by value. Even if estimating yardsticks were not utilized, the mere facts that the majority of domestic equity securities are held by individuals of wealth and that most such individuals utilized personal holding companies would be enough to substantiate this view.

Treasury Department statistics indicate that 46.4 percent of the total dividends on stocks of domestic and foreign corporations paid, during 1936, to individuals filing income-tax returns were paid to individuals reporting net income in excess of $25,000 for the year. If one were to assume that such statistics provided as good an index of ownership of equity securities by net income classes as is obtainable—and would make adjustments for the tax avoidance which was doubtlessly practiced in 1936—it would seem very conservative to estimate that at least 55 percent of the equity securities of domestic corporations, at the end of 1936, were held by individuals who reported net income in excess of $25,000 for that year.

Consider the probable effect on security markets and, of course, on business when, in one drastic move, a revenue measure destroys this relatively tremendous structure of equity security ownership both by forcing direct selling at the same time that it, by reason of newly instituted tax disadvantages, prevents buying by the individuals who in the past had constituted by far the major factor in making the market for those equity securities.

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The pressure of direct selling could have come from a number of sources, among which were:

(1) The liquidation encouraged by time features in the Revenue Act of 1937 which made it desirable to dissolve and distribute the assets quickly.

(2) The liquidation forced by the pressure of margin calls if foreign financing had been utilized—to which is added the fact that dissolution of a foreign personal holding company where credit is utilized is tantamount to liquidation, for the borrowings must be repaid, certainly in a declining market.

(3) The liquidation forced by distress selling of tax "evaders" or Securities and Exchange Commission Act violators. They had only two courses to pursue: To continue to evade and take the chances of incurring criminal liability, or to liquidate entirely and bring cash into the country. Most, doubtlessly, chose the latter.

(4) The liquidation encouraged by the realization that, without tax avoidance, it was unwise for these individuals to own equity securities.

(5) The selling propelled by individuals without ethics who attempt to profit from the distress of others.

One could have looked around despairingly for a source of buying which could be responsible for absorbing, even to a small degree, such offerings. There could be no buying power sufficiently large to take the place of or even absorb a small portion of the securities then and still being liquidated by individuals of large wealth, who themselves had formerly comprised the most important factor in the making of markets. Small-lot buyers were and still are merely like a thin wooden fence in the path of a tidal wave—lightened margin provisions almost wholly ineffective.

Now, doesn't this all largely explain why the stock market mysteriously broke badly beginning with August 14, 1937, struck fear into the hearts of men and converted what might have been a temporary business recession into a depression of major magnitude, a depression the major causes of which are still mystifying to most of the public?

How was the great body of the public to know that the drastically dropping prices were not, certainly during the early stages of the decline, largely interpreting the prospects for profits though, at the time, there were growing doubts as to the prospects for profits? How could a businessman, owning or observing investments mysteriously melting away in value, do other than begin to retrench, cancelling orders for merchandise and making haste to liquidate inventories and receivables?

How could industrial managements seeing the market prices of the shares of their corporations mercilessly drop in persistent fashion without any real show of resistance, propel their business in optimistic fashion, particularly when they knew that if they needed capital either for expansion or working capital purposes it would be well nigh impossible to obtain it through the

sale of equity securities? Then, too, one must consider their fears in terms of a realization that corporate cash positions had been weakened by liberal dividend disbursements, impelled by the undistributed-profits tax penalties, as well as by relatively large inventories of merchandise.

Thus, the drastic decline in security prices has set in motion physical, financial, and psychological factors which, in themselves, have greatly reduced the strength, soundness, and intrinsic value behind the investments. The vicious spiral of destructive deflation is on its way, this time to end in chaos if we do not soon stop it.

The situation becomes more strained and delicate almost as the minutes pass. The foreign picture certainly has not helped to create stability. There is good chance that, without mention to the possible desire of some foreigners to prefer cash to securities, it could quite easily impel, through fear, an even more hurried liquidation by our nationals of securities held in foreign personal holding companies which had been evading taxes or violating Securities and Exchange Commission regulations. It could impel more hurried dissolution of some companies which had not been law evaders—and dissolution, inherently, creates some selling of securities.

One could go on and on, indicating the suicidal results which are inevitable if this deflation were allowed to continue—but the portrayal of the consequences, if what must be done is not done, needs no further enlargement.

It is believed that chaotic conditions cannot be averted if this revenue measure does not meet the emergency by, in some way, having the effect of temporarily nullifying or postponing the operation of the provisions of the Revenue Act of 1937, thus removing, for a period at least, the pressure to liquidate securities—at the same time that it sets activities in motion which definitely promise the creation of a tax structure so revised as not to be economically to high under conditions of complete elimination of tax avoidance.

Do not misunderstand. There is not the least intent to suggest that the Revenue Act of 1937 should be repealed or that its principles be abandoned. By all means, the terms of this legislation should be preserved, for it embodies what appears to be an efficient, air-tight elimination of tax avoidance which will, once and for all, assure the enforcement of tax laws as such laws were intended by our legislators to be enforced. What is suggested is merely that some means must be adopted to cushion the impact of the provisions of the Revenue Act of 1937, which have been drastically operative.

I do hope I have made my arguments clear. It would certainly appear that this country has paid a mighty dear price for an injudiciously set-up tax structure, levied in hodge-podge fashion over a number of years, attempting to tax income and wealth as though they were objects which, when cornered, had to stand there and take it.

I wonder what really could have been expected in the form of income-tax revenue from wealthy individuals. My computations show that individuals reporting income in excess of $25,000 in 1936 paid 73.8 percent of the individual income tax even though they reported only 17.1 percent of the total net income reported—and that was before tax avoidance, and, of course, does not give effect to corporate taxes on personal holding companies, gift taxes, estate taxes, and the many indirect tax liabilities wealthy individuals assume.

It would really be tragic if, after paying such a price to learn the lesson that our whole tax structure needs revamping, we continue to allow the principles of taxation to apply which largely have brought us into the present deplorable state of affairs. Certainly, we have found out that we cannot levy taxes based merely on need for revenue or the ability to pay as gaged by someone's questionable standards of "ability to pay," but must also give more than due consideration to levying so as to create the most economic good to the country. I think most of us would regard it as a small price our Government would have to pay if, for example, it were to agree to give up all individual income-tax collections ($1,200,000,000) in return for a promise of recovery, especially if the recovery were to reach levels formerly thought unattainable. But only a small portion of the excess over that sum is all that is temporarily being asked, and that will come back to you manyfold when recovery comes.

It seems ridiculous to think only of revenue from taxing corporate profits, individual income and gains, when the tax itself is automatically destroying those corporate profits, individual incomes, and gains.

It was truly fortunate for the country that, unethical as it may have been, tax avoidance was utilized, since the depth of the previous

depression, to reduce the levels of a tax structure which, under a condition of eliminated tax avoidance, was economically too high to encourage investment. It was really deplorable that real estate, which by its very nature does not lend itself to tax avoidance, had to bear the full brunt of a tax structure economically too high—so that, try as we have, through lending aids of tremendous size, we have not been able materially to encourage investment in construction. One cannot realize how unsound and ineffective these lending aids are, as long as the Government, through its tax structure, simultaneously sentences real estate to a trend of declining values.

Certainly, if for no other reasons, self-preservation itself dictates that the tax structure must be recreated so that, under conditions of eliminated-tax avoidance, it is not economically too high to prevent or discourage investment—and, frankly, I believe that, under existing tax laws, an individual with large income is a plain, stupid jackass if he purchases any securities in which even a small measure of risk is involved.

In setting up your tax structure, all you need do is place yourself in the position of an investor and think the problem through on pure investment considerations. I am sure you will agree with me that, under present tax disadvantages, you wouldn't buy "risk" securities—and most securities today are "risk" securities. You, apparently, don't have to pay those high surtaxes levied against income and gains—thus, you haven't realized how oppressive they are. Previous to the Revenue Act of 1937, most wealthy men didn't pay them—so it wasn't important that they be regarded as oppressive. Now, when they are faced with paying them in full as levied, at rates far higher than those to which they were accustomed, they are doing just what you and I would do under similar circumstances—they are adjusting their investment programs, with considerable ultimate loss of revenue to the Government and tremendous adversity to the country.

The CHAIRMAN. Mr. Elisha M. Friedman of New York City.

STATEMENT OF ELISHA M. FRIEDMAN, NEW YORK CITY

The CHAIRMAN. Mr. Friedman, whom do you represent?

Mr. FRIEDMAN. I represent no one. I came here as the result of having made a careful study of the capital-gains tax over a number of years, and have arrived at some conclusions from the Treasury's own statistics.

The CHAIRMAN. Have you got a brief?

Mr. FRIEDMAN. I have, yes; and I shall leave it with you.

The CHAIRMAN. We have got to leave here pretty quickly now.

Mr. FRIEDMAN. I shall be very brief.

The CHAIRMAN. All right, Mr. Friedman.

Mr. FRIEDMAN. The capital-gains provisions of the present law apparently tried to accomplish two results: To produce revenue and to reduce fluctuations in the market by penalizing the big trader. It failed in both. The yield to the Treasury was a small fraction of that produced under the flat 12½-percent tax. Further, the fluctuation of the market in 1937 was the greatest in stock-market history. Obviously the present law is not a revenue producer.

As to stabilizing the market, the decline from August to October 1937 was a most violent decline. The financial records show that thousands of small holders bought vigorously during August and September. The little fellows were "hooked," because the big men who would have sold in June, July, and August were deterred from selling by the capital-gains tax.

I shall rapidly go through some of the high spots. To show the unproductivity of the present capital-gains tax, "income other than capital gains" in the years 1934 and 1935 was about 94 percent as high as such income in 1926, 1927, and 1928. Income from capital gains, however, was only about 10 percent as high. The reason, obviously, is the change in the rates of tax on capital gains.

Again, the present rates create a violent instability of income. I am quoting from the report of the Hill subcommittee to Mr. Doughton in 1933.

The British have no capital-gains tax. We do. For the period in the schedule prepared for the Ways and Means Committee, from 1923 to 1933, the maximum fluctuation in income-tax revenue was as follows:

For the British the average was 1.6 billion dollars; maximum, 1.9 billion dollars; minimum, 1.4 billion dollars. For the United States the average was 1.9 billion dollars; maximum, 2.8 billion dollars; minimum, 700 million dollars. We get violent swings, clearly.

Senator CONNALLY. You mean that is the volume of sales?

Mr. FRIEDMAN. No; that is the total of income-tax receipts in the two countries. In other words, whereas the total British income-tax receipts fluctuated 35 percent, the American tax fluctuated 280 percent. These figures were cited in the above House subcommittee report.

Now, the report follows with the comment:

> It (the capital-gains tax) greatly reduces our revenue in years of depression and greatly increases our revenue in prosperous years. The result is unfortunate, for our revenue is reduced during those periods when we are most in need of revenue and increased when additional revenue is not required.

Now, just to show the great effect on our fiscal structure, the above House report of December 1933, submitted in support of the present law, makes a forecast that if we changed the capital-gains rates from the former 12½ percent, we should get $30,000,000 additional. What was the result? Instead of producing $30,000,000 additional revenue, the higher-graduated rates of tax on capital gains actually produced a small fraction of what the former flat 12½-percent rate produced in similarly prosperous years. Obviously, there is something wrong with the high-graduated tax. It obviously is unsound.

The advocates of the present capital-gains tax say that if a lawyer, by hard work, earns $10,000 and pays a tax thereon, then $10,000 of capital gains on a stock-market tip from a client should equally be subject to taxation. However, such a lawyer can earn approximately the same income 5 years in succession, but few or no lawyers can show 5 years of capital gains in succession. If they did everybody could get rich. Speculative aspirations would become sober realities. Five million American stockholders do not believe this.

I shall tell you another thing: If any investment counsel in the United States could show a record such as is assumed in the present

capital-gains tax they would be overwhelmed with clients. You examine their records, and you will see how fallible the judgment of investors and investment counsel is, gentlemen. Most people lose money in the market over a period of years. This tax assumes capital gains are persistent.

Here are the Treasury's own figures: Net capital gains in 1917 yielded about $300,000,000, followed by 6 years of net losses, and then there were 5 years of net capital gains, 1924 to 1929, and again 4 years of net losses.

Now, obviously capital gains are not a stable, predictable, or steady source of income.

Furthermore, to give you a long-range idea of the relative importance of capital gains to other income, may I cite from this report of the Subcommittee on Taxation of 1933. Take its figures on taxation from 1917 to 1931, and the average net gain, including the 7 profitable years and the remaining 8 unprofitable years, shows an average of $800,000,000 as compared with the Government's official figures of an average annual net income available for taxation from 1917 to 1931 of $20,000,000,000. Capital gains were less than 4 percent of this figure.

The CHAIRMAN. What do you suggest?

Mr. FRIEDMAN. I should say there is no one that can estimate what rates of tax on capital gains will yield the most revenue, because we are the only country in the world that has a capital-gains tax. The only thing we can do is to go back to our own experience. We do know that when there was the 12½-percent tax we collected great sums; a minimum of $225,000,000 and a maximum of $576,000,000 in the years 1926–29, and under the graduated rate we collected $17,000,000 in 1934 and no higher than $85,000,000 in 1935. Therefore, let us go back to some reasonable rate. You suggested in your press statement last Monday 15 percent; some others say 10. I should be inclined to say 10 percent on this principle. You are interested in one thing, and that is high volume of revenue, and if you can encourage people to take their profits, the Government would have a share of that profit.

Now the President says over and over again: "Lower selling prices to increase the volume of production and of employment; lower wage rates to increase volume of building, and volume of employment, and annual wages in building." Then, on the same principle, you should lower the tax rate if you wish volume in revenue.

May I take 1 minute to tell a story. Two salesmen met in a junction station near Chicago, where trains coming from opposite directions met. They had not seen each other for a great while and became absorbed in their conversation. At the signal "All aboard" they both jumped on the train, and after settling comfortably in the smoker, the first one asked, "Where are you going?" The other replied, "Los Angeles; and where are you going?" The first salesman answered, "Boston." Whereupon the other remarked, "This is certainly a marvelous age of hearing and seeing thousands of miles away by radio and television. Most wonderful of all, however, here we are sitting in the same car and going in opposite directions." [Laughter.]

The Treasury should first make up its mind as to which way it intends to go. Does it wish to produce large revenue or to penalize

the speculator? If you want to penalize the speculator you should then decide how much you want to pay in revenue to accomplish that purpose. If you want revenue, which is a fundamental consideration, the course is clear.

Now as to the time factor, the time scale seems an irrational imitation of the graduated scale of the income tax. To attempt to impose a scale which varies each month has no economic basis. The market may be high and would justify an investor in selling even though he has held a stock only 1 year or 18 months when the present graduated rate is so high as to deter selling. Yet investors and even the nonstock-holding public generally benefit when stocks are sold on high markets. Under the proposed bill, an investor wishing to sell must, therefore, consider not the stage of the business cycle, but the accidental date of his purchase. He must consult not an economist but a tax expert. Does this seem rational? The very concept of a scale graduated by time is unsound. If the tax is to be graduated at all, it should be graduated not by the calendar, but by the cycle.

The department of the Government that regulates trading and stock exchanges is the S. E. C. If the S. E. C., which really knows the field of securities, says that a period up to 6 months constitutes a speculative turn, why should not the tax authorities adopt the same time standard? The Government compels one to hold stock that every prudent man is justified in selling. May I illustrate that by giving you an example. There was a big stockholder of Chrysler stock, who bought an additional block of about 6,000 shares near 50, and when the stock got up to 80 he wanted to sell it. His tax expert said, "You can't sell that. The stock has got to decline to 56 before you break even on the tax payable if you sell at 80."

He would have sold it at 80 and on a scale up to 100. Well, because he dared not sell and stabilize the market, there were a lot of little chaps who bid Chrysler up to 135 before the market broke, and these fellows got hung up in the market crash. Now, this large holder did not want to sell at a loss, even though he did not want to sell at a profit and pay most of his profits back in taxes. Then when the stock fell to his purchase price he placed an order to sell it, and he sold it when the market was very low. In other words, the tax compelled the man who owned this stock to keep from selling on the upswing, and thus stabilizing the price. The Government forfeited all revenue and disturbed the market. If that is what the Government desires, then the present tax is admissible.

You have these additional facts before you.

In July, August, and September the little odd-lot fellows, according to the S. E. C. records, bought over 3,000,000 shares, with a market value of over $102,000,000. Then the market crashed and prices were practically cut in half, and $50,000,000 was lost by the several hundred thousand little people. How do you think they feel about the Government's policy? How do you think they feel about the capital-gains tax, and about destroying the mechanism that would stabilize the market—doing the very same thing to the common-stock market that the Federal Reserve Board is doing to the Treasury bond market.

Furthermore the graduations are wrong. You ought not to graduate the rates at all, because you are putting a penalty on selling and a premium on holding.

Then again you ought to give the little fellow the option to pay either at the rate of the capital-gains tax or income tax, whichever is lower. This would be a fair deal to the little fellow.

The CHAIRMAN. I think everybody agrees on that.

Mr. FRIEDMAN. The most important immediate aspect is the need to accelerate business recovery. When the stock market began to decline purchases fell away rapidly in automobiles, refrigerators, and other goods. If the capital-gains tax is reduced long pull investors could begin to buy shares and the market would go up and thousands of small-business men would soon buy raw materials, hire labor, and expand. With the market rising they would take courage, because rising stock prices create confidence. A gradual rise in the market would stimulate business recovery, and that, it seems to me, is the significance of acting, and acting quickly.

The S. E. C. has enough power to expose manipulation and wrong dealing, and besides you should not rely on a Treasury instrument, like a revenue measure, to check speculation.

The CHAIRMAN. Thank you very much, Mr. Friedman. You may put your brief into the record.

(The brief referred to is as follows:)

CAPITAL-GAINS TAX

I. SUMMARY AND CONCLUSION

The proposed revision of the capital-gains tax has been submitted in the report of the subcommittee, dated January 14, 1938, to the Ways and Means Committee. It shows some slight concession to the pleading of businessmen for a drastic reduction of this tax. However, the proposed revision retains features which are both economically unsound and socially destructive.

The capital-gains provisions of the present law apparently tried to accomplish two results—to produce revenue and to reduce fluctuations in the market by penalizing the big trader. The results, discussed below, prove that neither aim was achieved. Indeed, the results were directly opposite to those sought. The yield to the Treasury was a small fraction of that produced under the flat 12½-percent tax. Further, the fluctuations of the market in 1937 was the greatest in stock-market history. With these results clearly before Congress and the country, no soft compromise on confused and conflicting aims is likely to produce revenue. A drastic reduction (if not complete elimination), is called for.

II. THE TAX IS UNPRODUCTIVE

The years 1926 to 1928 were subject to the 12½-percent rate. The years 1934 and 1935 were subject to the graduated high rates. The former flat tax on capital gains of 12½ percent did produce revenue, as shown in the following table:

[In millions of dollars]

Year	Total net capital gain [1]		Estimated taxes on capital gains and losses [2]		Estimated taxes on individual income tax other than capital gains [2]	
	Amount	Percent	Amount	Percent	Amount	Percent
1926	2,378.5	100.0	225.4	100.0	506.9	100.0
1927	2,894.6	121.7	296.8	131.6	533.7	105.2
1928	4,807.9	202.1	576.0	255.5	588.2	116.0
1934	312.6	13.2	17.1	7.6	491.2	97.5
1935	730.7	30.7	85.2	37.8	572.1	112.8

[1] Table No. 8 of subcommittee report.
[2] Table No. 9 of subcommittee report.

The figures in the Treasury table show that the high tax on capital gains in force since 1934, produced insignificant revenue, and that the low flat rate of 12½ percent of capital gains produced abundant revenue. Obviously, under the law effective in 1934 and 1935 the rise in the rate of tax on capital gains discouraged the taking of profits and resulted in a lower yield to the Treasury. In other words, although in 1935 the yield of taxes on individuals, other than capital gains, exceeded that of 1926 and 1927, the yield of the capital-gains tax itself was only about one-third that of 1926 and 1927. A comparison of 1935 with 1928, or of 1934 with 1926, shows up even more unfavorably the unproductiveness of the present high rates on the capital-gains tax. The figures show that high tax is clearly not as good a revenue producer. In fact for the period 1934 and 1935 the capital-gains tax produced only about 10 percent as much Treasury revenue as the "other tax on individual incomes," so that a 10-percent rise in the income tax would more than offset the yield from the capital-gains tax.

Or, looking at the matter from a slightly different angle, the total taxes on capital gains amounted for the period 1927–28 to $873,000,000 and for the period 1934–35, to $102,000,000; however, the individual income tax, other than capital-gains tax, amounted to $1,122,000,000 and $1,066,000,000, respectively. In other words, comparing the total yield in the period 1934–35 and the period 1927–28, the capital-gains tax was only about 11.7 percent as productive, whereas the other income taxes were 93.6 percent as productive. Furthermore, it should be borne in mind that in the period 1927–28 gross capital losses were deductible in full from other income and could be carried forward, but in the period 1934–35 net capital losses were limited to $2,000, and could not be carried forward.

The argument could end here. No further evidence is needed that the present high rate of capital-gains tax is not a good revenue producer. This evidence, submitted to impartial businessmen or economists would be conclusive. Other phases will be examined further below.

III. THE REVENUE IS UNSTABLE AND UNPREDICTABLE

The tax is economically unsound. The revenue therefrom is not only unproductive but more, it is undependable. Therefore it vitiates Government estimates of revenue and upsets Budget calculations. The British Chancellor of the Exchequer is able to achieve close accuracy in his estimates. The American Secretary of the Treasury shoots wide of the mark. In the 1920's the actual receipts by the Treasury were more than $1,000,000,000 in excess of estimates. In the current fiscal year the receipts will be under the estimates by approximately $1,000,000,000 or more.

According to a report of the Subcommittee on Tax Revision in 1933: [1]

"Speaking generally, we have always taken account of gains and losses from capital transactions in the computation of net income, while Great Britain has pursued the opposite policy and disregarded such gains and losses in determining net income * * *.

"The great advantage of the English system lies in the stability which it gives to the income-tax revenue. The stability of their revenues and the instability of our own can be readily seen from the following comparison of Federal and British income-tax receipts:

Income-tax receipts

Fiscal year	United States	Great Britain (£=$4.86)	Fiscal year	United States	Great Britain (£=$4.86)
1923	$1,691,000,000	$1,936,000,000	1931	$1,800,000,000	$1,553,000,000
1924	2,842,000,000	1,724,000,000	1932	1,057,000,000	1,762,000,000
1925	1,761,000,000	1,746,000,000	1933	747,000,000	1,528,000,000
1926	1,974,000,000	1,652,000,000			
1927	2,220,000,000	1,482,000,000			
1928	2,175,000,000	1,521,000,000	Annual average	1,916,000,000	1,621,000,000
1929	2,331,000,000	1,436,000,000	Maximum	2,842,000,000	1,936,000,000
1930	2,410,000,000	1,443,000,000	Minimum	747,000,000	1,436,000,000

[1] Exhibit C, p. 32, Report Subcommittee on Tax Revision, December 4, 1933 (73d Cong., 2d sess.).

"The minimum British income-tax revenue in these 11 years was collected in 1929, when it amounted to $1,436,000,000; the maximum revenue was collected in 1923, when it amounted to $1,936,000,000. Thus, the maximum annual revenue from income tax was only 35 percent above the minimum revenue.

"The minimum Federal income-tax revenue in these 11 years was collected in 1933, when it amounted to $747,000,000; the maximum revenue was collected in 1924, when it amounted to $2,842,000,000. Thus, the maximum annual revenue from income tax was 280 percent above the minimum revenue. * * *

"While this stability of the English revenue is not entirely due to their treatment of capital gains and losses, it is a very important factor in producing this condition. It is easy to show that much of the instability of the Federal income-tax revenue is due to our system of taxing these gains and losses.

"It greatly reduces our revenue in years of depression, and greatly increases our revenue in prosperous years. The result is unfortunate, for our revenue is reduced during these periods when we are most in need of revenue and increased when additional revenue is not required."

The unproductivity and undependability of the low capital-gains tax after 1929 were investigated and the current high rates were recommended in the official report of the Subcommittee on Taxation, December 4, 1933 (73d Cong., 2d sess., p. 6):

"It is believed that the adoption of this plan will result in much greater stability in revenue, will give all taxpayers equal treatment, will encourage normal business transactions, and will give a revenue of perhaps $30,000,000 additional under present conditions without any substantial loss over a long period of years."

Instead of producing $30,000,000 additional revenue, the higher graduated rates of tax on capital gains actually produced a small fraction of what the former low 12½-percent rate produced in similarly prosperous years.

When the capital gains, subject to taxation, fluctuate by $10,000,000,000 to $20,000,000,000 per annum, obviously any tax on such a fluctuating item must be unpredictable.

Market value on first of month of listed stocks on New York Stock Exchange [1]

	High	Low	Fluctuation
1933	$36,700,000,000	$19,700,000,000	$20,000,000,000
1934	37,400,000,000	30,800,000,000	6,600,000,000
1935	45,000,000,000	30,900,000,000	14,100,000,000
1936	60,000,000,000	46,900,000,000	13,100,000,000
1937	62,600,000,000	40,700,000,000	21,900,000,000

[1] New York Stock Exchange Bulletin, January 1938.

Fluctuations are greater from the dates of the absolute high of the year to the absolute low than between the first days of the month.

IV. CAPITAL GAINS ESSENTIALLY NOT INCOME

Income is regular and recurs annually. Income may decline but it never becomes a minus. Capital gains of one year may be followed by capital losses in one or more years as 1918 to 1923. Income is more or less dependable. A capital gain, by its very nature, is thoroughly unpredictable as to time or amount.

The advocates of the capital-gains tax say that if a lawyer by hard work earns $10,000 and pays a tax thereon, then $10,000 of capital gains on a stock market "tip" from a client should equally be subject to taxation. However, such a lawyer can earn approximately the same income 5 years in succession, but few or no lawyers can show 5 years of capital gains in succession. If they did, everybody could get rich. Speculative aspirations would become sober realities. Five million American stockholders do not believe this.

On the one hand, the administration warns against speculation because people lose money. On the other hand, the tax bill is framed on the theory that people persistently make money in speculation.

Capital gains appear only during periods when national income, income taxes, and Treasury revenue are rising, and disappear and are reversed when these are falling. Whereas income persists and is fairly stable, yet capital gain, which

is a multiple of the income, disappears during the decline and even changes to capital loss.

Capital gains and losses on sales of assets by individuals

[Source: Report of Subcommittee on Tax Revision, 73d Cong., 2d sess. Dec. 4, 1933, p. 34, and Report of Subcommittee on Taxation, 75th Cong., 3d sess., Jan. 14, 1938, p. 88]

	Gains	Losses	Net difference
1917	$318, 200, 000	$110, 700, 000	+$207, 500, 000
1918	291, 200, 000	571, 500, 000	−280, 300, 000
1919	999, 400, 000	1, 175, 100, 000	−175, 700, 000
1920	1, 020, 500, 000	1, 680, 300, 000	−659, 800, 000
1921	462, 900, 000	1, 832, 600, 000	−1, 369, 700, 000
1922	991, 400, 000	1, 252, 000, 000	−260, 600, 000
1923	1, 172, 200, 000	1, 619, 100, 000	−446, 900, 000
Subtotal, high tax years	5, 255, 800, 000	8, 241, 300, 000	−2, 985, 500, 000
Annual average	750, 800, 000	1, 177, 300, 000	−426, 500, 000
1924	1, 513, 700, 000	896, 900, 000	+616, 800, 000
1925	2, 932, 200, 000	655, 100, 000	+2, 277, 100, 000
1926	2, 378, 500, 000	212, 800, 000	+2, 165, 700, 000
1927	2, 894, 600, 000	276, 100, 000	+2, 618, 500, 000
1928	4, 807, 900, 000	212, 800, 000	+4, 595, 100, 000
1929	4, 684, 500, 000	1, 039, 000, 000	+3, 645, 500, 000
Subtotal, low tax years	19, 211, 400, 000	3, 292, 700, 000	+15, 918, 700, 000
Annual average	3, 201, 900, 000	548, 800, 000	+2, 653, 100, 000
1930	1, 193, 100, 000	1, 313, 700, 000	−120, 600, 000
1931	449, 400, 000	1, 234, 200, 000	−784, 800, 000
Subtotal, depression years	1, 642, 500, 000	2, 457, 900, 000	−905, 400, 000
Annual average	821, 200, 000	1, 273, 900, 000	−452, 700, 000
Total, net gains (1917–31)			+12, 027, 800, 000
Average annual net gain (1917–31)			+802, 000, 000

	Gains	Losses	Net difference
1932	$162.9	(1)	(1)
1933	553.2	(1)	(1)
1934	312.6	(1)	(1)
1935	730.7	(1)	(1)
1936	(1)	(1)	(1)

1 Data not available.

As compared with an average net gain available for taxation of $802,000,000 for the period 1917 to 1931, the total net income available for taxation was very much larger, as shown as follows:

Total net income available for taxation[1]

[In millions]

1917	$13, 652
1918	15, 924
1919	19, 859
1920	23, 735
1921	19, 577
1922	21, 336
1923	24, 777
Subtotal	138, 860
Annual average	19, 837
1924	25, 656
1925	21, 895
1926	21, 959
1927	22, 545
1928	$25, 226
1929	24, 801
Subtotal	142, 082
Annual average	23, 680
1930	18, 119
1931	13, 604
Subtotal	31, 723
Annual average	15, 861
Grand total	312, 665
Annual average	20, 844

1 Statistical Abstract 1936, p. 178.

The insignificance of the capital-gains tax as a source of revenue is shown in these figures. It constituted only 3.9 percent of total net income. When one considers that the capital gains may have been wiped out and are fictitious, it appears to be not merely an unsound tax but an unethical one.

A tax on annually recurring income like salary or business profits, is a suitable measure of capacity to pay. A tax on occasional capital gains is not. From August to December 1937, the capital losses on the New York Stock Exchange alone amounted to over $30,000,000,000 and allowing for the other stock exchanges outside of New York City, these losses probably exceeded $40,000,000,000, and yet the subcommittee report, dated January 14, 1938, when these 1937 statistics were already available still says that "capital gains constitute real tax-paying ability to the recipient no less than income derived from other sources" (p. 30). Suppose an investor whose tax year ended July 31, 1937, had taken substantial capital gains by switching stocks that advanced greatly to stocks that had advanced little. What is his capacity to pay on March 15, 1938? It is even possible, and undoubtedly there are many actual cases, that as a result of switching securities the resulting tax on capital gains taken on the securities sold is so large as to exceed the total value of the securities bought in the switch. For such an investor the tax on his paper profits may compel him to go into bankruptcy. Do such capital gains represent capacity to pay?

A capital gain represents merely a shift of assets and is not income in the economic sense. The Nation as a whole is not richer or poorer because of the shift. It is richer or poorer when the national income rises or falls and when the individual income rises or falls. For the Treasury as a whole the capital-gains tax constitutes fiscal "rainbow chasing."

To the extent that the capital-gains tax depends upon a change in values, it is important to note that the changed dollar value may be unreal, owing to changes in currency, interest rates and other factors beyond the control of the individual, purely factitious, nonrecurring and often self-compensating as, for example, the declining purchasing power of the dollar. This was admitted in Report of Subcommittee on Tax Revision, December 4, 1933, page 35.

V. EXPANSION IS CHECKED

The incentive to expand, to invest in productive enterprises, to increase employment, to develop possibilities of genuine revenue available for income tax—all these are checked. The capital-gains tax ignores fundamental psychological factors. The great mass of mankind seeks some expression of its ego. The motive to accumulate property is fundamental, primitive and powerful. In the economic field, this psychological motive may be utilized for socially productive purposes.

The economic expansion of the individual is very often a social good. Consequently, taxes that unduly repress the economic motives of the individual often curtail the economic advance of the country. This repressive effect applies to oil wells, mines, industries, and, most important of all, to the housing recovery where private initiative in this important social activity has been largely checked by the capital-gains tax.

The capital-gains tax kills the goose that lays the golden egg, whereas the income tax is satisfied to take one of the several eggs that is laid and keeps the goose going. The restrictive effect of the capital-gains tax may perhaps be indicated by a scientific test or "control." The United States is practically the only country in the world with a capital-gains tax. At the same time, the United States is behind other countries in its recovery. There may be other factors, but the capital-gains tax is undoubtedly also a check to economic recovery.

As George O. May points out "no effort has been made to appraise the effect of tax measures upon savings or business initiative."

VI. THE TAX REDUCES INVESTMENT RESOURCES

The capital-gains tax depletes the capital reserves of the country. The capital-gains tax causes a gradual whittling away of the Nation's private investment resources which constitute the basis of private employment. For example, A buys a stock at 100 and sells it to B for 200 and then pays a tax to the Government of 20 percent to 70 percent. Assume the stock breaks and falls again to 100. What happened? B has lost $100. A has lost the amount of his tax. The chief gainer is the Government, which has drained part of the Nation's

combined capital resources from the investment market. It is like burning the furniture to keep the house warm.

VII. BUILDING RECOVERY DELAYED

This deterring effect is particularly important in contributing to keep the country underhoused. The builder of private homes and residences is a speculator. He builds, holds for a number of years, and then sells. By taking away the bulk of the increase in his capital gains, the incentive to build is lessened or removed and the expansion of building funds is checked. The shortage in housing is, therefore, frozen. The speculative builder is penalized. He usually loses out in a depression anyway, even without a tax. High rents and poorer accommodations for the masses may be ascribed in part to the capital-gains tax.

Clarence M. Woolley, in the annual report for the American Radiator Co. for 1929, stated that the building industry employs two and a half million workers directly and another two and a half million in related lines, a total of 5,000,000 men, and that it furnished 12½ percent of the railroad traffic. Building recovery should greatly stimulate employment in many allied lines. It should increase traffic and also employment on the railroads, as well as employment in the equipment industries that supply the railroads.

VIII. INCREASED EXPENDITURES, DECREASED REVENUES, AND MORE DEFICITS

The stimulation of private incentive should increase employment. The check to private incentive freezes unemployment. Therefore it increases the expenditures for relief and public works and thus increases the fiscal burdens of the Government.

During the war Lloyd George, then Premier, introduced a high tax on the so-called nonessential industries. The purpose was not to produce revenue but rather to prevent revenue so as to divert money and energy to the so-called essential industries. He hoped no taxes would be paid. In other words, rates were made so high as to be nonproductive. Similarly, now in our own country the Federal Government actually loses revenue by imposing high rates of tax on capital gains. The high rates freeze holdings, prevent sales, and therefore curtail Federal capital-gains revenue and State transfer taxes from that source.

Our deficits are due in some part to the double effect of the capital-gains tax—on the one hand, increased expenditures for relief and public works, because the unemployed would normally be taken care of by less-trammeled private industry; and, on the other hand, diminishing income due to smaller receipts on stock sales and greater flight into securities bought for revenue rather than appreciation. The capital-gains tax must necessarily vitiate every Budget estimate.

IX. THE CAPITAL-GAINS TAX DOES NOT REACH THE RICH

The irony is that the capital-gains tax does not "soak" or even reach the rich. Whereas for the year 1936 (table No. 5 of subcommittee report, January 14, 1938) net capital gain was about 9 percent of the total income of all reporting taxpayers, yet the very rich took very small capital gains and paid little in capital-gains taxes, as follows:

Net income class and net capital gains taken as a percentage of total income

	Percent
$1,000,000 to $1,500,000	1.9
$3,000,000 to $4,000,000	1.6
$4,000,000 to $5,000,000	0
All classes	9.2

The people who paid the tax on capital gains were in the lower income-tax brackets; not in the brackets of the rich.

The aim may have been to soak the rich. The result was to punish the poor by lessening reemployment. Furthermore, many a Congressman can testify as to the complaints about the capital-gains tax, not from the few rich but from innumerable small investors.

These results for 1936 are borne out by official statistics covering previous years. Comparing the 2-year period 1934–35 with the 2-year period 1926-27, the Government statistics show that the percentage of capital gains taken in the latter period, when the rates were high, was a small fraction of that shown in the preceding period, when the rates were low. Furthermore, the richer the group, the less was the percentage of capital gains taken in the latter period compared to the former period, as shown herewith:

Ratio of 2-year periods, 1934–35 to 1926–27

Income-tax class	Capital gains taken	Total net income
	Percent	*Percent*
Under $5,000	40.2	96.4
$5,000 to $25,000	28.9	60.0
$25,000 to $100,000	20.0	36.5
$100,000 to $1,000,000	9.9	20.8
$1,000,000 and over	3.8	12.0
Average	19.8	62.2

In other words, the smaller taxpayers, of whom there are over 3,000,000 in the class with net incomes under $5,000 and almost 1,000,000 with incomes of $5,000 to $25,000, were affected by the high capital-gains tax. They took smaller gains, both absolutely and as a percentage of their total income. The rich, of course, were virtually compelled by law to refrain from taking capital gains. As a result, the percentage of capital gains to total net income declined relatively more for the rich than for the lower-income groups. In the highest class the capital gains taken in the latter period were only a tiny fraction of those for the earlier period.

Ratio of capital gains to total net income by net income classes

[In millions]

Year	Under $5,000			$5,000 to $25,000			$25,000 to $100,000		
	Capital gains taken	Total net income	Ratio (percent)	Capital gains taken	Total net income	Ratio (percent)	Capital gains taken	Total net income	Ratio (percent)
1926	$241.3	$8,730.1	2.8	$673.7	$7,499.6	9.0	$557.5	$3,344.0	16.7
1927	301.5	8,490.9	3.6	725.6	7,643.8	9.5	708.1	3,587.2	19.7
1928	227.6	8,270.4	2.8	1,075.4	8,320.4	12.9	1,197.8	4,184.4	28.6
1929	293.8	8,101.8	3.6	914.6	8,506.8	11.1	925.5	3,820.9	26.1
1934	70.5	7,796.0	.9	120.6	3,466.5	3.5	72.4	1,114.5	6.5
1935	147.9	8,814.4	1.7	283.6	4,105.7	6.9	181.4	1,418.1	12.8

Year	$100,000 to $1,000,000			$1,000,000 and over			Total		
	Capital gains taken	Total net income	Ratio (percent)	Capital gains taken	Total net income	Ratio (percent)	Capital gains taken	Total net income	Ratio (percent)
1926	$622.0	$1,859.7	32.9	$281.0	$491.4	57.4	$2,378.5	$21,958.5	10.8
1927	819.7	2,232.6	36.7	839.7	600.6	56.6	2,894.6	22,545.1	12.8
1928	1,578.3	3,342.3	47.2	728.8	1,108.9	65.8	4,807.9	25,226.3	19.0
1929	1,591.2	3,150.0	50.4	859.4	1,212.1	70.9	4,684.5	21,800.7	18.9
1934	42.0	362.0	11.6	7.1	57.8	12.3	812.6	12,790.8	2.4
1935	101.4	498.0	20.4	16.4	73.6	22.3	730.7	14,909.8	4.9

Source: Capital gains: Hearings before the Committee on Ways and Means on Revenue Revision, 1938, 75th Cong., 3d sess., Washington, 1938, pp. 96-97. Total net income: Statistical Abstract of the United States, 1935, p. 183; 1936, p. 184; and mimeographed release of U. S. Treasury Dept., dated Oct. 7, 1937 (Press Service No. 11-42).

X. THE TAX EXAGGERATED MARKET FLUCTUATIONS

The tax on capital gains was intended to eliminate the speculator and thus reduce fluctuations in the market. The aim was stabilization. The result was exactly the opposite. From August to October 1937 the stock-market decline was relatively the greatest in history for that length of time. The decline was also the greatest in history for the same volume of transactions. The market became thin.

A tax on capital gains lessens the stability and liquidity of markets. It is a penalty on selling. Stocks, therefore, rise artificially. The market becomes unstable. People who think that prices are high would ordinarily sell and would check the rise. Buyers, however, are not deterred by any tax, and by buying accentuate an already excessive rise. Then when the market turns down there is little support, because the people that thought stocks were high, and yet for tax reasons could not sell, have not the cash to buy. As a result the market declines extensively and steeply. Without a capital-gains tax, stockholders in the United States would (and stockholders abroad still do) sell on a rise and accumulate cash to rebuy shares on breaks, thus cushioning the shock and rescuing panicky sellers.

Statistics show that the market has moved more violently in both directions since the capital-gains tax went into effect than it did before 1917. The Stock Exchange Bulletin of November 1937 shows price fluctuations in bear markets, per unit of volume, were as follows:

Points of price decline per unit of sales volume

Year:	*Points*	Year—Continued.	*Points*
1917	1.95	1929	4.36
1919	1.99	1935	6.92
1923	2.82	1937 (August to October)	12.54
1926	2.92		

In other words, during the severe panic of 1929 stocks moved only one-third as much under the same volume of selling as they did in the last break. Obviously, something is wrong. The high capital-gains tax is one of the factors involved. Is it an accident that the most violent stock-exchange panic, August to October 1937, occured under the steep capital-gains tax? The American market seems stark mad to foreign investors. The experience of the last few months seems to prove that the capital-gains tax is not a stabilizer. The small investor, of whom there are more than 5,000,000, excluding duplications, is hurt worse when he is caught at the top of such a "Government-rigged" market than he was in the days of manipulation, which merits universal condemnation, but which at least allowed the little fellow to get out because the declines were not so sensational and the markets not so thin. According to the S. E. C. reports, the odd-lot buyers or "little people" bought on balance from July through September, approximately 3,000,000 shares valued at over $100,000,000. Because of the high capital gains, the market rose too high and declined too far. Because of Treasury policy these "little people" were hooked at high prices or actually lost money if they were sold out.

The American market moves more violently than the British market, where no capital-gains tax is in effect. The S. E. C. is seeking a stable investor's market, but the capital-gains tax creates a violently fluctuating erratic market; with a high capital-gains tax, the market must decline very substantially before a prospective purchaser can realize a net profit after paying the capital-gains tax. If there were no tax or a very low tax, it would pay a prospective purchaser to buy on small declines and sell on small rises and thus stabilize the market. If at present there were in effect either no capital-gains tax or a low capital-gains tax, buyers of large blocks would begin to accumulate stocks and the market would rise in anticipation of an improvement in business and the very rise in the market would tend to increase confidence on the part of businessmen who would accelerate such a business revival.

XI. ARTIFICIAL PRICES AND POOR MARKETS

The heavy capital-gains tax also not only makes the general market artificially high but creates artificial differences between particular shares, just because in one company a large stockholder is frozen in and cannot sell. It creates artificial differences between shares and bonds and other values, like real estate, which ought to be at reasonable parities with respect to yields, considering the risks involved. Because stocks are frozen at high levels, the small investor who then buys becomes a dupe of Government policy and his losses in the decline become the greater. The capital-gains tax has ruined the liquidity of markets. To the extent that this hurts the rich man, the Government may not be concerned. But when this small buyer of odd lots finds large spreads between the bid and asked prices, he is paying a heavy toll both in buying and selling. The S. E. C. records show that the small investor is coming into the markets by

hundreds of thousands annually. Furthermore, illiquid markets deter new capital issues, so necessary for expansion, recovery, and reemployment. The effect of the capital-gains tax should now be a matter of Government concern.

XII. DIFFUSION OF OWNERSHIP OBSTRUCTED

The capital-gains tax defers the historic process of widening the circle of the Nation's stockholders. Because the holders of large blocks of stock cannot afford to liquidate, the normal process of the diffusion of stock ownership throughout the community is impeded. The tax virtually compels large blocks to remain intact instead of being pulverized and distributed.

XIII. PANICS AGGRAVATED

Thin markets and high prices result in violent swings. Is it an accident or a logical consequence that the worst panic in American history took place under the system of taxing capital gains? In its policy of attempting to cope with stock-market panics the administration has turned its attention to thin margins and pools. However, it left unstudied and uncorrected one of the most vicious, exaggerating influences in stock-market panics, namely, the high capital-gains tax. Considering the repercussions on the economic life of the country of stock-market panics, the social implications of the capital-gains tax deserve serious study.

Europeans sold American shares in 1928 and early 1929 because they had no capital-gains tax to pay. The American Government has found no way to tax the capital gains of foreigners, despite exhaustive study. The foreigners do not pay capital-gains tax on their home shares, and, therefore, object now to paying a capital-gains tax on their American shares. A banker in Holland said that if the American Government taxes the capital gains of Dutch holders of American shares, the Dutch Government would retaliate by taxing American manufacturers doing business in Holland. As the Hawley-Smoot tariff provoked foreign retaliation throughout the world, so the attempt to tax capital gains by foreigners would provoke similar retaliation.

What will be the effect of this different treatment on the American investor? Recalling that in 1928 and 1929 the foreigners sold first and left the American investors "holding the bag," there is every prospect that this process will again be repeated when the next collapse comes.

XIV. THE TIME SCALE IS UNSOUND

The time scale seems an irrational imitation of a graduated scale of income tax. To attempt to impose a scale which varies each month has no economic basis. To correlate sales to time is artificial. The market may be high and would justify an investor in selling, even though he has held a stock only 1 year or 18 months, when the graduated rate is so high as to deter selling. Yet investors, and even the non-stockholding public, generally benefit where stocks are sold on high markets. Under the proposed bill an investor wishing to sell must, therefore, consider not the stage of the business cycle but the accidental date of his purchase. He must consult not an economist but a tax expert. The very concept of a scale graduated by time is unsound. If the tax is to be graduated at all, it should be graduated not by the calendar but the cycle. The Federal Reserve Board or S. E. C. might be empowered to vary the rates, depending upon the stage of recovery or depression. Such variation may help to reduce cyclical fluctuations in stock prices. The present time scale exaggerates cyclical fluctuations.

The meticulous graduation by months is utterly unwarranted by the facts. Table No. 6 of subcommittee report of January 14, 1938, shows that of total net gains taken, those in the class of 1 year and under constitute 34 percent; more than 10 years, 36 percent; and those from 2 to 5 years, only 7 percent. For this 7 percent the new tax proposal makes 36 graduations, an utterly needless and unwarranted complication of the tax law.

XV. INTERNATIONAL EXPERIENCE

(a) *United States unique.*—The United States is the only important country in the world which has a capital-gains tax. One of the smaller countries has a capital-gains tax, limited, however, to capital gains which are realized within

90 days. The British have the longest record of experience in income-tax administration. In the 95 years since 1842 Great Britain has developed an efficient income-tax technique, so that its record for balancing the budget is probably the best in the world. But there is no capital-gains tax in Great Britain. A record of successive large budget deficits in the United States during 5 years of recovery, as contrasted with budgets that are balanced or almost balanced in most of the other countries, would throw question on the merit of our capital-gains tax as a revenue producer.

(*b*) *British versus American view on appreciation in shares.*—The United States Treasury suffers from confused thinking, exactly as do the American investment trusts. The British trusts invest for income, but appreciation is regarded as a windfall and set aside in a reserve against a period of depression, which may not be paid out in dividends. However, most American trusts invest for appreciation in value and regard the appreciation as income. In fact, the new tax on undistributed profits compels them to pay realized gains as dividends to the stockholders. Our trusts suffered a severe shrinkage of assets in this recession and only now realize that what they and their stockholders regard as income was really principal. In the case of both the American Government and the American investment trusts, the fundamental approach is wrong. Capital gain is not income.

(*c*) *European tax on capital.*[1]—A tax on capital is very unusual abroad. Before the outbreak of the war the German Government imposed such a levy for military purposes, the Wehrbeitrag, a nonrecurrent tax on property, not because this particular type of tax was productive or efficient, but because the German Federal Government had not then the right to tax incomes. Only the States did. Great Britain had no tax on capital or on property before, during, or after the war. Neither did France.

(*d*) *Capital levy and war-wealth levy.*—After the war several European countries discussed for some time the question of a capital levy or a single levy on property. This was defeated twice in the House of Commons in 1919 and 1920, and it is interesting to note the position of the then Chancellor of the Exchequer, Austin Chamberlain, "that a capital levy would discourage saving, check enterprise, and create fear and insecurity," and that death duties "constitute the only possible and practical levy on capital. It is paid once by every individual estate in addition to the income tax during the lifetime of the owner of the estate." (P. 512.)

In Great Britain the war-wealth levy—that is a tax on capital gains from 1914 to 1918—never came to a vote, for in June 1920 the Chancellor of the Exchequer stated in the House of Commons that "the government, after full consideration of the report of the select committee and of the respective advantages and disadvantages, have come to the conclusion that the dangers attendant upon such a levy altogether outweigh any advantage which could be derived from it and have decided not to make any proposals in that sense to the House" (p. 513).

In France, likewise, after prolonged discussion, Minister of Finance Klotz abandoned the idea in his budget speech of May 27, 1919, in the words, "The form of capital levy best suited to France is the inheritance tax graduated according to the degree of relationship of the heirs" (p. 515).

During the war the German Government did enact a tax on property increments, somewhat similar to our capital-gains tax, except that the tax was paid on the increase of inventory rather than on the profit on the sale. The German Government likewise enacted a capital-gains tax based on 3-year intervals with the top rate of 10 percent. By using an interval of 3 years instead of 1 year, and by limiting the rate to 10 percent, it showed better judgment and fiscal sense than our Treasury did in the current capital-gains tax. To facilitate payment of the tax, payments were stretched out over a number of years and really constituted an additional income tax. Germany, after the war, imposed both a non-recurrent levy on total wealth and a non-recurrent levy on wartime increases of wealth. However, the inflation of the currency robbed the experiment of any value.

Italy levied a tax called the war-wealth levy and a tax on pre-war capital, but the tax, as in Germany, was payable in installments over a period of 10 to 20 years, so that it was really equivalent to a form of income tax.

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[1] See International Finance and Its Reorganization, Elisha M. Friedman, New York, Dutton, 1922, chs. II, III, IV, and XIII.

The discussion in European countries, therefore, indicates that a tax on property or on increases of property has never been as productive nor effective as a means of raising tax revenues, except when it was made in the form of annual installments—a revindication of the income tax.

XVI. ALTERNATIVE PROPOSALS

In summary, the capital-gains tax now proposed produces less revenue than the flat 12½-percent rate did, checks investment, economic expansion, and employment, and makes markets more illiquid. What is the alternative?

a. Low flat tax on capital gains.—A low flat tax on capital gains, regardless of time, would produce revenue, would not discourage or prevent holders from selling when the market seems high and from buying when the market seems low.

The capital-gains tax had as one of its aims to reduce speculation. However, speculation is already under the close scrutiny of the S. E. C. The capital-gains tax cuts across all the administration's efforts at stability and, by causing violent fluctuations in the stock market, vitiates the other good efforts made in other directions. By using the device of the capital-gains tax for this purpose, there has been incurred the offsetting disadvantage that the funds available for industry have tended to be frozen.

Furthermore, instead of having the speculation under control and under close supervision by the S. E. C. and by the governors of the exchange, speculation has been driven into devious bypaths. The slot machines, the numbers racket, and the gambling in the Irish Hospital lottery all indicate that the gambling motive is very fundamental and had better be brought under control and publicity rather than excessively restricted. It is amazing that an administration, which had the insight to see that drinking wine and liquor could not be stamped out and therefore repealed prohibition, should have shortly thereafter attempted to stamp out speculation by a high capital-gains tax instead of bringing speculation out into the open.

Assuming an annual fluctuation of about $12,000,000,000 on the New York Stock Exchange, it is obvious that if the rates of tax were low, traders would be encouraged to lessen fluctuations by buying on set-backs and selling on advances. Under the old 12½-percent rate, the total net gains actually taken during 1926 and 1927 were about $2,500,000,000. A 10-percent tax on this amount would yield about $250,000,000, or as compared with the yield on about $17,000,000,000 in 1934 and $85,000,000 in 1935, when the rates were high. At the same time, the market in 1926 and 1927 was much closer, so that genuine investors would have the benefit of a close spread between the bid and asked prices. The community would have the benefit of smaller stock-market fluctuations. Furthermore, without the severe handicap of the high rates of tax on capital gains, traders could begin to buy on small reactions or the prospects of slight profits, whereas now, under the high rates, they must wait for big breaks or the prospect of substantial profits before they will risk their principal. A rise in confidence and in business is tied up with the capital-gains tax.

b. *The inheritance tax is the final capital-gains tax.*—The inheritance tax is a genuine capital-gains tax. It is a case of selling out and staying out, because the decedent's estate is actually liquidated and converted into cash. The annual capital-gains tax operates as a homeopathic dose of the inheritance tax. Many of the arguments for the capital-gains tax seem to disregard the fact that there is already an inheritance tax to accomplish the purpose of the annual tax on capital gain.

The inheritance tax already is in effect. It is a sort of final capital-gains tax. Therefore, there is no need to continue to tax capital gains annually during the lifetime of the taxpayer. To do so implies that the State can do better than the individual in putting these annual accretions of funds to work during his lifetime in increasing production and creating employment. From the actuarial point of view, there should be no difference, as far as Government revenue is concerned, whether the Government taxes 130,000,000 people on their annual capital gains or whether it taxes the decedents of each year on the capital gains of a lifetime. In fact, the inheritance tax should be more productive than the annual capital-gains tax because the annual capital gains are put to work again.

Why is it necessary to collect a capital-gains tax of each year, of each 3-year period as formerly in Germany, or even of each cycle? Is not a lifetime as good and proper a period for the application of the capital-gains tax? It seems a more natural unit of time for such a tax. Large-visioned statesmanship can conceive such a time standard, but small impatient minds cannot.

Inheritance tax rates can be graduated as in many European countries, more steeply in accordance with the degree of removal of blood relationship to the decedent.

c. *Special tax on traders.*—Again traders or professional speculators whose annual income consists of accumulated capital gains could be taxed differently from the rest of the several million stockholders who trade infrequently and with whom capital gains may be followed, and generally is followed, by capital loss for 2, 3, or 4 years, as in 1930 to 1933. Besides, such millions of small holders might sell stocks at one time to buy bonds for old age or to expand plants or develop new industries.

d. *Broadening the base of income tax.*—The elimination of the capital-gains tax would not actually curtail Government tax revenue because the capital gains are largely potential paper profits which the investors never realize. As one cynic said, the taxpayer who worries about his capital-gains tax and does not sell, finally ends up by having no capital gains to worry about. The capital-gains tax is the Treasury's "pot of gold at the end of the rainbow," or the bundle of hay in front of the donkey's nose, always seen and never eaten. A little reflection will show that this must be so. The capital-gains tax is a fiscal illusion. Think of the billions of capital gains wiped out from August to October 1937. Just as a neurotic must be rid of his fantasies before he can readjust to reality, so the Treasury must be rid of this illusory tax before it can begin to find real revenue. With the capital-gains tax eliminated, the Treasury can then settle down to finding suitable and stable Government income.

The income tax pyramid is productive at the base of the national income. Lower exemptions and higher rates in the lower brackets, as in Great Britain, would increase the Treasury's revenue. The British law very wisely permits deductions from income of individuals of life-insurance premiums up to one-sixth of the income. In this way the Government encourages each individual to provide for his own old age and dependents and thus reduces the Government burden for social insurance. Lowering exemptions would also increase the number of taxpayers in the United States, which today on a per capita basis is less than one-third as large as that of Great Britain. Twelve million taxpayers in the United States would constitute a powerful force for Government economy, for opposing Treasury raids by interested bodies like the veterans, and "pork barrel" grabs by local interests.

Since the United States has proportionately only one-third as many taxpayers as Great Britain, therefore Treasury raids are frequent in the United States and rare in Great Britain, therefore also Congress is under pressure to spend money in the United States and Parliament is under pressure to economize in Great Britain. A broadened income-tax base will produce more definite revenue and more predictable revenue and make possible a balancing of the Budget and promote a sentiment of economy and the desirability of living within the Treasury's income.

XVII. Conclusion

The Treasury must now clarify its objectives on capital gains. Does it wish revenue? Or does it wish to check speculation? A low rate in the past has produced abundant revenue and should again do so in the future. The present high rate has neither produced revenue nor has it "soaked the rich" nor has it checked speculation. The Treasury has a clear aim with respect to other taxes, for example on liquor. It does not seek prohibition. Nor, like Sweden and Denmark, does the Treasury use a steep tax to check consumption and encourage temperance, regardless of revenue received. Our Treasury merely seeks revenue from liquor. And the tax does produce revenue, over $500,000,000 per annum. The same applies to tobacco. If the rates on liquor and tobacco were sharply raised, probably they would produce little revenue.

After the last 4 years of experiment with the capital-gains tax, certain conclusions are obvious. A businessman having these conclusions would abandon the policy. A scientist in the laboratory would say that his results were negative and have value insofar as they tell him what not to do. Can Congress afford to draw any other conclusion or follow any other policy?

The subcommittee's report leads inevitably to the conclusion that if abundant revenue is desired, the rates of tax on capital gains should be drastically lowered.

SUPPLEMENTARY MEMORANDUM ON THE CAPITAL GAINS TAX PRESENTED BY ELISHA M. FRIEDMAN

A. SUGGESTIONS FOR LEGISLATION

I. *What constitutes capital-gains tax.*—Investors who buy and sell infrequently would report realized appreciation under the capital-gains tax. Stock exchange specialists, floor traders, outside operators and others whose income is derived from in-and-out trading would not do so, except for such of their long pull holdings as are clearly investments in accordance with some definition in the law.

II. *The rate.*—The optimum rate must be a matter of guesswork. There is no accurate knowledge on this subject. There is definite evidence, however, that the former 12½-percent flat rate produced as much as $575,000,000 in 1 year and averaged $380,000,000 in the 4 years 1926 to 1929. The current graduated rate produced $56,000,000 average for the only years available, 1934-35. What the optimum rate is can be discovered only by experimentation. Obviously the lower the rate, the greater is the incentive to take a risk. The lower the rate, the greater the revenue to the Government. Would it not, therefore, seem desirable, purely from the revenue point of view, to experiment for a period of 1 year with a low flat rate, perhaps 10 percent, with a probability that it will produce a higher income than the 12½-percent rate did. Any concession to nonrevenue purposes, such as economic doctrines or punitive measures against buying and selling, should be weighed in the light of the cost in revenue to the Treasury.

The President has persistently advocated the principle of a low rate in other fields. He asked for lower selling prices in order to obtain larger volume of production and employment. He asked for lower building wage rates in order to obtain a larger volume of home construction, large annual wages, and fuller employment. Why should not this principle apply fiscally, namely, lower the tax rate to obtain larger Government revenue?

III. *The time factor.*—Any feature of the law which would penalize selling or put a premium on holding is undesirable. A free market should depend purely on investment judgment. When stocks are high they should be sold. When stocks are low they should be bought. Otherwise the failure to sell on a high market exaggerates the upswing and the failure to buy on a declining market exaggerates the downswing.

Theoretically it would be desirable that capital gains and losses of long-term investors should become effective immediately after purchase. However, as a compromise, perhaps the Government's own standard in another department should provide the proper time basis or precedent. The S. E. C. law (sec. 16) on trading by directors, officers, and large stockholders sets a 6-month limit as the measure of a speculative turn. If 6 months is a measure of what constitutes a speculative turn for the S. E. C., why is it not as good a measure for the Treasury? In other words, profits on transactions consummated within 6 months might be considered as ordinary income even for the investor. Thereafter a low flat rate of capital-gains tax fixed by Congress could apply. Since the prime purpose of the revenue act is revenue, there should be no penalty on transactions which provide that revenue.

IV. *Graduated rates.*—The graduated rate has no place in the law. It puts a premium on holding when prudent judgment would justify selling. It penalizes selling when the sale would be a public benefit. To make the date of the sale depend upon an accident like the date of purchase is fundamentally unsound. Selling should depend upon the position of the business cycle and the free and unrestricted judgment of the investor. The 36 rates of tax, in the House bill, graduated monthly make the administration difficult and complicated. The provision is utterly unjustifiable from any point of view.

V. *Carry-over of losses.*—The carry-over of losses should be permitted for a period of 2 years at least, as the House bill provides for a 3-year carry-over in the case of the undistributed-profits tax. This provision is fair in view of the fact that according to the Government's own figures, net losses followed for 6 years after 1917 and for at least 4 years after 1929, although the Treasury figures for the years since 1932 have not been published.

VI. *Options for the small taxpayer.*—The small taxpayer should have the option of including his capital gains in other income so as to have the benefit of capital-gains tax or the tax on other income, whichever is lower. Obviously the higher the capital gains rate, the higher is the income which will benefit. A

total tax rate of 10 percent applies to a surtax net income of $18,000 and a 15-percent rate applies to a surtax net income of over $32,000.

VII. *International precedent.*—The above conclusions are borne out by the experience in the old Austrian Empire and in some of the small succession states. Speculative profits were taxable as such. Capital gains were not taxable. The term speculation was limited to sales consummated within periods of 90 days. Intent was the determining factor. The sale of securities less than 3 months after the purchase would constitute taxable speculation, and the burden of proof of new taxability was on the taxpayer. Sales after 3 months were construed as capital gains and the burden of proof that the sales were taxable speculation was on the Treasury. Purchases on margin constituted speculation and gains were subject to tax. Outright purchases constituted prudent investment and gains were not subject to tax. Appeals were made to a board of review having mixed representation of Government officials and laymen, including tax experts and outstanding businessmen.

Canada, our neighbor most similar in economic and political ideals, has no tax on capital gains. In fact no country in the world has a tax on capital gains.

B. EFFECT OF MODERATING THE TAX ON CAPITAL GAINS

I. *Market stability.*—In 1937 the decline in the market was the greatest in history. A 40-percent decline from August 15 to October 19 was caused by a turn-over equivalent to 5 percent of the number of shares listed on the New York Stock Exchange. In 1929, however, a decline of 47 percent from September 3 to November 19 was caused by a turn-over equivalent to 27 percent of the number of shares listed. This high turn-over in 1929 meant Government revenue. A classic case was a wealthy man who bought a stock at 50 and would have sold it at 90 on a scale, and thus have prevented the little people, or odd-lot public, from buying the stock from 100 up to 138. This would have been a public service. Had he sold, he would have supplied stock to the little people at lower prices than they actually paid, and supported the market from 65 down. Not having any buying support of sold-out long-holders, the stock declined to his purchase price, about 50, when he ordered the sale of several thousand shares, which broke the market and exaggerated the selling. In the meantime the Government missed the revenue that would have been paid under a lower tax, the market swing was exaggerated, and the "little public" was hooked.

This low turn-over in 1937 resulted in low Government revenue. To obtain Government revenue the capital-gains tax must be lowered so as to encourage the taking of profits out of which capital-gains taxes are paid.

II. *Business recovery.*—A low capital-gains tax will encourage wealthy men to buy more readily. The resulting stock-market rise would generate confidence throughout the country. A rising stock market is necessary to float new bond issues, upon which employment depends. The small-business men who are holding back on the purchase of material, the hiring of labor, and the expansion of their plant would proceed with greater courage. A reduction of the capital-gains tax is an investment in recovery. There would not only be no cost in revenue but a large increase in revenue. The return in employment, expanding business, and social tranquillity would be huge.

(Subsequently Mr. Friedman submitted the following for the record:)

THE CAPITAL GAINS TAX

[New York Times, February 10, 1938]

We publish on this page today an impressive letter from Elisha M. Friedman on the capital-gains tax. Mr. Friedman demonstrates rather conclusively that the tax in its present form, wholly apart from its other defects, does not even produce revenue. For the 2 years 1934 and 1935 the capital-gains tax produced only about 10 percent as much Treasury revenue as the balance of the tax on individual incomes. And even this 10 percent did not come out of incomes in the highest brackets. For 1936, where all taxpayers together reported their net capital gains as 9.2 percent of their total income, those with net incomes in excess of a million dollars reported net capital gains at less than 2 percent of their total income. The obvious explanation is that the rich could not afford to take capital gains at the prevailing prohibitive rates.

Quite as striking is the comparison made between revenue in the years 1926, 1927, and 1928, when the flat tax of 12½ percent on capital gains was in effect, and revenue in recent years when capital gains have been taxed as regular income, with reductions allowed only in accordance with the length of time an asset has been held. The capital-gains tax in 1934–35 was only 11.7 percent as productive as in 1927–28, whereas other income taxes were 93.6 percent as productive. This was in spite of the fact that in the earlier period gross capital losses were deductible in full from other income and could be carried forward, but in the latter period net capital losses were limited to $2,000 and could not be carried forward.

This means that a drastic reduction, at the very least, is called for in the capital-gains tax. The question might even be raised whether it is worth retaining that tax at all. In the whole period from 1917 to 1931 capital gains after deducting losses, Mr. Friedman calculates, constituted less than 4 percent of individual income subject to tax. The British, without the capital-gains tax, have achieved far greater stability in revenue than we have.

The CHAIRMAN. We will adjourn until 2:00 o'clock, and we will meet in the District Committee room in the Capitol.

(Whereupon, at the hour of 12:05 a. m., the committee recessed to 2 p. m. in the District Committee room of the Capitol.)

AFTERNOON SESSION

The committee reconvened, pursuant to the taking of the recess, at 2 p. m., in the District Committee Room, Capitol, Senator Pat Harrison (chairman) presiding.

The CHAIRMAN. Mr. M. L. Seidman, of New York, representing the taxation committee, New York Board of Trade. Mr. Seidman, you appeared before the House committee?

Mr. SEIDMAN. Yes, sir.

The CHAIRMAN. And gave your views there?

Mr. SEIDMAN. Yes, sir.

The CHAIRMAN. Have you got a brief that you want to file?

Mr. SEIDMAN. No; I have a short statement. I will condense it into my 10-minute allotment.

STATEMENT OF M. L. SEIDMAN, CHAIRMAN OF TAXATION COMMITTEE OF NEW YORK BOARD OF TRADE

Mr. SEIDMAN. Gentlemen, your distinguished chairman has stated that he wants to do justice, to give encouragement, and to restore confidence through every provision of this tax bill. I hope that he is in fact expressing the views of this honorable committee as a body.

We, in this country, are today menaced not by a foreign power, but by destructive economic influences at home; influences that sap our national strength and vitality. We are laboring under the most costly Federal Bureaucracy in our history, under the greatest peace-time budget in our history, under the largest national debt in our history, and under the most burdensome taxes we have ever known.

In the opinion of a great many people, we are not in a business recession. We are in a depression, a synthetic, managed-economy depression, a depression that is estimated to have cost us some 70 billions of dollars in the period of a single year. Many of our troubles can be traced directly to faulty and oppressive taxation. So much so that taxation is today the most decisive deflationary influence in our capital economy.

Besides dislocating our economic equilibrium, extreme taxation defeats its own purpose through the operation of the natural law of

diminishing returns. There is a point beyond which such taxation produces less revenue than would result from more moderate taxation. That point has long ago been reached in our Federal tax laws. I do not believe I am overemphasizing the points, therefore, when I say to you that there is nothing of greater or more immediate importance to all of us than is this tax bill which is now before you.

It would certainly seem that the best investment Congress can make in relieving the present distress to business and employment is to take a constructive, long-term view of our taxing methods. A reasonable tax policy, one which will allow business to carry on and prosper must eventually produce greater revenue than a system of punitive and extreme taxation.

I am glad to say that this tax bill, even in its present form, is a better bill than what we have at the present time. But "better" is a relative term. The present law is so bad for business, and in so many important respects, that the proposed bill is still a long way from what is needed to get business back on its feet.

We understand your difficulties, gentlemen, and we are not here to ask for magic or miracles. Nor do we lack understanding, or full appreciation, of the Government's revenue needs under the present state of affairs. We believe, however, that the situation calls for certain minimum "musts" in the development of a constructive tax policy. Your able chairman has mentioned nearly all of them in his public utterances recently.

The bill, in its present form, retains the principle of the undistributed profits tax, a tax which businessmen have learned to despise. They regard it as a tax, not upon income, but upon working capital. They know it as a tax which penalizes corporations who try to strengthen their financial condition. They see it as a tax, based not upon ability to pay, but upon inability to pay.

This bill proposes, in the case of certain corporations, to force income distributions by taxing undistributed income at a rate 25 percent higher than distributed income. True, the tax would apply to but 10 percent of our corporations, but these happen to transact about 90 percent of the country's business and to employ about 90 percent of the country's workers. The tax is a milder form of our present undistributed profits tax. If enacted it would remain to haunt business, not only for what it is, but also for what it may eventually grow into if permitted to remain as a permanent part of our tax structure. This, then, is the first "must"—and I use this word most respectfully. Nothing but unconditional repeal of this tax will have the desired effect on business confidence.

Your chairman has referred to the need for a broadening of our tax base, if government is to continue its spending at anything like the present rate. That observation is particularly encouraging to the New York Board of Trade which for many years has been contending for this very principle. It seems clear enough to us that taxes have multiplied and become more and more severe due to the extreme pressure of Government spending. Also, that the problem of Government spending is directly tied in with the matter of tax consciousness on the part of our people.

The only practical way to bring about increased tax consciousness is to increase the number of direct taxpayers and to decrease the

amount of concealed indirect taxes. These are unknowingly paid by the great mass of our people in the price of everything they buy. Were personal income tax exemptions cut in half, the number of taxable returns from individuals earning under $5,000 a year would increase fivefold—from about two million to about 10 million. We consider a broadening of the tax base as another important "must" in any constructive rearrangement of our permanent taxing laws.

Yet, very frankly, our hopes for success in this regard are not very high. Only the other day, when this witness urged that point of view upon the Ways and Means Committee, he was told by one of its distinguished members:

> We have a very practical situation facing us here. Of course, it does not influence me so much, because I am a member of the minority party. But the majority party, and the administration in power, realize that this is an election year. You know they are not going to broaden any tax base in an election year—it just cannot be done. The boys are not going home and tell their folks that they are going to reduce exemptions and make them pay more taxes. That is not going to be done.

I hope, gentlemen, that with your able leadership, it is going to be done.

But, by far the most important single item in this bill is its provision for the treatment of capital gains and losses. The bill would continue to say to the taxpayer, "Heads, I win—tails, you lose." In addition to taxing capital gains at high rates, it would continue to deny him the right to unqualifiedly deduct capital losses from other taxable income. Nay, it would go further—it would undertake to "quarantine" short-term gains and losses so as to extend the principle of taxing the gains but disallowing the losses.

Those who seek to justify the taxing of capital gains, argue that such gains represent ability to pay. If that be true, then it must, by the same token, also be true that capital losses represent a diminution of ability to pay. Under no method of fair reasoning can one justify the taxing of all capital gains without at the same time also permitting the deduction of all capital losses.

The problem involves more than the mere readjustment of tax rates. Until you remove the manifest unfairness of the entire arrangement, the root of the evil will remain. It is, in fact, difficult to understand why this obvious injustice to the taxpayer was permitted, by the subcommittee of the House Ways and Means Committee, to remain in the law, in the light of the following statement in its report:

> There is a widespread feeling among taxpayers that it is inequitable and arbitrary to include capital net gains in the tax base for progressive income taxation while at the same time refusing to take account of capital net losses. This feeling is aggravated by the fact that capital gains and losses, like other income, are computed upon an annual basis, as a result of which an individual may be required to pay a heavy tax on a large capital-net gain in a given year, despite the fact that he has in the preceding year sustained a heavy capital net loss from which he has derived no tax benefit. The existence of this feeling among the body of taxpayers, whether or not entirely justified, is prejudicial to the maintenance of proper relations and necessary cooperation between the Government and its citizens in the administration of the revenue laws.

That, gentlemen, is certainly a clear enough condemnation of this obnoxious and unfair practice. Yet, here it is proposed for reenactment.

It is by this time well known that our present tax treatment of capital gains and losses has played havoc with industry. I will not, therefore, take the time to repeat the many counts of indictment. I want only to remind you that capital gains flow chiefly from the risking of so-called enterprise money, and that now, more than ever, that kind of money needs to be put to work to develop new products and new businesses, so as to give employment to our unemployed.

Business flourishes only when enterprise capital is disposed to take risks. Men must be willing to risk their money to make money. Our economic managers have learned, if they have learned anything at all, that chance taking can be encouraged, but it cannot be forced. Enterprise capital will be risked only if a reasonable net profit is the prospective reward. Why should a man in the higher brackets take that risk today if his gains are heavily taxed while his losses may not be deductible at all? Frequently this method of taxation results in a 100-percent tax on all his net gains over a period of years.

From the business angle, therefore, I consider it the most important "must" of all that capital gains be taxed at a rate sufficiently low to encourage the taking of risks, and that capital losses be deductible in full from other taxable income. For many years, a 12.5-percent tax rate under such an arrangement worked out satisfactorily. I respectfully recommend its reinstatement.

The CHAIRMAN. All right, Mr. Seidman; thank you, sir.

Dr. Charles E. Diehl, of Memphis, Tenn.

STATEMENT OF DR. CHARLES E. DIEHL, MEMPHIS, TENN., REPRESENTING THE ASSOCIATION OF AMERICAN COLLEGES

The CHAIRMAN. Dr. Diehl represents the Association of American Colleges.

You have a brief on your subject, have you not?

Dr. DIEHL. Mr. Chairman, I have this brief statement which will facilitate matters by reading it.

My name is Charles E. Diehl. I am president of Southwestern at Memphis, Tenn., and am appearing before you as a representative of the Association of American Colleges and as chairman of a special committee of the association appointed to bring to your attention a situation which faces private philanthropy.

The association includes 528 American colleges. Our membership, a full list of which will be filed with you if desired, includes colleges and universities, large and small, male and female of both races representing the State institutions, as well as church-related colleges of all denominations. They are found in every State of the Union.

Today circumstances are prevalent which seem to handicap the flow of privately directed philanthropies toward colleges, universities, orphanages, and hospitals; institutions dedicated to the service of the State, which are largely dependent upon endowments for their incomes.

The CHAIRMAN. I think it would be well if you would give us a list of those for the record.

Dr. DIEHL. All right.

(The list referred to is as follows:)

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Institution	Executive Officer
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St. Anselm's College, Manchester	Bertrand C. Dolan
University of New Hampshire, Durham	Fred Engelhardt

NEW JERSEY

Institution	Executive Officer
Brothers College, Drew University, Madison	Arlo A. Brown
College of St. Elizabeth, Convent Station	Sister Marie José Byrne, *Dean*
Georgean Court College, Lakewood	Mother M. Cecelia Scully
Princeton University, Princeton	Harold W. Dodds
Rutgers University, New Brunswick	Robert C. Clothier
The College of Arts and Sciences	Walter T. Marvin, *Dean*
The New Jersey College for Women	Margaret T. Corwin, *Dean*
St. Peter's College, Jersey City	Joseph S. Dinneen
Seton Hall College, South Orange	James F. Kelley
Upsala College, East Orange	F. A. Ericsson, *Acting*

NEW MEXICO

Institution	Executive Officer
University of New Mexico, Albuquerque	J. F. Zimmerman

NEW YORK

Institution	Executive Officer
Adelphi College, Garden City	Paul D. Eddy
Alfred University, Alfred	J. Nelson Norwood
Brooklyn College, Brooklyn	William A. Boylan
Canisius College, Buffalo	James P. Sweeney
Colgate University, Hamilton	George B. Cutten
College of the City of New York, New York	F. B. Robinson
College of Mt. St. Vincent, New York	Sister Catherine Marie, *Dean*
College of New Rochelle, New Rochelle	Cornelius F. Crowley
College of St. Rose, Albany	Sister M. Rosina, *Dean*
Columbia University, New York	Nicholas Murray Butler
Bard College, Annandale-on-Hudson	Donald G. Tewksbury, *Dean*
Barnard College, New York	Virginia C. Gildersleeve, *Dean*
Columbia College, New York	Herbert E. Hawkes, *Dean*
Cornell University, Ithaca	Robert M. Ogden, *Dean*
D'Youville College, Buffalo	Mother Saint Edward
Elmira College, Elmira	Wm. S. A. Pott
Fordham University, New York	Robert I. Gannon
Good Counsel College, White Plains	Mother M. Aloysia
Hamilton College, Clinton	Frederick C. Ferry
Hobart College, Geneva	Wm. Alfred Eddy
Houghton College, Houghton	Stephen W. Paine
Keuka College, Keuka Park	J. Hillis Miller
Manhattan College, New York	Brother Patrick
Manhattanville College of the Sacred Heart, New York	Mother Grace C. Dammann
Marymount College, Tarrytown-on-Hudson	Mother M. Gerard
Nazareth College, Rochester	Mother M. Sylvester
New York University, New York	Marshall S. Brown, *Dean*
Niagara University, Niagara Falls	Joseph M. Noonan
Russell Sage College, Troy	J. L. Meader
Saint Bonaventure College, Saint Bonaventure	Thomas Plassman

Institution	Executive Officer
St. John's University, Brooklyn	Edward J. Walsh
St. Joseph's College for Women, Brooklyn	William T. Dillon, *Dean*
St. Lawrence University, Canton	Laurens H. Seelye
Sarah Lawrence College, Bronxville	Constance Warren
Skidmore College, Saratoga Springs	Henry T. Moore
Syracuse University, Syracuse	Chancellor (May 29, 1937) W. P. Graham
Union College, Schenectady	Dixon Ryan Fox
United States Military Academy, West Point	W. D. Connor
University of Buffalo, Buffalo	Samuel P. Capen
University of Rochester, Rochester	Alan C. Valentine
Vassar College, Poughkeepsie	Henry N. MacCracken
Wagner College, Staten Island	Clarence C. Stoughton
Queens College	Paul Klapper
Hunter College	Eugene A. Colligan
Wells College, Aurora	William E. Weld
Yeshiva College, New York	Bernard Revel

NORTH CAROLINA

Institution	Executive Officer
Bennett College, Greensboro	David D. Jones
Catawba College, Salisbury	Howard R. Omwake
Davidson College, Davidson	Walter L. Lingle
Duke University, Durahm	W. P. Few
Elon College, Elon College	L. E. Smith
Flora Macdonald College, Red Springs	Henry G. Bedinger
Guilford College, Guilford College	Clyde A. Milner
Johnson C. Smith University, Charlotte	H. L. McCrorey
Lenoir Rhyne College, Hickory	P. E. Monroe
Meredith College, Raleigh	Charles E. Brewer
North Carolina College for Negroes, Durham	James E. Shepard
Salem College, Winston-Salem	H. E. Rondthaler
Shaw University, Raleigh	Robert P. Daniel
University of North Carolina, Chapel Hill	Frank P. Graham

NORTH DAKOTA

Institution	Executive Officer
Jamestown College, Jamestown	B. H. Kroeze

OHIO

Institution	Executive Officer
Antioch College, Yellow Springs	A. D. Henderson
Ashland College, Ashland	Chas. L. Anspach
Baldwin-Wallace College, Berea	Louis C. Wright
Bluffton College, Bluffton	A. S. Rosenberger
Capital University, Columbus	Otto Mees
College of Mount St. Joseph, Mount St. Joseph	Sister Maria Corona, *Dean*
College of Wooster, Wooster	C. F. Wishart
Defiance College, Defiance	Frederick W. Raymond
Denison University, Granville	A. A. Shaw
Findlay College, Findlay	Homer R. Dunathan
Heidelberg College, Tiffin	Clarence J. Josephson
Hiram College, Hiram	Kenneth I. Brown
John Carroll University, Cleveland	W. M. Magee
Lake Erie College, Painesville	Vivian B. Small
Marietta College, Marietta	H. K. Eversull
Mary Manse College, Toledo	Sister M. Catherine Raynor
Mount Union College, Alliance	Melvin W. Hyde, *Acting*
Muskingum College, New Concord	Robert N. Montgomery
Notre Dame College, South Euclid	Mother Mary Evarista
Oberlin College, Oberlin	Ernest H. Wilkins
Ohio Northern University, Ada	Robert Williams
Ohio Wesleyan University, Delaware	Edmund D. Soper
Otterbein College, Westerville	W. G. Clippinger
St. Mary's of the Springs College, Columbus	Sister Mary Aloyse
Kenyon College, Gordon	K. Chalmers
University of Akron, Akron	H. E. Simmons
University of Cincinnati, Cincinnati	Raymond Walters
University of Toledo, Toledo	Philip C. Nash
Ursuline College, Cleveland	Mother M. Veronica

Institution	Executive Officer
Western College, Oxford	Ralph K. Hickok
Western Reserve University, Cleveland	W. G. Leutner
Wilberforce University, Wilberforce	D. Ormonde Walker
Wilmington College, Wilmington	Walter L. Collins
Wittenberg College, Springfield	Rees E. Tulloss
Xavier University, Cincinnati	Dennis F. Burns

OKLAHOMA

Bethany-Peniel College, Bethany	A. K. Bracken
Oklahoma Agricultural and Mechanical College, Stillwater	H. G. Bennett
Oklahoma Baptist University, Shawnee	John W. Raley
Oklahoma City University, Oklahoma City	A. G. Williamson
Phillips University, Enid	(resigned) I. N. McCash
University of Tulsa, Tulsa	C. I. Pontius
Oklahoma College for Women	M. A. Nash

OREGON

Albany College, Albany	Thomas W. Bibb
Linfield College, McMinnville	Elam J. Anderson
Pacific University, Forest Grove	John F. Dobbs
Reed College, Portland	Dexter M. Keezer
Willamette University, Salem	Bruce R. Baxter

PENNSYLVANIA

Albright College, Reading	J. Warren Klein
Allegheny College, Meadville	William P. Tolley
Bucknell University, Lewisburg	A. C. Marts, *Acting*
College Misericordia, Dallas	Sister Mary Loretta McGill
Dickinson College, Carlisle	Fred P. Corson
Drexel Institute of Technology, Philadelphia	Parke R. Kolbe
Duquesne University, Pittsburgh	S. J. Bryom, *Acting*
Elizabethtown College, Elizabethtown	R. W. Schlosser
Franklin and Marshall College, Lancaster	John A. Schaeffer
Geneva College, Beaver Falls	McLeod M. Pearce
Gettysburg College, Gettysburg	Henry W. A. Hanson
Grove City College, Grove City	Weir C. Ketler
Haverford College, Haverford	W. W. Comfort
Immaculata College, Immaculata	Francis J. Furey
Juniata College, Huntingdon	Charles C. Ellis
Lafayette College, Easton	William Mather Lewis
Lebanon Valley College, Annville	Clyde A. Lynch
Lehigh University, Bethlehem	Clement C. Williams
Lincoln University, Lincoln University	Walter L. Wright
Beaver College	Walter B. Greenway
Cedar Crest College for Women	Wm. F. Curtis
Marywood College, Scranton	Mother M. Josepha
Mercyhurst College, Erie	Sister B. Borgia Egan, *Dean*
Moravian College, Bethlehem	William N. Schwarze
Moravian College for Women, Bethlehem	Edwin J. Heath
Mount Mercy College, Pittsburgh	Mother M. Irenaeus
Mount St. Joseph College, Chestnut Hill	Sister Maria Kostka, *Dean*
Muhlenberg College, Allentown	Levering Tyson
Pennsylvania College for Women, Pittsburgh	Herbert L. Spencer
Pennsylvania State College, State College	R. D. Hetzel
Rosemont College, Rosemont	Mother Mary Ignatius
St. Francis College, Loretto	John P. J. Sullivan
St. Joseph's College, Philadelphia	Thomas J. Higgins
St. Thomas College, Scranton	Brother D. Edward
St. Vincent College, Latrobe	Alfred Koch
Seton Hill College, Greensburg	James A. W. Reeves
Susquehanna University, Selinsgrove	G. Morris Smith
Swarthmore College, Swarthmore	Frank Aydelotte
Temple University, Philadelphia	Charles E. Beury
Thiel College, Greenville	Earl S. Rudisill
University of Pennsylvania, Philadelphia	Thomas S. Gates
University of Pittsburgh, Pittsburgh	John G. Bowman

Institution	Executive Officer
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Villa Maria College, Erie	Joseph J. Wehrle
Villanova College, Villanova	Edward V. Stanford
Washington and Jefferson College, Washington	Ralph C. Hutchsion
Waynesburg College, Waynesburg	Paul R. Stewart
Westminster College, New Wilmington	Robert F. Galbreath
Wilson College, Chambersburg	Paul S. Havens

RHODE ISLAND

Institution	Executive Officer
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Pembroke College in Brown University, Providence	Margaret S. Morris, *Dean*
Providence College, Providence	John J. Dillon

SOUTH CAROLINA

Institution	Executive Officer
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College of Charleston, Charleston	Harrison Randolph
Columbia College, Columbia	J. Caldwell Guilds
Converse College, Spartanburg	Edward M. Gwathmey
Erskine College, Due West	Robert C. Grier
Furman University, Greenville	Bennette E. Geer
Lander College, Greenwood	John W. Speake
Limestone College, Gaffney	R. C. Granberry
Newberry College, Newberry	James C. Kinard
Presbyterian College, Clinton	William P. Jacobs
Winthrop College, Rock Hill	Shelton J. Phelps
Wofford College, Spartanburg	Henry N. Snyder

SOUTH DAKOTA

Institution	Executive Officer
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Huron College, Huron	Frank L. Eversull
Yankton College, Yankton	George W. Nash

TENNESSEE

Institution	Executive Officer
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Cumberland University, Lebanon	Ernest L. Stockton
Fisk University, Nashville	Thomas E. Jones
King College, Bristol	Thos. P. Johnston
Knoxville College, Knoxville	Samuel M. Laing
Lincoln Memorial University, Harrogate	S. W. McClelland
Maryville College, Maryville	Ralph W. Lloyd
Milligan College, Milligan	H. J. Derthick
Southwestern, Memphis	Charles E. Diehl
Tennessee College for Women, Murfreesboro	Edward L. Atwood
Tusculum College, Greenville	Charles A. Anderson
Union University, Jackson	John J. Hurt
University of Chattanooga, Chattanooga	Alexander Guerry
University of the South, Sewanee	B. F. Finney
Vanderbilt University, Nashville	O. C. C.

TEXAS

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Baylor University, Waco	Pat M. Neff
Bishop College, Marshall	Joseph J. Rhoads
Hardin-Simmons University, Abilene	Jefferson D. Sandefer
Howard Payne College, Brownwood	Thomas H. Taylor
Incarnate Word College, San Antonio	Sister M. Columkille
Mary Hardin-Baylor College, Belton	Gordon G. Singleton
McMurry College, Abilene	Thomas W. Brabham
Our Lady of the Lake College, San Antonio	H. A. Constantineau
Rice Institute, Houston	E. O. Lovett
St. Edward's University, Austin	Patrick Haggerty
St. Mary's University of San Antonio, San Antonio	Alfred H. Rabe
Southern Methodist University, Dallas	Charles C. Selecman
Southwestern University, Georgetown	J. W. Bergin
Texas Christian University, Fort Worth	E. M. Waits

Institution	Executive Officer
Texas College, Tyler	D. R. Glass
Texas State College for Women, Denton	L. H. Hubbard
Texas Technological College, Lubbock	Bradford Knapp
Texas Wesleyan College, Fort Worth	Law Sone
Trinity University, Waxahachie	Frank L. Wear
Wiley College, Marshall	M. W. Dogan
Texas College of Arts and Industries	J. O. Loftin

UTAH

Brigham Young University, Provo	F. S. Harris
University of Utah, Salt Lake City	George Thomas

VERMONT

Benning College	Robert D. Leigh
Middlebury College, Middlebury	Paul D. Moody
Norwich University, Northfield	Porter H. Adams
University of Vermont, Burlington	Guy W. Bailey

VIRGINIA

Bridgewater College, Bridgewater	Paul H. Bowman
College of William and Mary, Williamsburg	John S. Bryan
Emory and Henry College, Emory	J. N. Hillman
Hampden-Sydney College, Hampden-Sydney	J. D. Eggleston
Hampton Institute, Hampton	Arthur Howe
Hollins College, Hollins	Bessie C. Randolph
Lynchburg College, Lynchburg	R. B. Montgomery
Mary Baldwin College, Staunton	L. Wilson Jarman
Randolph-Macon College, Ashland	R. E. Blackwell
Randolph-Macon Woman's College, Lynchburg	Theodore H. Jack
Roanoke College, Salem	Charles J. Smith
Sweet Briar College, Sweet Briar	Meta Glass
University of Richmond, Richmond	F. W. Boatwright
University of Virginia, Charlottesville	John L. Newcomb
Virginia Military Institute, Lexington	Gen. Charles E. Kilbourne
Virginia Polytechnic Institute, Blacksburg	Julian A. Burruss
Virginia State College for Negroes, Ettrick	John M. Gandy
Virginia Union University, Richmond	William J. Clark
Washington and Lee University, Lexington	Francis P. Gaines

WASHINGTON

College of Puget Sound, Tacoma	Edward H. Todd
Gonzaga University, Spokane	John J. Keep
Whitman College, Walla Walla	W. A. Bratton, *Acting*
Whitworth College	Ward W. Sullivan
Seattle Pacific College, Seattle	C. Hoyt Watson

WEST VIRGINIA

Bethany College, Bethany	W. H. Cramblet
Davis and Elkins College, Elkins	Chas. E. Albert
Marshall College, Huntington	James E. Allen
Salem College, Salem	S. O. Bond
West Virginia State College, Institute	John W. Davis
West Virginia University, Morgantown	C. S. Boucher
West Virginia Wesleyan College, Buckhannon	Roy McCuskey

WISCONSIN

Beloit College, Beloit	Irving Maurer
Carroll College, Waukesha	Wm. Arthur Ganfield
Lawrence College, Appleton	Thomas N. Barrows
Milton College, Milton	Jay W. Crofoot
Milwaukee-Downer College, Milwaukee	Lucia R. Briggs
Mount Mary College, Milwaukee	Edward A. Fitzpatrick
Northland College, Ashland	J. D. Brownell
Ripon College, Ripon	Silas Evans

CANADA

Institution	Executive Officer
University of Western Ontario, London, Ontario	W. Sherwood Fox
Victoria University, Toronto, Ontario	E. W. Wallace
Mount Allison University, Sackville, N. B.	Geo. J. Trueman

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American Association for the Advancement of Science.
American Association of University Professors.
American Association of University Women.
American Council of Learned Societies.
American Council on Education.
Carnegie Corporation.
Carnegie Foundation for the Advancement of Teaching.
Council of Church Boards of Education and its constituent Boards.
General Education Board.
Institute of International Education.
John F. Slater Fund.
Social Science Research Council.
United States Office of Education.

Dr. DIEHL. Such institutions, though they render public service and as such relieve the State of many millions of dollars which would otherwise have to be provided by additional taxation, are not eligible to receive State or Federal subsidies. None of them can operate without income from outside sources. Such incomes, as in the past, have come from contributions and endowments and have greatly decreased within recent years.

This decrease has resulted in past from the failure of existing endowments to produce the accustomed revenues and even more from a drying up of the sources of endowment.

According to the United States Office of Education, the new contributions to endowments of privately controlled colleges and universities have decreased from $70,119,672 to less than $33,538,827 in 10 years time.

A continuation of this trend will have dire consequences upon the entire field of privately directed and supported philanthropy and would force the closing of the doors of many privately supported public educational and charitable institutions such as schools, colleges, universities, orphanages, and hospitals.

The continued existence of these institutions is vital to the welfare of the Nation. We cannot afford to lose the stabilizing influence of such institutions which serve as a complement and corrective to publicly controlled institutions. Many of the outstanding statesmen, the leading business and professional leaders of America, are the products of such colleges and universities. We have undergone many changes in our social structure within recent years, but it is unlikely that America is ready to accept a completely socialized state in our field of education and charity. Nevertheless, the trend is at present definitely and dangerously in that direction.

We appreciate the friendly and helpful attitude already manifested by Congress in the solution of these and similar problems, but we who labor in the field of higher education fear that a continuation of the present trend will force the closing of the doors of many privately controlled institutions of public education and charity. Every time such a privately supported college, orphanage or hospital closes, the load automatically falls upon the publicly controlled or State institutions, and the cost must be paid by additional taxation.

It would be a saving in dollars and cents, therefore, for Congress to recognize this dangerous trend now in an endeavor to meet the situation before it is too late, before too large a proportion of the cost which was formerly carried by private philanthropy is dumped upon the Public Treasury.

The Association of American Colleges, which our committee represents, does not profess to know all the causes of the present alarming trend. There are no doubt many contributing influences.

We do, however, receive, from all sides, reports that the economic uncertainty and the high-income-tax brackets have caused philanthropists to insist that they have not sufficient net income left for philanthropies, and they are reluctant to jeopardize their estates by contributions from the corpus thereof.

It is not our province to discuss or evaluate the present economic uncertainty, nor do we suggest a reduction of the higher income-tax brackets. We do feel, however, that Congress can wisely amend the Revenue Act, by allowing a bit more of flexibility, so as to encourage gifts, in limited amounts, which are used solely and exclusively for charity and education.

With this thought in mind we have made a careful study of the Revenue Act of 1936, as amended, and recommend for your consideration two amendments which we are told by counsel will tend to solve this problem of private philanthropy with a minimum of loss in revenue to the Government and without presenting any loopholes for tax evasion.

Our original thought on this subject, presented by Mr. William P. Jacobs to the Ways and Means Committee of the House, involved the utilization of the instrument of the revocable trusts. In view of the fact that the revocable trust has not heretofore been used for charitable or educational purposes, and is not held in high esteem by some because of its use within family groups for the avoidance of taxation, it is thought best to substitute for our former amendment the following amendments which will accomplish the desired end without any question as to the integrity of its purpose.

Amendment No. 1: The revenue bill of 1938 is amended by inserting after section 121 a new section, reading as follows:

"SEC. 122. Deduction for charitable and other contributions in case of assignments of corpus and income taxable to the grantor.

"Allowance of deduction: If a donor shall set aside and assign the corpus and income from said corpus to an institution or organization for purely educational or charitable purposes for a period of three or more years; the income from said corpus during the period of the assignment shall be considered the income of the beneficiary and shall not be included in computing the net income of the donor. This deduction shall be allowed in addition to the 15 per centum limit imposed by section 23 (o). However, said income so donated shall not exceed $20,000 per year with respect to each donor, regardless of the number of such assignments made by the donor."

The CHAIRMAN. Now, the only change in that from the suggestion made in the House was that you suggested a revocable trust over there; that the income during the 3 years would be transferred over to them, but it might be revoked?

Dr. DIEHL. Yes.

The CHAIRMAN. Here you transfer the corpus over to them for 3 years?

Dr. DIEHL. Yes.

The CHAIRMAN. And they are to get the income?

Dr. DIEHL. Yes.

The CHAIRMAN. And the limit is $20,000?

Dr. DIEHL. Yes.

The CHAIRMAN. In other words, for that time it is not a revocable trust?

Dr. DIEHL. It is irrevocable for that period.

Amendment No. 2: On page 34, line 25, strike out the period and insert a semicolon and the following:

Except that for the taxable years 1939, 1940, and 1941 such 15-per centum shall be increased to 20 per centum.

It is believed that the substitute amendments which we now recommend would involve annual contributions which in the main would be within the present 15-percent allowance for deductions for charity, and that their incorporation in this bill would cost the Government not exceeding $2,000,000 in revenue. It is hoped that the flexibility of definite term assignments of corpus and income would encourage the man of moderate means, who is somewhat fearful of the future, to contribute more of his income to charity than he now does. Those who regularly utilize the full 15-percent allowance or more are the relatively few who have the unusually large incomes. Such philanthropists ordinarily contribute to the larger universities, and the 20-percent provision for a limited time would encourage their larger giving. Those of moderate means are more often the supporters of smaller institutions which are apt to be local in character.

Thus the two proposed amendments will help both types of institutions, the larger and the smaller types. They will, on the one hand, encourage philanthropy on the part of those whose estates are small and need to be kept in more liquid form; and, on the other hand, they will aid those large estates who can afford outright gifts from corpus and income.

There is no way of knowing in advance the extent to which donors will make use of the assignment feature. No one can foretell the full value of the effect of such an amendment on private philanthropy.

It is believed, however, that the psychological effect of such a privilege, during uncertain periods when donors are in doubt as to the future, will be to encourage definite time assignments, and that such assignments may lead in time to a considerable increase in permanent contributions to endowments.

The Association of American Colleges, together with other representative American philanthropies, urge you to endorse and sponsor these two amendments for the sake of private philanthropy.

Mr. Chairman, might I say just a word, or have I used up my time?

The CHAIRMAN. That is all right, Doctor.

Dr. DIEHL. I don't know how much this private philanthropy and education is saving the country, but I do know this, and I think you would be interested in knowing it, that Dr. Guy Snavely, who is now executive secretary of the Association of American Colleges and who made a study of the matter for the State of Alabama, and President Seaton, of Albion College, who made a study of the thing for the State of Michigan, an independent study, they found that these colleges, these so-called private institutions—there are not any private institutions, they are all public—some are publicly controlled and some are privately controlled—they found that these privately

controlled institutions were saving the State of Alabama $3,000,000 a year, and it was the same figure for the State of Michigan.

Now, when you take the State of Tennessee, which I represent, or the State of Ohio, both of which have so many colleges, it is even more than that, and any method by which you gentlemen can see your way clear to aid us in this situation will be gratefully received.

The CHAIRMAN. May I ask what the views of the committee were with reference to this House amendment which seeks to reciprocate deductions when property is given to these institutions in kind, not to the market value but to the value of the property, what it cost them?

Dr. DIEHL. That is very vigorously opposed, especially by the larger institutions. I have a letter from President Dodds, of Princeton, about that, and he said that that provision would be disastrous to them, that "whichever is the lower" is a terrible blow to an institution like Princeton and Harvard and Yale and the larger ones. Of course, we who are presidents of the smaller institutions are not so much affected, but we belong to the same fraternity, and I do wish that that could be changed, that "whichever is the lower" could be eliminated.

The CHAIRMAN. Thank you very much, Doctor.

Senator Capper, is Mr. John Vesecky here?

Mr. VESECKY. Right.

The CHAIRMAN. All right, Mr. Vesecky. I understood you wanted a few minutes.

Mr. VESECKY. Yes, Mr. Chairman.

STATEMENT OF JOHN VESECKY, PRESIDENT, NATIONAL FARMERS' UNION

Mr. VESECKY. My name is John Vesecky. I am president of the National Farmers' Union.

The CHAIRMAN. Of Kansas?

Mr. VESECKY. Of the National Farmers' Union. I live in Kansas.

The CHAIRMAN. You have heard of Senator Capper before, have you not?

Mr. VESECKY. Yes; for a long time. If we did not have Senator Capper here, I don't know what Kansas would do.

The CHAIRMAN. Well, you want to get that in the record surely. [Laughter.]

Mr. VESECKY. The Kansas farmers are willing to have it in the record.

The CHAIRMAN. All right.

Mr. VESECKY. There are two things I want to talk about, and, since being here, I want to say a few things about three. All of them have an effect on farm incomes. As you all know, we are working to try to raise farm incomes. There are three things that affect farm incomes very directly. One is the excise tax on pork products, the other is the tax that is being tried to be removed from certain board of trade operations, and the third is the proposition of broadening the income-tax base. All three affect the problem of the United States farmers.

Let us take up the excise tax first. You all know that the imports of pork products are increasing, and they are increasihg continu-

ously to the detriment of the American farmer. We are now starting to put into operation a bill which will limit the production of our United States farms, and we certainly do not want that limited production to be replaced by imports from foreign countries. We are very anxious that we retain as much of the American market for the American farmer as we possibly can.

Personally, I am not a high protectionist. I was raised in the old Democratic school of free trade, or tariff for revenue only. But as long as that is the system under which the world operates now, we must follow that system, and we should protect our citizens in the enjoyment of the market that they have now rather than the markets somewhere across the water.

We think that this tax, if, as some of them claim, that pork products are a luxury, will not keep the luxury-eating people from buying those products. What we are trying to bring about here is a production quota in this country that will enable our farmers to use their machinery and get an income that will be sufficient to keep the farmers going.

The next thing that I want to speak about is this proposition of reducing the tax on certain board-of-trade transactions. I tell you folks if there is anything more than any other that will break down the operation of the present farm bills that Congress has passed it will be the operations of those folks that are trying to remove the tax on speculation. Your Congress over here is now fooling around—not fooling around—I think it is good work to do, to cut out this gambling on numbers in the District of Columbia. That gambling on numbers is child's play compared to the gambling in the products of the American farms. I don't believe that we ought to reduce the tax on that. It is absolutely gambling that would be affected by this, these wash sales or these scalper sales. A scalper is absolutely gambling; he is not a legitimate trader. He does not expect to keep the product if he buys it, nor to deliver it if he sells it. It is straight, out-and-out gambling on farm products.

The third thing is this broadening of this tax base on incomes. There are two things in connection with that: The ability of people to buy things is regulated by the amount that they have left after they pay all the overhead, part of which is the tax. If you go and broaden the tax base and put it on the fellow, as I heard suggested, who has only a $500 net income, you are going to take from that fellow who doesn't have enough to buy the difference with which to buy clothes, you are going to take some more from him to make up for the amount that you leave to the fellow that has an excess, more than he could use to buy things that he needs to eat or to clothe his family. Don't do that, folks.

There is another reason: The State legislatures in large measure have used this lower-bracket-income fellow, not in the national income tax picture, to raise funds for the State through State income taxes. If you take them into your national income tax, then you will take from the State a source of revenue that they use now for State purposes.

Those are the things that I want to speak to you folks about, and I thank you very much for giving me the opportunity to do so.

The CHAIRMAN. Let me ask you, with reference, first, to this excise duty on pork products: Have you read the communications from the Secretary of Agriculture with reference to that matter?

Mr. VESECKY. No; I have not. I have read Secretary Hull's communication.

The CHAIRMAN. You read that?

Mr. VESECKY. Yes; I read that.

The CHAIRMAN. Well, Secretary Wallace points out this fact—I am not stating it to you in an argumentative way, but merely to try to get the facts.

He says:

> Even with no additional import taxes, the imports of pork products in 1938 will probably be substantially less than they were in 1937 and will still show a further decline in 1939. The relatively large imports of 1937 were due primarily to the short domestic supplies of pork, and the resultant high prices caused by the droughts of 1934 and 1936.

That is the main point that he makes, that this large importation that is pointed out in 1937 was due to that.

Mr. VESECKY. He may be part ways right in that; but the price is not regulated by that short crop, because the price of hogs now has dropped considerably below the top and our number of hogs has not increased, we still have a shortage of hogs, and if we permit those importations we will still further reduce the amount that we can use. It is a dangerous precedent to set, to first reduce the production of our own farmers and then to permit importations.

Now, ordinarily, gentlemen, I am in favor of these reciprocal trade treaties. I think that they do lots of good. But this is one case where I think we ought to have something to say about what is going to be done. You cannot pass upon these reciprocal trade treaties, but if they get too wild with them you can put on excise taxes and protect the interests of the farmers.

The CHAIRMAN. I want to ask you one other question. Is it your belief that the board of trade is beneficial—that transactions on the board of trade are beneficial in obtaining higher prices for farm products?

Mr. VESECKY. I have said that many times, that my belief is that it is detrimental.

The CHAIRMAN. It is your opinion, then, that if you had no board of trade or had no cotton exchange, that it would not affect it?

Mr. VESECKY. As far as futures trading is concerned, it is my belief that we need a place for a buyer and seller to meet, but we don't need a place where they can go ahead and gamble, and my honest opinion is that if you people don't eliminate that we are going to have a recurrence of farmers coming here asking Congress for relief.

The CHAIRMAN. And you do not subscribe to the theory that the market price in the futures market with reference to cotton and that the market transactions in futures on meat products or farm products on the board of trade influences the present price?

Mr. VESECKY. It may influence it, but it does not better it. I was going to remark that if the railroad people thought that was so good, why don't they put the transportation business on the futures market and sell January transportation or February transportation. They could sell it just like we farmers do at any price that anybody would pay for it.

The CHAIRMAN. Well, I doubt that they would be able to sell anything with the present condition of the railroads.

Mr. VESECKY. Well, somebody would buy it, just like they do our products.

The CHAIRMAN. In this connection, I will have inserted in the record the letter from the Secretary of State with reference to that matter and also from the Secretary of Agriculture, Mr. Wallace.

[The letters are as follows:]

MARCH 16, 1938.

MY DEAR SENATOR HARRISON: I am taking this means of bringing to the attention of the Senate Finance Committee the serious objections to the retention in the general revenue bill, as passed by the House of Representatives last week, of the provision in section 702½ which would impose special import taxes of 6 cents per pound on imports of pork, bacon, hams, sides, shoulders, loins, and other pork, including fresh, chilled, frozen, cured or cooked, steamed, prepared or preserved pork, and of 3 cents per pound on pork joints, sweet, pickled, fresh, frozen, or cured.

I am, as you know, deeply concerned about the welfare of our corn-hog industry. However, I am firmly of the opinion that this proposal, if adopted, would not benefit the corn-hog industry of this country even temporarily. On the contrary, it is directly and seriously opposed to the immediate, as well as the long-run, interests of both our corn-hog industry and our meat-packing industry. I feel certain that, if this fact were realized, those who supported the provision would be the first to abandon it.

I now deem it my duty to bring these facts to the attention of your committee, not alone because of my genuine concern for the interests of the vast number of farmers depending upon income derived from the production of corn and hogs for a considerable part of their livelihood, but because their interests will be jeopardized as a result of the effect of the proposed taxes on a governmental activity in which this Department carries a large share of official responsibility. I refer to the Trade Agreements Act and to the efforts which the Government is making, through trade agreements, to reopen export outlets for hog products.

The nub of the situation is this: The corn-hog industry of this country is heavily dependent upon export markets. Normally, our imports of corn and of hog products are trifling in relation to domestic production and are exceeded manyfold by our exports, mainly in the form of hog products. The average annual exports from the United States of pork and pork products in the fiscal years 1925-26 to 1929-30 exceeded 1,000,000,000 pounds, whereas imports averaged only 11,000,000 pounds. Even in the depression years 1930-31 to 1933-34 exports of pork and pork products averaged 570,000,000 pounds as compared with imports of 3,100,000 pounds.

Because of the droughts of 1934 and 1936, and the greatly reduced supplies of corn, followed by a marked decline in hog numbers there has been an increase in imports of pork products during the past 2 or 3 years. These imports have come in over the tariff, in response to rising domestic prices, as a supplement to inadequate domestic supplies. Hog slaughter in the summer of 1937 was smaller than it had been for 40 years. Pork imports reached a peak of 75,000,000 pounds in 1937. This is equivalent to only about 1 percent of domestic production which is not enough to have any appreciable effect on domestic prices though it is much larger than normal imports.

This increase in imports appears to have been largely a temporary phenomenon. The industry remains fundamentally on an export basis and, with the return of a large corn crop in 1937, which is stimulating an increase in hog production, we shall shortly be faced once more with a serious problem of finding export outlets for our large surplus of pork products. Our farmers must look abroad for markets for a volume of pork products equivalent to from 125 to 150 million bushels of corn, as well as for markets for a large volume of corn itself in years when growing conditions are favorable.

Because of this situation we are overlooking no opportunity to get concessions on hog products in our trade-agreement negotiations. In this connection the pending negotiations with the United Kingdom are of the utmost importance to the corn-hog growers. That country constitutes by far our most important market for pork and lard. In the fiscal year 1929-30 the United Kingdom took 187,000,000 pounds of pork out of total exports amounting to 335,000,000 pounds and 210,000,000 pounds of lard out of total lard exports amounting to 787,000,000 pounds.

Adoption of the proposed taxes on imports of pork would definitely and directly handicap this Government in its negotiations with the United Kingdom and lessen the likelihood of a full measure of success in our efforts to regain outlets for pork and other farm products in that country. This arises from the fact that the tax would fall heavily on pork imported from Canada. Although these imports are insignificant to our enormous corn-hog industry, they have been of real value in the past year or two to the relatively small hog-raising industry of Canada. To place heavy taxes on this trade at the present time would add materially to the difficulties already involved in working out mutually profitable agreements with Canada and the United Kingdom. It is a well-known fact that, under the Ottawa agreements with the United Kingdom, Empire products of interest to American exporters of farm products have been accorded special advantages in the United Kingdom market.

The proposed taxes, which would also curtail imports of tinned ham from Poland, would strike a dangerous blow at our profitable export trade with that country. Poland has long provided a substantial outlet for American farm products and has purchased from the United States much more than she has sold to us. Normally the value of cotton alone that we sell to Poland is greater than the total value of all United States imports from Poland. Even in 1937 our imports of tinned ham from Poland were less in value than our exports of cotton to that country. The volume that has been imported is much too small to have an appreciable effect upon the price received by domestic hog growers for their product, and there is every reason to suppose that, with adequate supplies of pork available in the United States, and the price well below last year's unusually high levels, imports will diminish. It should be borne in mind in this connection that tinned ham is a high-priced luxury product and would never displace in large measure the less expensive untinned domestic ham. To place a heavy tax on such ham would not help the corn-hog grower, but it would jeopardize a substantial market for American cotton. As is true with regard to imports of other pork products from Canada, imports of canned ham from Poland are insignificant to American pork producers but are of substantial importance to the smaller Polish industry.

While it is not within the province of this Department to consider in detail the fiscal aspects of the proposed taxes, it is observed that it is hardly conceivable that they would yield $5,000,000 as estimated by the author of the amendment providing for the insertion of section 702½ in the revenue bill. Import statistics are not compiled in such a manner as to make it possible readily to determine what proportion of our imports of pork would be subject to the 3-cent rate and what proportion to the 6-cent rate. However, if every pound of pork imported in 1937 had paid a tax of 6 cents the yield would have been only about $1,500,000. Inasmuch as circumstances last year favored pork imports to an extent that probably will never again recur, and the proposed taxes are so heavy that they obviously would greatly reduce imports under what they would be without the extra taxes, and since the 6-cent rate is not applicable to all imports, it is evident that the actual yield of the taxes would not even approach the figure $5,000,000.

The imposition of unreasonable burdens on our foreign commerce is inconsistent with our present commercial policy and, in my opinion, is clearly contrary not only to the best interest of the corn-hog industry but also to the best interest of the country as a whole. There is no more dangerous game than an embargo policy in foreign trade. It can be played by everybody, with suicidal results for all. If embargoes are imposed upon the products of any one group, the way is open for all other groups of producers to demand and secure embargoes upon their products, even though but nominally or remotely competitive. Other countries are encouraged and, in fact, compelled to act in the same way toward American exports. Once you embark upon an embargo policy, you must be prepared to see its boomerang effects spread far and wide.

Because of the urgency of the matter this report has not been submitted to the Acting Director of the Bureau of the Budget.

Sincerely yours,

CORDELL HULL.

Hon. PAT HARRISON,
United States Senate.

TABLE I.—*United States foreign trade in pork products*

[In thousands of pounds]

	Exports		Imports	
	Lard	Pork products, including lard	Lard	Pork products, including lard
1928	759,722	1,060,922	3	12,870
1929	829,328	1,173,028	1	8,516
1930	642,486	919,856	2	4,657
1931	568,708	728,608	3	3,979
1932	546,202	662,502	8	5,782
1933	5[illegible],132	721,132	1	2,927
1934	431,237	581,737	(1)	1,647
1935	9[illegible],355	185,055	37	10,531
1936	111,292	178,792	3	41,846
1937	1[illegible]6,150	199,350	247	76,078

1 Less than 500 pounds.

Source: Foreign commerce and navigation of the United States; Monthly Summary of Foreign Commerce.

TABLE II.—*United States exports of pork products to all countries and to the United Kingdom, 1936*

[In thousands of pounds]

	Exports to all countries	Exports to United Kingdom	Percent exports to United Kingdom are of total exports
Pork carcasses, fresh or frozen	152	11	7.2
Pork loins, fresh or frozen	2,594	1,264	48.7
Hams and shoulders, cured	42,163	36,828	87.3
Bacon	4,095	1,156	28.2
Sausage casings—hog	6,949	3,067	44.1
Cumberland and Wiltshire sides	467	261	55.9
Other pork, pickled or salted	10,520	593	5.6
Canned pork	7,937	6,454	81.3
Total, pork products (not including lard)	74,877	49,634	66.3
Lard	111,292	63,547	57.1
Total, pork products, including lard	186,169	113,181	60.8

Source: Foreign Commerce and Navigation of the United States.

TABLE III.—CONCESSIONS RECEIVED BY UNITED STATES ON PORK PRODUCTS IN 17 TRADE AGREEMENTS CONCLUDED TO DATE

PORK, FRESH OR FROZEN

Duty reduced: 5 agreements (Haiti, Canada, Columbia, Guatemala, France).

HAMS

Duty reduced: 6 agreements (Cuba, Canada, Honduras, Colombia, France, and Salvador).

Quota obtained: Belgium.

Duty bound: Guatamala.

BACON

Duty reduced: 5 agreements (Cuba, Canada, Honduras, Colombia, and France).

Duty bound: Guatemala.

SALTED AND PICKLED PORK

Duty reduced: 5 agreements (Cuba, Canada, Colombia, Guatemala, and France).
Duty bound: Haiti, Sweden.
Quota obtained: Belgium.

CANNED PORK

Duty reduced: 6 agreements (Cuba, Belgium, Canada, Honduras, Colombia, Costa Rica).
Duty bound: Guatemala, Salvador.

LARD

Duty reduced: 7 agreements (Cuba, Haiti, Canada, Switzerland, Colombia, Nicaragua, Costa Rica).
Quota obtained: Belgium, Czechoslovakia, Switzerland, Netherlands.
Bound free: Belgium, Netherlands.
Duty bound: Guatemala.

MARCH 17, 1938.

Hon. PAT HARRISON,
United States Senate.

DEAR SENATOR HARRISON: My attention has been called to the excise taxes on pork and pork products included in the internal revenue bill just passed by the House of Representatives. There are certain considerations regarding these taxes which I should like to call to the attention of the Senate Finance Committee.

In the first place, it is necessary to consider these taxes from the point of view of their revenue-producing possibilities. In the debate on the floor of the House it was suggested that these taxes would yield $5,000,000 annually. In order to produce this amount of revenue our imports of pork and pork products would have to exceed the imports of 1937. What are the prospects of their doing so?

Even with no additional import taxes the imports of pork products in 1938 will probably be substantially less than they were in 1937 and will show a still further decline in 1939. The relatively large imports of 1937 were due primarily to the short domestic supplies of pork and the resultant high prices caused by the droughts of 1934 and 1936. With larger domestic pork supplies already in prospect as a result of the better-than-average corn crop of 1937 it may be expected that pork imports will show a marked decline.

A better indication of future pork imports can be obtained from the import situation prior to 1935 than from the drought-affected trade of recent years. In the 5-year period 1930 to 1934 imports of pork into the United States averaged 3,790,000 pounds per year against imports of 74,831,000 pounds in 1937. On the basis of the quantity imported in the period 1930 to 1934 the proposed excise taxes on pork would have yielded less than $300,000 instead of the estimated $5,000,000.

But with the addition of a 6 cents per pound tax, on the principal items, to the 3¼ cents per pound import duty there would probably be practically no imports of pork except a small amount of very high-priced specialties. It is likely, therefore, that the actual revenue from these taxes would be insignificant.

Since it seems evident that the taxes would not be of any importance from the revenue point of view, it is necessary, in the second place, to consider their value from the point of view of "protection" to domestic hog producers. It is clear, as pointed out above, that these taxes coupled with the present import duty would constitute a virtual embargo on imports of pork products. But this would be of little or no value to our hog producers since the United States is normally on a substantial export basis for hog products. In other words, the problem is not one of keeping out imports but of finding foreign outlets for our surplus supplies. The imposition of the proposed high excise taxes on pork imports is likely to prejudice our much more important pork export trade.

During the period 1930 to 1934 our exports of pork excluding lard averaged 178,000,000 pounds annually against imports of only 3,790,000 pounds. With increasing hog numbers in this country the export-import ratio in respect to pork will undoubtedly tend to return to the pre-drought situation. The prospects of getting back to our previous large pork exports, however, will depend to a

large extent upon our ability to reduce import restrictions in some foreign countries and to keep them from rising in others. The prospects of being able to do this will be greatly diminished by the imposition of unnecessarily high restrictions on imports from abroad.

There is only one item of our total pork import trade which is likely to be of any significance whatever in years of normal domestic pork supplies. This is canned ham which has been coming chiefly from Poland. But since ham is our principal pork export item, except lard, and since we are able with normal supplies to compete successfully with Poland, or any other country, in foreign markets for ham, it is not reasonable to expect that imports of this relatively high priced specialty product could become a matter of real concern to the hog producers of the United States. Incidentally, the United States exports to Poland have always been larger than our imports from that country and the principal item in our export trade with Poland is raw cotton.

The situation then, with respect to the proposed pork import taxes, may be summarized as follows: The United States Government will get very little additional revenue from the taxes. The United States hog producers will get "paper" protection against imports. And in the process the prospects of increasing, or even of maintaining, foreign outlets for American pork may be seriously jeopardized.

Because of the urgency of this matter it has not been possible to ascertain the relation of this report to the President's program.

Sincerely yours,

H. A. WALLACE, *Secretary*.

The CHAIRMAN. Mr. Davidson, you may file your brief, but I hope you will be brief.

Mr. DAVIDSON. Less than 10 minutes.

STATEMENT OF CLINTON DAVIDSON, REPRESENTING FIDUCIARY COUNSEL, INC., NEW YORK CITY

Mr. DAVIDSON. Mr. Chairman and gentlemen, my name is Clinton Davidson. I represent Fiduciary Counsel, Inc., of 14 Wall Street, New York City, an investment advisory organization that is now supervising approximately $280,000,000. I am not seeking assistance for our organization, Fiduciary Counsel, Inc., but through the continuous studies of our statisticians and economists, we have first-hand information regarding the effect of our tax laws upon investment holdings and I hope to be able to make a suggestion that will greatly increase business activity, free some of our clients from their frozen positions, and secure millions of tax revenue from a source that is now producing practically none.

If I may have my little 10 minutes free from questions I shall appreciate it and be glad to answer all questions at the end.

Mr. Chairman, you have recognized the need for changes in the capital-gain provisions as they apply to individuals. I wonder, however, if you realize that because capital-gain provisions do not apply to corporations, billions of dollars are tied up in a certain class of corporations, whereby taxes up to 80 percent or more, in many cases, must be paid when capital gains are realized? This condition exists because (1) the capital-gain rates do not apply to corporations and (2) such profits, in addition to the regular corporation tax, are taxed 75 percent to the corporation if not distributed, and if distributed the stockholder often pays 70 percent Federal plus 8 percent State tax. This situation still exists under the House revenue bill of 1938.

To visualize the deadening effect upon new business enterprises produced by the tying up of billions of investment capital in this manner, just picture what would happen to business if you stopped

the turbines and generators in all of the hydroelectric plants owned privately and by the Government and in the course of construction. Obviously, the 20,000,000 horsepower piled up behind these dams would be useless if the generator wheels were not permitted to go round and round.

Now, then, imagine what happens to business when twice as much capital as is invested in all of the hydroelectric plants is frozen in the class of investment corporations just referred to. Well, the capital in such corporations, which cannot be changed without incurring prohibitive tax rates, is certainly frozen. Estimates based upon Treasury figures indicate that nearly twice as much capital is in such corporations as is invested and is planned to be invested, by private capital and the Government in all hydroelectric plants. The free flow of this capital is stopped by these prohibitive taxes and the wheels of new productive businesses cannot go round and round. I refer to the billions tied up in personal holding and investment companies.

I should like to tell the story of just one case to illustrate what I mean.

In 1910, 3 years before income tax, a resident of California formed a corporation to hold various interests under one management. The present taxpayer inherited all of the capital stock of this company. The assets of the holding company, now worth $15,000,000, have a cost basis to the holding company of $2,000,000. These assets now consist entirely of stock in the business originated by the taxpayer's father, a stock that has very limited marketability.

Investment advisers have repeatedly advised that the taxpayer is not safe in having all of his eggs in one basket, local interests have often requested its leading citizen to invest in new productive enterprises in California, and educational and charitable interests have sought endowment. The taxpayer can do none of these things under the present proposed law. Here is why: If the holding company sold $1,000,000 of its assets, the gain would be $866,666. The corporation under the proposed law—the House bill—would pay 16 percent tax and distribute the remainder as a dividend on which the taxpayer would pay 75 percent Federal and 15 percent California tax. No one would pay these taxes for the privilege of changing investment holdings. Even if there was no State income tax, no one would pay 16 percent plus 75 percent of the remainder; and, therefore, those holdings, which we believe amount to as much as $5,000,000,000, simply cannot be changed; they are frozen as tight as anything can be frozen.

In our business we are forced to explain quite often that a personal-holding corporation can never afford to invest for the purpose of making a profit. The crying need today is for more capital to be invested in the home-building industry and other productive enterprises, but the billions of capital in large personal-holding corporations cannot be invested there as long as profits incur taxes of 16 percent to the corporation and 75 percent to the stockholder. This is a net rate of 79 percent.

It has been suggested that such corporations should liquidate, but under the proposed law many cannot afford to do so. This can be illustrated by the case previously referred to, for example, upon liquidation, the corporation worth $15,000,000 would represent a paper

gain of $13,000,000 to the stockholder, thereby incurring $2,080,000 Federal tax. The cash to pay this tax cannot be raised because the assets do not have sufficient marketability. The American Bar Association suggested to the Ways and Means Committee a method that would permit all such corporations to liquidate—a method which would remove the bars that obstruct the free flow of such capital.

They suggested that there be an amendment allowing the dissolution within a limited time of personal-holding companies without tax being paid upon dissolution, but tax to be paid when the assets so distributed are sold by the stockholders. A copy of the resolution of the American Bar Association is attached to this statement. It states that fairness as well as the Government's purpose seem to favor such a provision. This provision will permit the dissolution of such corporations because the tax is incurred as the securities are being sold by the stockholder, who is therefore always able to secure sufficient cash to pay the tax due.

If your committee wishes to aid business by freeing such dammed-up capital, but thinks that even more tax should be paid by the stockholders, we would suggest in addition to the recommendation of the American Bar Association—and may I remind you that that recommendation was that instead of stockholders paying a tax on dissolution the corporation pay a tax as the securities were being sold—that an excise tax of 5 percent of the aggregate gain be paid within 60 days of the date of such liquidation. This excise tax would not affect the tax to be paid when the assets are later on sold by the stockholder. May I point out that this excise tax on the entire gain is probably equal to one-third of the capital-gain rates proposed for the new revenue law and is in addition to the regular capital-gain rates collected when the assets are sold?

The American Bar Association recommendation was as follows:

Add within section 112 (b) the following subdivision or its equivalent in purpose and effect:

"(7) Property received upon complete liquidation of a domestic or foreign personal holding company. No gain or loss shall be recognized upon the receipt of property distributed in complete liquidation of a domestic or foreign personal-holding company, provided that such liquidation was completed between December 31, 1936, and December 31, 1938."

You may wish to restrict this provision further by limiting it to domestic personal-holding companies and limiting the time to the date between the enactment of the Revenue Act of 1938, and December 31, 1938.

In order to secure some immediate revenue you may wish to restrict this provision further by adding something similar to the following:

Within 90 days of the complete liquidation of such personal-holding company there shall be levied, collected, and paid by the stockholders receiving any assets in such liquidation an excise tax equal to 5 percent of the gain which would have been recognized had subdivision (7) of paragraph 112 (b) not been enacted. In the event the taxpayer shall exercise an option to pay such 5-percent excise tax then he shall be taken to have agreed that for the purposes of determining gain or loss upon the sale or exchange of any property received by him upon such liquidation, the basis of such property shall be the same as the basis of such stockholder.

Why an excise tax? The purpose of suggesting this 5-percent tax being an excise tax measured by the amount of the gain, is to meet any objection that might be raised regarding the legality of retaining

the stockholder's basis so as to make certain that the Treasury will be able to collect the full capital-gains tax on future sales.

Several billion dollars of investment capital are tied up in personal holding and investment companies because capital transactions resulting in profits to such companies are in many cases, in addition to the regular corporation tax, either taxed 75 percent to the corporation or over 70 percent to the stockholder. This, I believe, is contrary to the principles expressed by your chairman and has a deadening effect upon business. Such capital does not move and the expected capital-gains taxes from such capital do not materialize. The results of our suggestion would, I believe, be as follows:

1. Most personal-holding companies which have no useful purpose today would be eliminated. All parties want this done.

2. The individuals who incorporated would, through this change, be no better off taxwise than other individuals.

3. Millions of fixed or static capital will then become liquid or usable capital. A condition that we all hope for.

4. Large taxes on the sale of the assets that are now frozen would then be collected.

Now, gentlemen, I am not making any brief in behalf of personal-holding companies. What I am asking you to do is to make it possible to get rid of all personal-holding companies, and I believe, if you will follow the recommendation of the American Bar Association—I believe that between now and December 31, 90 percent of the personal-holding companies that are in existence now will be out of existence by December 31.

(Subsequently Mr. Davidson submitted the chart on p. 284.)

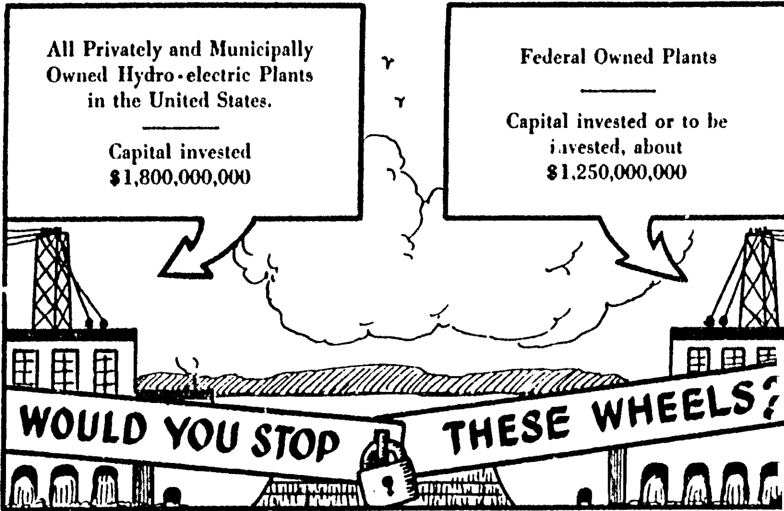
The CHAIRMAN. Pardon me. Do you mean that you think personal-holding companies per se are iniquities and ought to be destroyed, that none of them possess merit?

Mr. DAVIDSON. The companies that I know, Senator, nearly all of them were not formed for the purpose of income-tax avoidance. Most all of them were formed to have group management, or, prior to the decision, where if you had stock in New York Central and died, six different States taxed that stock. Of the personal holding companies with which I am in touch I know that nearly all of them were formed for that purpose or for group management. I must, however, admit that many personal holding companies have been formed for income-tax saving and have taken tremendous advantage of the income-tax savings they afforded and, of course, in that respect, there are some that are iniquities, but I could not say that all of them are.

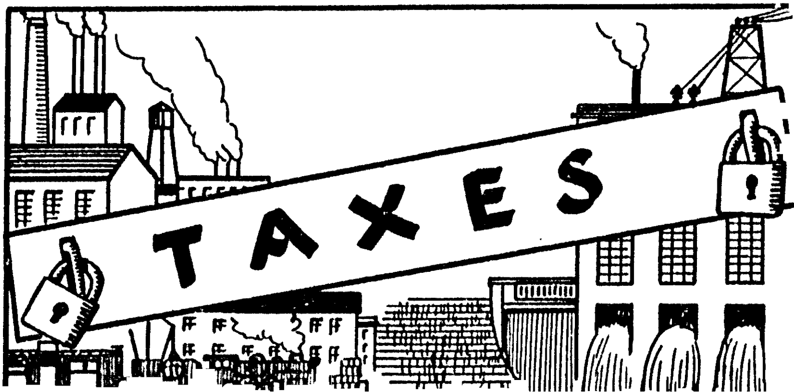
Senator TOWNSEND. Your criticism does not apply to personal-holding companies where a decedent left some estate to his family, and his estate consisted of several corporations in different States, farms in one State, and a mining company in another State, and other things in another State, and where, in order to conserve the assets and prevent their separation, they formed a holding company, taking over the assets of the decedent? Do you think that is an iniquitous thing?

Mr. DAVIDSON. The answer to that is given by the State of New York Legislature. When Miss Wendell died and left a million dollars to charity, it was not possible to have one part given to one college and another part to another college, and so a special act was

Would stopping the turbines and generators in all of the hydro-electric plants in the United States make business worse? Certainly it would. The 20 million horsepower dammed up in hundreds of miles of rivers and lakes—and three billions of invested capital—would become useless if the wheels were not permitted to go round and round.



What happens to business when prohibitive taxes on funds locked up in personal holding and investment companies (15% tax paid by the corporation plus 70% or more, in many cases, paid by the stockholders) stop capital transactions and freeze present investments? Almost twice as much capital is tied up in personal holding and investment companies as is invested in all of the hydro-electric plants in the United States.



passed by the New York Legislature to permit the organization of that estate into a personal-holding corporation, giving them stock in that corporation.

The CHAIRMAN. I may say to the gentlemen of the committee that this is a very important matter, and it has been brought to the attention of Mr. Magill, and there was a conference about it, and I was in hopes that they could work out something, but they have not been able to agree on the proposition yet. Mr. Davidson was there and presented this matter to them. We will consider the matter in the committee.

Thank you very much.

Mr. McFarland. Is Mr. McFarland here?

Mr. MCFARLAND. Yes, sir.

STATEMENT OF ALEX J. McFARLAND, REPRESENTING THE WICKWIRE-SPENCER STEEL CO.

Mr. MCFARLAND. Mr. Chairman and gentlemen of the committee, I have a brief to submit for the record, and I have extra copies which I shall be glad to furnish to the members of the committee. I represent the Wickwire-Spencer Steel Co. My remarks are directed to every insolvent corporation which has been or will be reorganized under the bankruptcy laws of the United States. The problem is a capital-stock problem. It arises because of adjustments to the original declared capital stock value that are required by the present law. I hesitate to make my testimony here complicated, but I think if I use a few figures and dates it will more clearly fix the problem.

The CHAIRMAN. Well, if you will just let me ask you about three questions——

Mr. MCFARLAND. Yes, sir.

The CHAIRMAN. Are you for the repeal of the capital-stock tax?

Mr. MCFARLAND. Not entirely; no, sir.

The CHAIRMAN. Are you satisfied with the provision in the House that authorizes a new declaration of value?

Mr. MCFARLAND. I don't think that goes far enough to meet the question.

The CHAIRMAN. How do you want to meet that? Do you want it at an earlier date, do you want it more frequently, do you want to let them give it next year, in July, and then for 3 years thereafter?

Mr. MCFARLAND. Yes, sir. I think, to meet the present situation, one of the suggestions which is in my brief is that every corporation be permitted to redeclare values this June—June 1938. But, so that this problem will not arise again, naturally, I think that some additional provision should be inserted in the law so that during the subsequent 3-year period these reorganized insolvent companies that are continued will not be subjected to a high increase in their capital-stock tax.

The CHAIRMAN. Now, what is the situation about concerns that have gone into receivership or bankruptcy? What is your suggestion about them?

Mr. MCFARLAND. Might I present my example, and I think it will focus——

The CHAIRMAN. Yes. I just wanted to save a little time.

Mr. MCFARLAND. Let us assume a situation of a corporation, a business corporation, that was insolvent and whose assets were in

the hands of a trustee in bankruptcy under the Federal bankruptcy law. Its assets were worth $8,000,000 and were so found to be worth that amount by the court. Its liabilities, representing bonds, outstanding bonds and notes and interest on the same, amounted to $35,000,000.

That corporation was not doing business within the meaning of the capital stock-tax law during the period that the trustee was operating the business. The plan of reorganization, which provided for the elimination of all of the old stockholders, they having no equity in the corporation, also provided for the issuance of stock to the old creditors in extinguishment of their claims, so that there would be no fixed charges on the reorganized company. That plan was effected in May 1937.

Since the corporation as reorganized was doing business prior to June 30, 1937, it was required to file a capital-stock tax return on June 30, 1937, and fix a value for its capital stock as of the close of its preceding income-tax taxable year. That corporation operated on a calendar-year basis.

The effect, therefore, was that it was required to declare a value for its capital stock on December 31, 1936, which was prior to its reorganization. That was the requirement. It at that time had to fix a value which would sufficiently cover it, to use a slang expression, for excess-profits-tax purposes.

Now, June 30, 1938, appears on the horizon. Certain adjustments are required by the present law and by the House bill to its original value. Those adjustments cover the period from December 31, 1936, to December 31, 1937, and those include the period during which the reorganization was effected and the transactions whereby it was effected.

The Bureau of Internal Revenue has held, with respect to the provision requiring an addition to the original value for the cash and fair market value of property for which shares are issued, that since the creditors, the bondholders and noteholders, surrendered $35,000,000 of their claims to the corporation and stock was issued therefor, that a $35,000,000 addition is required to that original capital stock tax value, thus saddling the new company with an enormous capital stock tax value and in addition to its capital stock tax each year of $35,000.

Now, it surely cannot be intended by this Congress that these reorganized companies should be penalized solely because of the reorganization proceedings themselves. In the 1936 act that fact was recognized by this committee when a provision exempting reorganized companies for the balance of the year from undistributed-profits taxes was enacted. I think that section is section 14 (d) (2) of the 1936 act.

That the situation is purely inequitable may be illustrated by this fact, that if that reorganization had been postponed from May 1, 1937, to July 2, 1937, no adjustment would ever be required on account of those reorganization proceedings. Why? Because the first value that would have been declared would have been on June 30, 1938, but as of December 31, 1937.

Now, surely, there is no reason for penalizing certain reorganized companies merely because the plan of reorganization under sec-

tion 77 or 77B was effected prior to June 30 rather than subsequent to that date.

The CHAIRMAN. Have you brought this matter to the attention of any of the Treasury officials?

Mr. MCFARLAND. I talked informally about this matter to Mr. Parker. At that time I did not have any concrete suggestions or amendments—that is, in so many words--to the law.

The CHAIRMAN. When was that?

Mr. MCFARLAND. That was on March 1, at the time the bill was reported to the House, and I did not have an opportunity to present the matter to the House committee.

I have three suggestions to make which are included in this memorandum. One is that the provisions of the present House bill be amended so as to permit every corporation, whether insolvent or not, to redeclare a value for its capital stock on June 30, 1938,—this coming June. That would have to be supplemented by a provision so that a company which is subsequently reorganized under section 77B would not be penalized by a further tax arising from reorganization under a situation such as I have just pictured.

A second suggestion is that some favor should be granted to all corporations, insolvent corporations, rather, reorganized under section 77 or 77B, and that they should be granted a period of exemption from capital stock taxes for a period of 2 years following the date of their reorganization.

It is perfectly clear that the directors of a reorganized, insolvent company have no idea what the future holds, aside from general business conditions. It has been recognized in the committee report of this committee in the 1936 act that those corporations should be entitled to recover their strength. For that reason they were exempted from the surtax on undistributed profits tax. That provision should not be so framed so as to permit corporations which have already been hit with this substantial tax to obtain a refund. I suggest that for purely administrative reasons. It would cause confusion. I do think, however, that the provision should be framed as I have suggested in my memorandum so that in future years those corporations should be exempted for that recovery period.

My third suggestion is that the provisions of the present laws be amended so that an insolvent company in bankruptcy under the laws of the United States which issues stock to its creditors shall not be subject to an additional capital-stock tax by reason of that fact alone.

Let me state one other matter. In the example that I have given you the corporation had assets valued at only $8,000,000. Its liabilities amounted to $35,000,000. It is perfectly absurd to say that $35,000,000 of cash was put into that reorganized company by anyone. At the same time it is likewise absurd to say that the claims of those creditors had a value of $35,000,000. At the most they could only be worth seven or eight million dollars.

I assure you gentlemen that I have discussed this matter with the members of the Bureau of Internal Revenue who have to do with the administration of this capital-stock tax, and they have assured me that the rule which I have given you will be applied, and I know of one case where a corporation not over a month ago was required to pay an additional capital-stock tax for the reasons thet I have set forth.

I think that this is a matter which vitally affects insolvent companies which are reorganized under the bankruptcy laws. I think that the Judiciary Committee, which has jurisdiction over the bankruptcy laws, would appreciate some action which would further the rehabilitation of such companies.

SUMMARY

Corporate reorganizations under section 77B of the Bankruptcy Act usually provide for the issuance of new stock to creditors for their former debts.

The Bureau of Internal Revenue proposes to automatically increase the value upon which the capital-stock tax is based by the full amount of the debts so exchanged for stock, even though—

(*a*) The original amount previously declared by the corporation as a capital-stock-tax value is suitable for its business.

(*b*) The amount of debts so surrendered is far in excess of their value. Under the Bureau rule the increase in the capital-stock-tax value is measured by the face amount of debts so exchanged, even though they far exceed the total value of the corporation's assets as a result of the former insolvent condition which required the reorganization under section 77B.

(*c*) The resulting capital-stock-tax value is far in excess of the total corporate assets or of any needs of the business.

(*d*) The earning assets of the corporation are not in any way increased by this transaction, with the result that there is no logic in increasing the capital-stock-tax value at all.

(*e*) A corporation emerging from bankruptcy is thereby penalized by a heavy tax which would not be levied on a solvent corporation.

Three alternative possible amendments are suggested in this memorandum.

(1) Provide that no increase to the capital-stock-tax value shall be made because of the issuance, in section 77B reorganizations, of stock in exchange for debts.

(2) Exempt corporations emerging from section 77B reorganizations from the capital-stock tax for 2 years.

(3) Permit all corporations to declare a new capital-stock-tax value in 1938.

The writer has been definitely advised by official of the Bureau of Internal Revenue that the following rule will be applied to the facts given, and knows of one instance where it was so applied. The officials rely on the ruling known as C. S. T. 4, VXI I. R. B. No. 29, which applies this rule to similar but not identical facts. The writer believes the rule is wrong even under existing law.

The provisions of the present capital-stock-tax law, section 105 of the Revenue Act of 1935, as amended by section 401 of the Revenue Act of 1936, impose a financial burden upon insolvent corporations reorganized under the provisions of sections 77 and 77B of the bankruptcy law which necessarily impedes the rehabilitation of such corporations and contributes to the defeat of the purpose and intent of those sections of the bankruptcy law. Under section 601 of H. R. 9682, the Revenue Act of 1938, as passed by the House, the same result will follow as under the present law.

Under the present capital-stock-tax law, and that proposed in H. R. 9682, an insolvent corporation which is reorganized and continued under section 77B of the bankruptcy law by the issuance of stock to its creditors—the stockholders being wiped out—may be burdened and penalized, as a result of the reorganization proceedings, with a large addition to its original declared value for capital-stock-tax purposes resulting in excessive and burdensome capital stock taxes and an adjusted declared capital-stock-tax value far beyond its needs. The foregoing results arise from the fact that the present law and the provisions of H .R. 9682 require adjustments to an original declared value of such a corporation to be made for transactions which have occurred during a period which may include the date of consummation of the reorganization plan and the transactions by means of which the reorganization under 77B is effected. The situations referred to, which undoubtedly frequently arise, may be illustrated by the following example:

A company, which keeps its books and accounts on a calendar-year basis, was, during the year preceding June 30, 1936, insolvent in that its liabilities, $35,000,000, exceeded its assets, valued at $8,000,000. During the year preceding June 30, 1936, and until May 1, 1937, the business of A company was operated by a trustee under court order in proceedings under section 77B of the Bankruptcy

Act. Having been found to be insolvent by the court, A company, on May 1, 1937, was reorganized pursuant to a plan of reorganization approved by the court, and a result of the plan of reorganization the interests of the old stockholders of A company were eliminated, and stock of A company was given to its old creditors in extinguishment of their claims.

The present capital-stock-tax law—the provisions of H. R. 9682, made no change, for the periods covered by H. R. 9632, in the matters referred to—required each corporation carrying on or doing business for any part of the year preceding June 30, 1936, to declare a value for its capital stock and pay a tax thereon. Subsection (f) of the law provided that the declaration of value on any June 30 should be as of the close of the last income-tax taxable year ending prior to June 30. Since A company was not carrying on or doing business during the year preceding June 30, 1936—its assets and business being in the hands of a trustee—A company was not subject to a capital-stock tax for the year ending June 30, 1936, and was not required to declare a value on that date for its capital stock.

Since A company was engaged in business from May 1 to June 30, 1937, it was required to declare a value for its capital stock on the latter date, such value being declared as of December 31, 1936. In order to avoid possible excess-profits taxes with respect to the calendar year 1937, it was necessary for A company to declare a value on June 30, 1937, which was at least 10 times its expected earnings for that year. Accordingly, A company declared a value of $10,000,000 for its capital stock in its return for the year ending June 30, 1937.

The capital-stock-tax law requires adjustments to be made to the original declared value for each income-tax taxable year included in the period from the date as of which the original declared value was declared to the close of its last income-tax taxable year ending at or prior to the close of the June 30 for which subsequent capital stock taxes are imposed. In the case of A company, the period thus prescribed by law for adjustments to its June 30, 1937, declared value is the period from December 31, 1936, to December 31, 1937.

The capital-stock-tax law requires an adjustment to the original declared value, or the periods mentioned above, for various items, including an addition of "the cash and fair market value of property paid in for stock or shares." This provision, as construed by the Bureau of Internal Revenue, would require A company to add on June 30, 1938, to its original declared value of $10,000,000 the sum of $35,000,000, representing the fact amount of creditors' claims which were satisfied by the issuance of A company stock. This addition will result in an increased capital-stock tax to A company for June 30, 1938, and for each year thereafter until it is permitted to redeclare an original value for its capital stock of $35,000.

The present capital-stock-tax law—and that contained in H. R. 9682—as applied to a corporation which is found to be insolvent by the court and reorganized under 77B of the bankruptcy law produces the results indicated above of burdening such a reorganized company with an enormous adjusted declared value for its capital stock which is entirely disproportionate to its needs. The resulting large additional capital-stock tax imposes a severe financial burden upon the reorganized company. The provisions of the present capital-stock-tax law and of H. R. 9682 nullify to a great extent the intent and purpose of the bankruptcy proceedings—to relieve a corporation of past obligations and to afford a basis for profitable operations in the future. That the foregoing capital-stock tax results are inequitable may be illustrated by the fact that if A company, in the example given above, had postponed the consummation of its reorganization plan until July 2, 1937—its first value for capital-stock-tax purposes would be declared on June 30, 1938, as of December 31, 1937, and no adjustment to such value as a result of the reorganization in July 1937 would be required in a later year. The time of consummation of a reorganization plan under 77B should not be determinative of severe tax burdens.

Congress, in the past, has recognized the fact that insolvent and bankrupt corporations should be given a "breathing spell" before being subjected to severe tax burdens. Section 14 (d) (2) of the Revenue Act of 1936 provides that domestic corporations which for any portion of the taxable year are in bankruptcy under the laws of the United States or are insolvent and in receivership in court proceedings shall not be subject to the surtax on undistributed profits for such year. The report of the Senate Committee on Finance (No. 2156, 74th Cong., 2d sess., pp. 14–15) with respect to this provision of the Revenue Act of 1936, commented as follows:

"The committee proposal specifically exempts the corporation in this situation from the undistributed-profits surtax for its entire taxable year even if it is bankrupt or in receivership for only a part of the taxable year. This proposal is founded on the principle that if a corporation goes into bankruptcy or receivership after its taxable year has started, it is so weak that an undistributed-profits surtax ought not to be or cannot be imposed upon it. Similarly, if it comes out of bankruptcy or receivership during its taxable year, it should be allowed to operate free of such tax during the remainder of the year in order to recover its strength."

The present capital-stock-tax law and the provisions of H. R. 9682 result, as illustrated in the situations referred to above, in the imposition of a capital-stock tax on reorganized corporations in excess of that imposed on corporations with capital assets of the same value and engaged in the same line of business. The capital assets of an insolvent corporation reorganized under 77B are not increased by the reorganization proceedings, since the extinguishment of the creditors' claims by the issuance of stock does not furnish the reorganized company with additional working capital. The operation of the present law and H. R. 9682 is to penalize such a reorganized company, as compared with its competitors, solely as a result of the reorganization proceedings, although it has been recognized that such a reorganized company should be permitted "to recover its strength." The present and proposed laws in effect impose a discriminatory capital levy on such corporations.

Since the successful rehabilitation of an insolvent corporation which has been reorganized under section 77 or 77B of the bankruptcy law depends upon a minimum of taxes and other charges during the first few years subsequent to its reorganization, it would seem desirable to exempt such a corporation from capital stock taxes during the first 2 years subsequent to its reorganization. This period of rehabilitation would permit such a corporation "to recover its strength" and would permit the officers and directors of such a corporation an opportunity to more nearly estimate the probable earnings of the corporation for the future and thus more accurately determine a value for future capital-stock-tax purposes. Although such legislative action is desirable, it is recognized that from the standpoint of the administration of the revenue laws such corporations which may have been previously subjected to a capital-stock tax should not be entitled to a refund thereof.

Remedial capital-stock-tax legislation should be enacted which will operate so as to (1) relieve corporations which have been reorganized under section 77 or 77B of the bankruptcy law and have declared an original value for their capital stock, and (2) afford relief to corporations which may be reorganized under section 77 or 77B of the bankruptcy law in the future.

Three alternative amendments to the present capital-stock-tax law and/or H. R. 9682 are suggested:

(1) The following provisions would permit insolvent corporations reorganized under section 77 or 77B of the bankruptcy law a 2-year period of exemption from capital-stock taxes subsequent to the date of reorganization.

(*a*) Amend section 105 of the Revenue Act of 1935, as amended, by inserting as an additional provision in subsection (c) thereof the following:

"(3) To any domestic corporation which was insolvent and reorganized in bankruptcy under the laws of the United States until June 30 of the third year following the date of such reorganization. The exemption provided by this paragraph, however, shall be applicable only with respect to the year ending June 30, 1938."

(*b*) Amend section 601 of H. R. 9682 by inserting as an additional provision in subsection (c) thereof the following:

"(3) To any domestic corporation which is insolvent and reorganized in bankruptcy under the laws of the United States until June 30, of the third year following the date of such reorganization."

(2) The following provisions would permit all corporations to redeclare an original value for their capital stock on June 30, 1938, and would remedy the burdensome and discriminatory taxes on insolvent reorganized corporations as a result of the adjustments required under the present law:

(*a*) Amend section 601 of H. R. 9682 by striking out "June 30, 1939" whereever it appears and inserting in lieu thereof "June 30, 1938," and by striking out in subsection (h) thereof "June 30, 1938," and inserting in lieu thereof "June 30, 1937."

(*b*) Further amend section 601 of H. R. 9682 by inserting as a final clause in the first sentence in subsection (f) (4) thereof the following: "*Provided, however,* That no adjustment shall be made by a domestic corporation

which was insolvent and reorganized in bankruptcy under the laws of the United States as a result of the issuance of its stock or shares in exchange for or in satisfaction of claims of creditors in connection with such reorganization."

(3) The following provisions would make no change in the present capital-stock-tax law and that contained in H. R. 9682 except to relieve insolvent corporations reorganized under section 77 or 77B of the bankruptcy law from the burdensome adjustments to original declared value now provided by those laws:

(*a*) Amend section 105 of the Revenue Act of 1935, as amended by inserting as a final clause in the second sentence of subsection (f) thereof the following: "*Provided, however*, That no adjustment with respect to its adjusted declared value for the year ending June 30, 1938 shall be made to its original declared value by a domestic corporation which was insolvent and reorganized in bankruptcy under the laws of the United States, and which declared an original value for its capital stock under this section for the year ending June 30, 1936, or June 30, 1937, as a result of the issuance of its stock or shares in exchange for or in satisfaction of claims of creditors in connection with such reorganization."

(*b*) Amend section 601 of H. R. 9682 by inserting as a final clause in the first sentence in subsection (f) (4) thereof the following: "*Provided, however*, That no adjustment shall be made by a domestic corporation which was insolvent and reorganized in bankruptcy under the laws of the United States as a result of the issuance of its stock or shares in exchange for or in satisfaction of claims of creditors in connection with such reorganization."

The CHAIRMAN. Mr. McFarland, we are very glad you brought this matter to our attention, and if you will leave your brief here it will receive the consideration of the committee.

Mr. McFARLAND. Thank you, sir.

The CHAIRMAN. I can assure you of that.

Mr. McFARLAND. Thank you.

STATEMENT OF HON. ROBERT L. OWEN, WASHINGTON, D. C.

The CHAIRMAN. Senator Owen, have you a suggestion that you want to make to the committee?

Mr. OWEN. Mr. Chairman and gentlemen of the committee, I represent the class of attorneys who take very difficult cases that take a good many years to work out, on a contingent basis, and I am calling attention to the present law which seeks, in the event of a collection in a case which has taken many years at great expense to bring to a conclusion, if the collection takes place in a particular year, it will be subject to a surtax of 75 percent outside of the State tax and the attorneys will be deprived of a reasonable reward for the lawful pursuit of it during many years.

The provision as I have drafted or drawn it shows the extreme difficulty of changing the higher schedule. That cannot be done. So that the only way to provide equitable relief would be to provide that the amount collected should have those higher schedules apply only upon a portion of the amount collected, with a deduction for a period of years in excess of 2 years. I thought that a 10-percent reduction of the amount collected for the services in excess of 2 years up to not exceeding 9 years, so that the amount would be 30 percent upon which they would pay the tax rather than the higher amount, would be fair.

I think that the Government representatives in the Treasury Department recognize that there is equity there that ought to be provided for, but it is somewhat difficult to provide the exact terms which would meet the necessity. But I have written a short letter which explains my views with regard to the matter, and I have a copy of it

placed before each of the members of the committee, and I would ask if they would be good enough to read it.

The CHAIRMAN. I asked Dr. Magill the other day to talk to you about this matter. Did you have a conference with him?

Mr. OWEN. I was unable to see Dr. Magill, but I shall be glad to follow it up and see him at some convenient moment before this matter is disposed of.

The CHAIRMAN. Well, thank you very much, Senator. Was that all you desired to say?

Mr. OWEN. That is all I wish to say.

The CHAIRMAN. Thank you very much.

(The letter submitted by Senator Owen is as follows:)

Hon. PAT HARRISON,
Chairman, Senate Finance Committee, Washington, D. C.

DEAR MR. CHAIRMAN: The proposed item relating to earned, professional, legal fees on a contingent basis is intended to do equity both to the citizen and to the Government.

It is well known that attorneys are invited in cases of exceptional difficulty, involving long periods of time, to take contingent fees to cover their expenses. There are years of labor in bringing difficult cases to a conclusion. Some of these cases run from 2 years up to 20 years. To assess the recovery by the Federal Government up to 75 percent under the higher schedules is grossly unfair to the attorneys because in some States there is a further additional tax levied. Out of the remainder must come the large expenses to be reimbursed to the attorneys who have been compelled to incur heavy expense in the prosecution of such cases.

It seems to be impractical to find any relief through suggesting changes in the rate of the higher taxes imposed and which are supposed to apply, and do apply generally, to annual incomes not earned but arising from huge capital investments. These higher taxes are imposed on the theory of capacity to pay without inflicting any inequity upon those who have the capacity to pay from annual income going into large figures. This theory of capacity to pay does not apply to earned, professional, legal income based on contingent contracts. The amendment proposed does no injustice to the United States Government and will protect the reasonable equity of the attorneys who come within the scope of this proposed amendment. A fee of 30 percent to the Government on such earned, professional, legal fees seems fair alike to the Government and to the attorneys. If the committee deems 30 percent of the recovery too small an amount to be paid, it is suggested that the committee can raise this percentage to what seems to the committee equitable and just. But there can be no denial that a failure of the committee to protect such attorneys leaves them subjected to a serious inequity and injustice under existing law.

For these reasons we respectfully pray for such equitable relief as the committee may find equitable and just.

Yours very respectfully,

ROBERT L. OWEN.

STATEMENT OF ROBERT N. MILLER, WASHINGTON, D. C., COMMITTEE ON FEDERAL TAXATION, AMERICAN BAR ASSOCIATION

The CHAIRMAN. Mr. Robert N. Miller, Washington, D. C., representing the committee on Federal taxation, American Bar Association. Have you a brief there?

Mr. MILLER. Yes, sir; but there are some things that I would like to say concisely.

The CHAIRMAN. All right.

Mr. MILLER. I am appearing for the American Bar Association, since the American Bar Association has definitely acted on these recommendations of this committee of which I am chairman.

The association believes that the present provisions regarding limitations of capital losses are so unfair and ill-adjusted that they tend to bring the tax law into disrepute and thus diminish its productivity. What we recommend is that there should be no limitations on the deduction of losses that do not exactly match or correspond to the limitations on capital gains.

We believe that these present provisions hinder the flow of needed new capital in business and that the recently proposed changes in the present bill make the situation worse, as I will show in a moment.

I will not repeat the arguments that have been made there, but we would like very much for the committee to consider as a typical case a small-business man who owns his own place of business and has invested $50,000 in it. Suppose, in the course of a year, he makes $5,000 operating income, but decides to sell his place of business and operate in rented quarters for a while, and on that sale he loses $5,000.

Now, he knows he started the year with $50,000 and he finished with a net worth of $50,000, and nobody can tell him, because it would be untrue, that he made money that year.

But the United States Government says that he made $3,000. He knows the United States Government is wrong. When he asks why that is, he finds that the Government has no reason except that, needing money, it has seized upon this arbitrary limitation which penalizes losers.

If he thinks of putting any more money into that business, he knows that this is a one-sided kind of thing, and he acts accordingly.

I said a minute ago that the provisions of the new bill make this worse rather than better. As you know, under existing law, a man who has capital gains and capital losses has the right to offset against those capital gains all his capital losses. But the new bill has an arbitrary two-class arrangement. That is, capital gains are divided into two classes, short term and long term,. Capital losses are divided similarly, and this further limits the losses because short-term gains are the only gains that short-term losses can be offset against, and so on. That shows how narrowing the effect and how much worse the new law is even than what we have.

Moving along to the next recommendation of the association, as has been said by Mr. Davidson, the bar association, after careful consideration, recommends, with reference to personal holding companies and the undistributed-profits tax imposed on them that they be permitted to liquidate without the recognition of gain or loss, if liquidation is effected within some limited time. Without going into detail, I will state why, in the judgment of the association, such liquidation is in the Government's interest.

Liquidation now is prevented in a great many cases by the fact that liquidation will result in taxable income, and at high individual rates the taxpayer is worse off if he liquidates than if he keeps on going.

If the Government really wants the corporate structure simplified, it seems perfectly plain that it should not penalize the processes of simplification. If the definition of a personal holding company that appears on the law, covered only situations where tax-conscious individuals have been selfishly manipulating a holding company and so "getting away with murder," as we might say, the situation would be quite different from what it is; but, as some of the other gentle-

men have said, that is not the case. That definition is phrased so broadly as to cover a great many companies established and used only for absolutely legitimate nontax purposes, outside any shadow of suspicion, and they become innocent victims of the law.

Suppose a man owning all the stock of a small industrial corporation dies and he wants it to go on, and he leaves it to his five children. Those five children are scattered all over the United States, and it is a natural thing, in order to see that the business continues with consistent management, to put all the stock into a holding company. They may have done that 10 years ago just for that reason. Suddenly they find themselves, in spite of the utter innocence of their intention, subject to an additional tax at the rate of 75 percent of all the income that they are not able to distribute, and they are equally unable to get rid of that situation—that is, to undo the establishment of that holding company and just get back to where they were—because they have to pay a high income tax on the liquidation.

The simplest illustration I can think of is this: Suppose a law-abiding citizen is standing on the sidewalk, where he has a right to be, and a policeman comes along and says, "I am going to shoot you because you are standing on that sidewalk, but if you get off the sidewalk I am going to shoot you for getting off." That is just exactly what we have got here.

It pays our Government to avoid being unreasonable. Our committee finds that there are very few people—even people well informed in the tax field—who realize that about 85 percent of our income taxes are collected automatically by the voluntary action of income-tax payers, 85 percent of which is coming in because the taxpayer wants to pay his taxes.

That is vitally important in drawing a tax bill, and it is possible we are forgetting it. It shows that the Government now possesses something that it cannot afford to lose, a perfectly remarkable habit of voluntary compliance among its income-tax payers.

We are inclined to think that the attitude of our income taxpayers may be the best in the world. The American taxpayer may not like to comply with income taxes, but the figures we have prove that they do comply in the main, and hardly anything could be worse for the Government in the tax law today than anything that threatens the continuance of that habit.

Now, 85 percent of the income-tax dollars, as I say, come right in just because the taxpayer sends them in and reports them on a return. How about the other 15 percent?

That other 15 percent is collected mainly by deficiency letters, called 90-day letters. In those deficiency letters it is relatively rare for the Government to claim that the deficiency was due to intent to evade—that is, to put the 50-percent penalty on them. Most of those are due to the ordinary difficulties of the law, construction difficulties, valuation questions—perfectly honest, bona fide disputes.

That shows that the really ill-disposed taxpayers represent only a small percentage of the 15 percent, and the point of that is, I think, pretty important, and our committee thinks so. If we compare the number of dollars that we get from the people who intend to comply, and that very small relative amount which the Government gets by main force from the noncompliers, it is easy to see which is the big thing to watch, which one we must take care of at all events.

Members of our committee have in the past carried heavy responsibilities on the Government's side—some in the Department of Justice, some in the Treasury Department. We are convinced from that and other experience, as well as from what we read, that our Government's present problem of dealing at arm's length with the very small percentage of noncomplying taxpayers who are now met with, is hard enough; but to collect by force from any large body of taxpayers would be a very difficult thing. We do not know of any government that for any substantial length of time has been able to get much of its revenue by that means. The way to avoid destroying the present attitude of taxpayers is to avoid provisions of law which are unfair.

I turn now to speak of a matter which arises in connection with settlements, compromises, and reorganizations under section 77B of the Bankruptcy Act. It has been more and more evidence for the last year that a peculiar phase of the income tax is greatly interfering with reorganizations under that act. Almost every compromise under the Bankruptcy Act, of course, involves the scaling down of debts. But the scaling down of a debt, under the income-tax law, is under certain circumstances held to involve taxable income to the corporation that gets its debt scaled down. In bankruptcy reorganizations, therefore, this perfectly horrible result not infrequently occurs: If creditors agree to a scaling down of the debts, in the hope that the business may continue and pay off the remaining percentage of debt, the very fact of scaling down is held to create some new income, with a resulting new amount of income tax, which has to be immediately paid to the Government as a preferred creditor.

The creditors are discouraged from reducing their debts, because the embarrassed corporation thereby loses in tax to the Federal Government a part of the existing assets—to pay a new debt to the Government, actually created by the scaling down.

That has been recognized in a provision that has already been passed in the bankruptcy bill by the House. Our recommendation——

Senator CONNALLY. May I ask a question? For instance, if they had $100,000 and they would scale it down to $50,000, the Treasury Department would take the position that they are that much better off by that scaling down?

Mr. MILLER. Yes. The Treasury men are quite familiar with it, and it happens over and over again. The technical end of it is that if any net worth remains when there is a scaling down, the extent of that is income.

Senator CONNALLY. What do you mean? Take the case I gave, where they had $100,000 of debts and they made a composition for $50,000.

Mr. MILLER. If there would be anything left for the stockholders, then, that is income and is held to be income, and the Treasury definitely feels that under the existing law they cannot help but put in a preferred claim for that tax.

Senator VANDENBERG. The amount of the excess is taxable income?

Mr. MILLER. The amount of the excess is taxable income. And I have received letters, as chairman of the committee—letters received during the past year from Boston and from various other places—calling attention to the fact that creditors simply did not feel that they could agree to compositions because the Government comes in

and puts in a new special preferred claim based on the composition itself.

That, we think, properly belongs in the bankruptcy bill, because it rests on the considerations on which bankruptcy bills are rested; but we think that this committee ought to have an interest in it and that there ought to be a cross-reference, so that it will be visible in this bill.

There remain only these two small things that I ought to take time for, and then I will quit. The subcommittee of the Committee on Ways and Means in its report recommended a provision that does not amount to a great deal in money either way, but the bar association for 2 years has felt that to straighten it out would help the good will of the taxpayer. This is the situation where if a man, not being in business, earns $500, and he has to spend something to collect it, if he has to have a lawsuit, for instance. The recommendation was that a deduction be allowed for what it cost him to get it.

You can see that it is a terribly unfair thing if I merely have a claim for $500, and I cannot get it without spending $100, I ought not to be taxed on anything but what I get.

That did not appear in the bill as it was passed by the House, although recommended by the House subcommittee. We don't know why it did not, but we ask your consideration of it.

There are two new provisions having to do with administration in this bill that we heartily approve. One of them has to do with consents in transferee cases, and the other has to do with the finding of overassessments and overpayments by the Board of Tax Appeals. I won't elaborate on those. The other matters in our report I won't take up orally.

(Mr. Miller submitted the following brief:)

BEFORE THE FINANCE COMMITTEE OF THE UNITED STATES SENATE

RECOMMENDATIONS OF THE AMERICAN BAR ASSOCIATION PRESENTED BY ITS COMMITTEE OF FEDERAL TAXATION TO THE SEVENTY-FIFTH CONGRESS, THIRD SESSION

WASHINGTON, D. C., *March 18, 1938.*

To the Chairman and Members of the Finance Committee of the United States Senate.

GENTLEMEN: We respectfully offer herewith some specific comments regarding the pending revenue bill, H. R. 9682, based on directions given to this committee by the American Bar Association.

This Committee's work in the Federal taxation field, covering a period of more than fourteen years, has been directed mainly to the kind of tax questions which lawyers know most about from their daily professional experience—problems of administration, and problems affecting the actual productivity of the tax laws. Our object, like yours, is to promote the enactment of laws which in practice will work to the Government's best advantage. Since a tax law must be well adapted to administration if its actual productivity is to be maintained, this Committee is convinced that great practical importance attaches to efforts of this kind in the adjective field. We are content to leave questions of substantive taxing policy to be dealt with by those who have had special experience in that field.

Among the features of the pending tax bill, to which your favorable attention is invited, are the following:

1. ESTATE TAX RATES

Section 501, relating to the Estate Tax, which makes for simplification by substituting a single rate schedule for the two complicated schedules which under existing law have to be consulted in order to calculate the estate tax.

2. OVERPAYMENTS IN BOARD OF TAX APPEALS

The feature of Section 807 which makes clear that the Board of Tax Appeals has power to adjudicate refund of amounts paid *after* the mailing of the notice of deficiency, as well as amounts paid previous to that time.

3. CONSENT AGREEMENTS WITH TRANSFEREES

Section 311 (b) (4), making it clear that consents waiving the statute of limitations may be entered into between the Government and a transferee, as well as between the Government and a taxpayer.

Features of the pending bill which the Association opposes are:

4. SECTION 117 (D), REGARDING THE LIMITATION OF CAPITAL LOSSES

This section continues in effect—and even enlarges—a provision which operates against the interest of the United States as well as the interest of taxpayers. Under existing law, although *gains* from capital assets (as well as gains from every other possible source) must be included for taxation, the deduction of *losses* is denied except to a limited extent specified in Section 117 (d). This lack of balance is bad for the Government, because it confuses taxpayers by deviating from settled accounting practices under which it would be wrong for a taxpayer to disregard any part of any capital loss sustained; and because wholesome income-producing enterprise is frozen by any system which discourages the taking of risks, by putting especially heavy tax burdens on those who *lose*. It gives the act a "heads I win, tails you lose" flavor, which inevitably diminishes respect for the act to an important extent; this is serious, because the productivity of a law is adversely affected by such diminishing respect.

The present law allows deductions for capital losses only to the extent of $2,000 plus the capital gains—this arbitrary limitation of losses (without any corresponding limitation of gains) applying both to corporations and to individuals. The proposed law is the same as the old for corporations, but is still more grasping in the cases of individuals, as to whom it divides capital losses into classes—short-term capital losses and long-term capital losses—and further provides that short-term capital losses shall be allowed only to the extent of such capital gains, while long-term capital losses shall be allowed only to the extent of $2,000 plus long-term capital gains. Clearly this division into two classes restricts the allowance of capital losses even more harshly than under existing law, by preventing even the *offsetting* of long-term capital losses against short-term capital gains, and vice versa.

No adequate excuse has ever been offered for arbitrary limitation on the deduction of losses except that by this one-sided limitation the Government gets more money.

This is a short-sighted view, just as a merchant is short-sighted who temporarily increases his gains by ungenerous treatment of his customers. In the long run the Government gets maximum revenues by avoiding any taint of unreasonableness or overreaching in its tax laws.

The effect of these arbitrary loss limitations is that income tax rates which are high even when applied only to properly-defined "net income" are actually applied to a figure that is nearer *gross* income than net income (in spite of the fact that in the law it is called "net income") and the results are oppressive. The sense of injustice necessarily produced in taxpayers by provisions of law which have been thrown out of balance by the Government's desire to get money, is further injurious to the revenue because it sets a bad example to taxpayers. Extreme procedures by the Government tend to produce extreme procedures by taxpayers, however true it may be that, morally, a citizen ought to rise above his government's example. We are dealing with human nature, which is imitative, and is also very sensitive to injustice.

The existing limitations on loss deductions, here criticized, are further accentuated in their severity by the proposed changes in Section 23 (g) of the bill. Hitherto such limitations have applied only when losses were realized by sale—not in case of deductions for *worthlessness* of assets, and taxpayers have not been subjected to the complained-of injustice in that field. For the stated reason of securing uniformity, it is now proposed to extend the rule to a new field, by applying the limitation to losses based on worthlessness of securities. This increases the tax liability of some taxpayers, and so increases the yield,

but accentuates an already bad situation. Like the other loss limitations, it tends to destroy the Government's valuable good will, and, therefore, we believe, does the Government greater harm than good. In several cases, its application causes injustice so severe that it tends to destroy the earning power of taxpayers, also to the disadvantage of the revenue.

The Bar Association's resolution with reference to this matter is as follows:

"*Resolved*, That the American Bar Association recommends to the Congress that section 117 of the Revenue Act of 1936 be amended by repealing subdivision (d) thereof which places an arbitrary limitation on the deduction of capital losses and that the Association's Committee on Federal Taxation is directed to urge such action upon the proper committees of the Congress."

5. SECTION 802, REQUIRING LAWYERS TO MAKE RETURNS TO THE GOVERNMENT REGARDING CERTAIN BUSINESS MATTERS OF THEIR CLIENTS

This section repeats the unwise provision of Section 340 of the Revenue Act of 1936 added by the Revenue Act of 1937, requiring information returns from lawyers as to the organization or reorganization of foreign corporations, whether or not the purpose is related to taxation.

As a rough illustration of the nature of the harm this does to the Government's interest, consider the proprietor of a department store who is greatly outraged at the depredations of occasional shoplifters. He is justified, of course, in resenting this loss, but if in order to stop it completely he issued a regulation that every customer leaving the store must be searched, he would be doing himself more harm than good. In fact, a wise proprietor would not do anything whatever which he knew would inconvenience his best customers. In the same way, in the taxation field, a provision which is effective to accomplish one entirely proper purpose may do harm out of all proportion to the importance of the original purpose. An example of such a provision is Section 802.

It is designed to help the Bureau stop the practices of a very small group of persons who peddle tax schemes, mostly in a few of the larger cities. By this provision, which in effect requires that every lawyer in the United States, wherever located, shall ask himself every thirty days whether he has given any advice with reference to the organization or reorganization of a foreign corporation and that he shall make a return whether his advice had anything to do with taxation or not, the Government puts an unreasonable burden on thousands of lawyers, who are naturally disturbed by governmental attempt to force them to violate their obligation of preserving the confidence of any law-abiding client—particularly when the measure is inept even for its intended purpose.

It also has the injurious effect of advertising to a wide group of citizens, not especially interested in tax-saving schemes, the fact that there are clever schemes which other people are utilizing; it invites their close attention to the possibilities of tax avoidance through the organization or reorganization of foreign corporations. The Government's action might be compared to that of a man who in complaining that his house has been robbed advertises to the whole world that it contains very valuable treasures and is easy to break into.

Letters received from Association members show strong sentiment against the provision. We approve its purpose—to get information for the Treasury—but believe that the attempt to accomplish the purpose by this method is unnecessary and inadvisable. The Government can get this information directly and simply by requiring the taxpayers themselves, in the return forms, to answer definite questions with reference to such matters as would be disclosed by the returns filed by lawyers under Section 802. Such direct questions in regular return forms have never yet been tried; they furnish the most appropriate and effective method of inquiry. Further, Sections 338 and 339 of the Revenue Act of 1936, added by Section 201 of the Revenue Act of 1937, and similar provisions in the proposed bill, provide for returns by officers, directors, and shareholders, which returns will inform the Treasury from still other sources.

Section 802 is aimed at an almost infinitesimal group; the heavy burden which it puts upon the entire bar of the United States seems especially unreasonable, considering that no attempt has been made to accomplish the result by the direct and simple method mentioned above. The section is objectionable in that it assumes that it is right for the Government to destroy the confidential relation which has existed between lawyer and client for hundreds of years. The canon of legal ethics which forbids the lawyer, without the client's consent,

to disclose facts which he learned by reason of his employment as a lawyer is founded on sound public policy—that a citizen engaged in a wholly lawful pursuit may use the services of an attorney at law knowing that the lawyer will not disclose facts relating to the work so confided to him.

The probable effect of this provision is that clients will tend to employ foreign lawyers, who need not make returns; this makes the situation more difficult for the Government by encouraging operations outside its jurisdiction.

Suggestions are already being made by Government men that the last sentence in the section—

"Nothing in this section shall be construed to require the divulging of privileged communications between attorney and client."

does not protect the attorney from having to disclose *facts* as to the organization of all foreign corporations with respect to which he has been called upon for advice, even though the lawyer's information came to him solely because he was acting as an attorney.

Section 802 deserves especially serious attention, not as tax legislation, but because it may prove an entering wedge in governmental attempts to require lawyers to make periodical reports as to their clients' business affairs generally, as a substitute for the Government's getting necessary information direct from the client. It is difficult to believe that it would have appeared in the law if the proposals had received that degree of consideration which is usually given to any suggested revolutionary departure from long-settled policies. A law which makes it necessary for every citizen to say to himself: "I can safely confide in many people, but what my *lawyer* knows will be promptly known to my competitors and to the whole world," should in the opinion of this Committee be stricken at the first opportunity from the statutes of a free country.

The Bar Association recommends to the Congress that this provision be removed from the law, and in default of repeal of the whole provision, that it be amended so that no member of the Bar shall be required to make any returns thereunder.

The Association further recommends that the following provisions be incorporated in the pending bill. The Association has adopted the following resolutions, which are printed with comment explaining why each recommendation is made.

6. ADHERENCE TO BUSINESS CONCEPTS OF NET INCOME

Resolved, That the Committee on Federal Taxation be authorized, in connection with income tax legislation, to advocate the principle of adhering as closely as possible to the concept of net income which has been developed by settled business practice.

Comment

During the past 10 years, the various administrations in power from time to time have so allowed themselves to be influenced by the desire to make the income tax immediately produce more money, that what is now called "net income" in the tax laws has very little relation to the meaning of that term as developed by common business sense and practice. To illustrate, consider the capital loss provisions, previously discussed herein. The view of the well-trained accountant is that a business which makes a million dollars in its operations and loses a million dollars on the sale of capital assets has not in the net made anything during the year. In contrast, existing tax laws which give full effect to the gains and only a very limited effect to losses in determining net income, are so obviously out of line with reality as to place a severe handicap on any administrative official or group who must assume the duty of collecting the tax.

Such hampering defects in our existing tax laws are not ascribable to any one political party. We refer to them in this statement in the hope that our tax laws will be made to better serve their purpose. Revision of tax legislation has too often been delayed on the general assumption that existing inequities are injurious only to the taxpayers involved, and that the Government has little pecuniary interest in correcting them. The observation of this Committee leads it to conclude that this view, while superficially plausible, is unsound.

7. CANCELLATION OR FORGIVENESS OF INDEBTEDNESS AS INCOME; REORGANIZATIONS UNDER SECTION 77B

Resolved, That the American Bar Association recommends to the Congress that Section 77B of the Bankruptcy Act be amended by adding a new subsection (q) in order to preclude the treatment of modification, alteration, can-

cellation or forgiveness of indebtedness as income to the debtor corporation in reorganization proceedings brought under Section 77B of the Bankruptcy Act, and that the Association's Committee on Federal Taxation be directed to cooperate with the Committee on Commercial Law and Bankruptcy in urging the following proposed amendment or its equivalent in purpose and effect upon the proper Committees of the Congress:

SEC. 77B. CORPORATE REORGANIZATIONS

* * *

(q) If the plan of reorganization submitted and approved in accordance with the provisions of this section includes a modification, alteration, cancellation or forgiveness of indebtedness, in whole or in part, by creditors of the corporation, such modification, alteration, cancellation or forgiveness of indebtedness shall not be deemed to produce income to the corporation within the meaning of the applicable revenue laws.

It is further recommended that future revenue acts embody provisions to the same effect.

Comment

The confusion which exists in cases where cancellation or forgiveness of indebtedness occurs by reason of financial difficulties, has been referred to in the reports of the Committee on Federal Taxation at the fifty-eighth annual meeting and at the fifty-ninth annual meeting. As stated in those reports, the policy of the Bureau of Internal Revenue is, apparently, to treat all cancellations of indebtedness as income to the extent that the taxpayer has any net worth after such cancellation. The courts have applied a somewhat broader rule but the law is still not clear as to precisely what the rule is. Attention has been called to the bad effects of this uncertainty when reorganization is attempted under Section 77B of the Bankruptcy Act. When creditors are invited to reduce their claims in such a reorganization, the inducement to such action is the hope that the reduced claims may eventually be collectible, because having preserved a net worth useful in the business, the company may resume profitable operation. The inducement disappears, however, if the result is merely that the Federal Government will take the funds with which the company was expecting to operate. Uncertainty about these matters makes it difficult to effect reorganizations of this type, which are obviously in the public interest. The Committee has not arrived at a recommendation which would clear up the entire difficulty growing out of all the existing uncertainties, but as to settlements under the Bankruptcy Act, it recommends legislation set out at the beginning of this statement to the general effect that any cancellation or forgiveness of indebedness in connection with a reorganization carried out under Section 77B of the Bankruptcy Act shall be deemed not to be productive of taxable income.

A provision similar in substance to that suggested above is embodied in the current revision of the Bankruptcy Act (H. R. 8046) which has been passed by the House and is now pending in the Senate. We note that during the hearings held by the subcommittee of the Senate Judiciary Committee on H. R. 8046, the representatives of the Treasury expressed the opinion that such a provision should be a part of a revenue act rather than a bankruptcy act. We do not share this opinion, but in order to avoid confusion, we suggest that a cross-reference be made in the Revenue Act of 1938 to the provisions of the new Bankruptcy Act relating to this subject.

The suggestion was also made by the Treasury that where property had been purchased by issuing obligations, any scaling-down of such obligations should be reflected in a lowered cost or basis figure for the property. We submit that this objection could be easily taken care of by an appropriate amendment in the section of the Revenue Act dealing with basis for gain or loss purposes.

8. DISTINCTION BETWEEN REVENUE CONTROVERSIES AND CONTROVERSIES AS TO REGULATORY MATTERS

Resolved, That the Committee on Federal Taxation be directed to oppose any legislation under which the Board of Tax Appeals or any governmental agency charged with reviewing the correctness of Treasury tax determinations would be combined or associated with agencies charged with reviewing determinations by administrative authorities concerned with regulatory laws.

Comment

In connection with many suggestions which have been made, looking to the formation of a court whose duty it would be to review the findings and conclusions of a variety of administratice agencies, this committee is convinced that such a court should be given no jurisdiction affecting the revenue.

It is the Committee's conviction that, in the public interest, revenue questions and questions arising in governmental regulation—such as the regulation of business practices, communications, etc.—should be kept apart as far as possible.

The Committee wishes to point out, first, that the Government necessarily enjoys far greater powers in respect of summary collection of the revenue than it enjoys in the scope and method of enforcement of purely regulatory functions, so that to set up one reviewing body which would deal both with taxation matters and with regulatory matters must be against the public interest as tending to retard the highly important functions regarding the revenue.

Second, it is vitally important that the Government, in addition to having a fair system of corrective justice in respect of tax liability, shall have a system which functions so that the flow of necessary public revenue will move as swiftly as possible; there must be a very high degree of administrative cooperation between the Treasury on the one hand and any such reviewing agency as the United States Board of Tax Appeals. If the Treasury's determinations in tax controversies were to be reviewed by a mere division of a very large administrative court, coordination between the court and the Treasury would necessarily demand the cooperation of the chief justice. The chief justice, encumbered with administrative problems not connected with taxation, and perhaps without expert knowledge of the taxation system, could not possibly keep so closely in touch with the revenue situation as can the Board of Tax Apepals and its chairman, who have only revenue problems with which to deal.

Third, the efficiency and trustworthiness of such a reviewing agency depend almost wholly on the quality of the appointments made to it. The difficulty of maintaining a personnel of high caliber, able to command the respect of the taxpaying public, would be very much greater if it were merely a division of a much larger court, acting under a chief justice who might or might not be well informed as to problems peculiar to the revenue.

A suggestion has come to the attention of the Committee—at this writing no formal recommendation has been made—that the Court of Claims be invested with jurisdiction to determine the validity, for limited purposes, of any regulation issued by any administrative agency. The Committee believes that such a procedure would not be practical in a system of tax administration, and desires to emphasize the importance of a separate treatment of revenue matters and regulatory matters. It is worth noting that the Federal Declaratory Judgment Act was first enacted in general terms, and later amended so as not to apply to controversies with respect to Federal taxes.

9. NONRECOGNITION OF GAIN OR LOSS IN THE DISSOLUTION OF PERSONAL HOLDING COMPANIES

Resolved, That the American Bar Association recommends to the Congress that if the 1937 amendments of the Revenue Act of 1936 concerning personal holding companies continue in effect, there now be added an amendment allowing the dissolution, within a limited time, of domestic and foreign personal holding companies without recognition of gain or loss; and that the Committee on Federal Taxation be therefore directed to urge upon the proper Committees of the Congress (1) that there be added within Section 112 (b) the following subdivision, or its equivalent in purpose and effect:

> (7) *Property Received upon Complete Liquidation of a Domestic or Foreign Personal Holding Company.* No gain or loss shall be recognized upon the receipt of property distributed in complete liquidation of a domestic or foreign personal holding company, provided that such liquidation was completed between December 31, 1936, and December 31, 1938.

and (2) that, accordingly, Section 205 of the Revenue Act of 1937, amending Section 115 (c) of the Revenue Act of 1936, and Section 337 (h) of the Revenue Act of 1936, added by section 201 of the Revenue Act of 1937, be repealed. In the current bill the same designation of the section and subsection are appropriate.

Comment

The Revenue Act of 1937 increases the severity and scope of the tax on the undistributed net income of both domestic and foreign personal holding companies, not merely by increasing the rates but by broadening the definition. Thus, many corporations come within the new definition that were not within the old. The changes in the law are retroactive, applying to taxable years beginning after December 31, 1936. The Government's purpose in enacting these provisions would probably be best served by voluntary dissolution of personal holding companies, a result which will in many cases be achieved. It would be much more widely achieved, however, if it were not for the fact that stockholders of such companies subject themselves to income taxes, at such dissolution, if the value of the assets of the dissolved corporation then received by the several stockholders exceeds the cost of the stock held by them. This committee recommends that if the severe rates and broad definition of the Revenue Act of 1937 with regard to personal holding companies are to remain in effect, a provision be enacted so that domestic and foreign personal holding companies can be dissolved, within a certain limited period, without the recognition of gain or loss.

These holding companies, when organized, were lawful; many of them were organized without any purpose relating to taxation; many of these companies whose purpose is unrelated to taxation have business complications rendering it difficult or impossible to distribute all their earnings. Therefore, fairness as well as the Government's purpose seems to favor such a nonrecognizing provision as a companion to the 1937 legislation.

If legislation is necessary to insure that no step-up of "basis" would be enjoyed by the taxpayer in such a non-recognizing liquidation, a few words inserted in section 113 will serve.

In connection with what has been said as to the increase in rate, it is worth noticing that under the 1937 act the surtax on undistributed adjusted net income of domestic personal holding companies is imposed on amounts in excess of two thousand dollars at the rate of 75 per centum—this high surtax being in addition to other income taxes imposed upon the corporation. As one illustration of the greatly broadened scope of the definition of personal holding companies, we direct attention to the provision under which any individual having partners is considered, for purposes of "constructive ownership," as owning all stock owned by all or any of his partners.

10. DEDUCTIONS FROM GROSS INCOME; EXPENSE IN PRODUCTION OF INCOME

Resolved, That the American Bar Association recommends to the Congress that section 23 of the Revenue Act of 1936 be amended so as to permit the deduction of all ordinary and necessary expenses incurred in the production of taxable income whether or not incurred in carrying on a trade or business, and that the Committee on Federal Taxation be directed to urge the following proposed amendment or its equivalent in purpose and effect upon the proper committees of the Congress:

> Section 23. Deductions from Gross Income.
>
> In computing net income there shall be allowed as deductions:
>
> (a) Expenses.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business or *for the production of income required to be included in gross income under this title*, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business *or for the production of income required to be included in gross income under this title* and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, *or for the production of income required to be included in gross income under this title*, of property to which the taxpayer has not taken or is not taking title or in which he has no equity. [New matter in italics.]

In the pending bill, the same section designation is appropriate.

Comment

Under the general provisions of Section 23 (a) of the Revenue Act of 1936, expenses are deductible only if paid or incurred "in carrying on any trade or business." Questions constantly arise under this provision as to the deductibility of ordinary and necessary expenses incurred in the production of taxable income, but which it is difficult to show were incurred "in carrying on any trade or business." In determining net income it seems that the expenses of producing the income should be deductible whether or not the taxpayer may be regarded as carrying on a trade or business.

We note that the Subcommittee on Internal Revenue Taxation of the House Ways and Means Committee at page 46 of its report says:

> "Your subcommittee believes that a taxpayer should be granted a reasonable deduction for the direct expenses he has incurred in connection with his income. Under the present law, section 23 (a) of the Revenue Act of 1936, some expenses attributable to the collection or production of taxable income are not permitted as deductions because the statute limits deductible expenses to those incurred in carrying on a trade or business. Thus a taxpayer cannot deduct fees and expenses paid in litigation for moneys which are includible in gross income but which are not received in connection with a trade or business. In order that net income be more equitably ascertained, your subcommittee recommends (Recommendation No. 33) that section 23 of the Revenue Act of 1936 be amended so as expressly to include as deductible items all expenses not at present deductible, which are immediately and directly incurred in the collection or production of income, limited to 50 percent of the amount collected or produced."

A provision embodying this recommendation was not included in the bill, but we urge that such a provision be inserted in the present bill.

11. POWER OF SECRETARY OF TREASURY AND COMMISSIONER OF INTERNAL REVENUE TO COMPROMISE TAX LIABILITIES

Resolved, That the American Bar Association recommends to the Congress that section 3229 of the Revised Statutes be amended so as to make clear the power of the Commissioner of Internal Revenue to compromise tax cases where such compromise is in the best interests of the United States, and that the Committee on Federal Taxation be directed to urge the following proposed amendment, or its equivalent in purpose and effect, upon the proper Committees of the Congress:

> SEC. 3229. The Commissioner of Internal Revenue, with the advice and consent of the Secretary of the Treasury, may compromise any civil or criminal case arising under the internal revenue laws instead of commencing suit thereon; and, with the advice and consent of the said Secretary and the recommendation of the Attorney General, he may compromise any such case after a suit thereon has been commenced. *Such compromise may be made because of doubt as to the liability or the amount thereof, the insolvency of the taxpayer, doubts as to the collectibility of the full amount claimed, or because deemed to be in the best interest of the United States for other reasons.* Whenever a compromise is made in any case there shall be placed on file in the office of the Commissioner the opinion of the General Counsel for the Department of the Treasury, or of the officer acting as such, with his reasons therefor, with a statement of the amount of tax assessed, the amount of additional tax or penalty imposed by law in consequence of the neglect or delinquency of the person against whom the tax is assessed, and the amount actually paid in accordance with the terms of the compromise. (New matter in italics.)

Comment

Under the opinions of the Attorney General published as Nos. 6 and 7 in XIII-2 C. B. 442 and 445, it is the present attitude of the Treasury Department, which is stricter than the view which formerly prevailed, that it has no authority to compromise claims against taxpayers where the liability to pay is clear and where it is possible to collect. The Association believes that so strict a rule is not conducive to the best interests of the community in many cases, and that by statutory amendment a broader power to compromise should be made clear. In

many cases, although it is possible for the Government to collect its claim in full, the result will be to force the taxpayer out of business with consequent reduction in employment in the community, the loss of a potential source of revenue to the Government, or making the taxpayer a charge on the community for his existence.

Since under the statute every such compromise must be made by the Commissioner of Internal Revenue, must be approved by the Secretary of the Treasury and, in the event the matter is in litigation, also by the Attorney General, and a detailed statement of the matter with the reasons for the compromise must be filed in the office of the Commissioner of Internal Revenue, it is believed that the exercise of such power to compromise cases will not be subject to abuse.

12. LEGISLATIVE HEARINGS

Resolved, That it is the sense of the American Bar Association that the taxation field is one in which legislative processes should be orderly and unhurried; that hastily enacted tax legislation is reasonably sure to contain defects of substance and of expression; that even if perfect in draftsmanship, such legislation is likely to contain provisions ultimately unfair and unsound, all of which adequate discussion and consideration would probably avoid; that such defects of substance and of expression are likely to result in loopholes impairing the productivity of the legislation, or in injustice to taxpayers; that such provisions, ultimately unfair and unsound, operate in the end to the detriment not only of the taxpayer but of the Government as well; that in order to achieve satisfactory legislation time should be allowed between the introduction of a bill and any vote thereon, sufficient to permit members of Congress and the general public to inform themselves as to what is provided and as to the probable effects of the bill if enacted; that adequate hearings on proposed legislation are in the public interest; that hearings to be adequate should be announced at least 10 days in advance and should be held a sufficient time after the publication of a proposed law to give interested citizens opportunity to study its provisions and to formulate carefully any criticisms and suggestions.

Comment

Careful consideration is needed in enacting tax laws, not merely to make sure that they will have the tax effect intended, and that such effects will be useful in a long view, but also to insure their proper correlation with many matters unconnected with taxation. Furthermore, hastily constructed tax laws usually contain serious loopholes which could easily have been discovered by persons experienced in tax administration, if given time. The tax-collecting authority's task is lightened by well-considered legislation and made harder when the taxpayer's obligations have to be sought for in a series of laws, each of them hastily enacted in an effort to correct errors due to the hasty enactment of a previous law.

It is particularly important that after the introduction of a tax bill, voting on it shall not take place until after all the legislators have had sufficient time to study and digest its provisions and until the citizens who are able to criticize it intelligently have had full opportunity to examine the bill, and to make suggestions. Hearings conducted on a report which does not suggest the precise language recommended for enactment, or hearings conducted after only a few hours' notice, are not adequate, because very often those most competent to point out states of fact as to which the proposed bill would produce undesirable results are not at the legislative door, and because reasonable time is required for study and preparation.

In considering the need of taking time to scrutinize proposed legislation in terms of a great variety of actual situations, we note as an example the definition of personal holding companies in the 1937 Act. This definition is so broad that only when it has been applied in terms of real situations will anyone know how many companies not within the real purpose of the Act are included within its terms. Other parts of the Act which sound well to one who is intent on certain cases needing legislation may be recognized as unwise when their application to the whole income tax field is fully in mind.

We note that the text of the Federal revenue bill which developed into the Revenue Act of 1937 was introduced in the House on Friday, August 13. Copies of the bill were made available to the public on Saturday, August 14. On Monday, August 16, the bill passed the House and was sent to the Senate. On

Wednesday morning, August 18, public hearings (lasting approximately a half hour) were held by the Senate Finance Committee. Their report had already been filed the night before. No prior announcement of these hearings seems to have appeared either in the Congressional Record or in the public press. The Senate passed the bill with slight amendments on Thursday, August 19. The House concurred in the Senate amendments on Friday. The bill, first introduced on one Friday, had been passed both by the House and the Senate and the Senate amendments had been accepted by the House by mid-afternoon of the following Friday. No hearing on the bill was held in the House, although brief hearings had been held on the report of the Joint Committee on Tax Evasion and Avoidance, of which hearings four days' notice (Thursday to Monday) had been given.

The history of the Revenue Bill of 1938 is too fresh in your minds to need comment in this connection.

POLICIES AFFECTING WORKABILITY OF TAX LAWS

The Committee further submits the following statements, based largely on the experience of members of the Committee while in the Government service, as well as upon our close observation of the working of the tax laws over a long period. We ask you, if you find them to be sound, to apply them in current revenue revision.

This Committee has sought to include only propositions which can stand on their own feet, and whose soundness is indisputably supported by experience.

A. No law can be satisfactorily enforced unless it is supported by public opinion among those whom it is intended to affect. The Prohibition Act, armed with fines, penalties, and forfeitures, is a recent reminder. In the taxation field France is an example of the fact that tax laws which do not have the support of the taxpayers will be relatively unproductive no matter what their provisions or how high their rates.

B. An income tax law, of all laws, is particularly at the mercy of public opinion, because no Government is able to discover, even with the greatest diligence, any but a small part of income not voluntarily reported. The income of a nation's citizens is a matter of incredible complexity and multiplicity. The Government, indeed, can—and should to the limit of its powers—select individual income taxpayers, investigate fully what their income was, and force each one to comply with the law, but it cannot investigate everyone, and it is helpless to deal with a situation in which large numbers of taxpayers have a non-compliant attitude. The Government could not survive on the revenues collected by separate controversies with individual taxpayers. Fear of Government action is one of the necessary instruments to be employed in inducing voluntary compliance, but such fear ceases to be very effective if the weight of public opinion is adverse to the wisdom or fairness of the law.

C. The public revenue will be injured rather than helped by a law that is passed under the illusion that the great body of taxpayers can be forced by governmental power or by the fear of the exercise of governmental power, to do whatever the law provides, if the law seems unreasonable and unfair. Public opinion is far stronger than government, and that must be borne in mind in drafting a law which is to succeed.

D. Scrupulous care exerted in drafting a law so that it will be fair and will be otherwise worthy of respect from the taxpayer finds its justification not as a mere kindness to the taxpayer or as a conscientious duty to him; honesty and reasonableness are *necessary* government policies because it is the Government that suffers most if the law is not fair; the Government is compelled to observe these principles from pure self-interest, and suffers drastic consequences if it fails in that respect.

To repeat, an unclear or an unfair tax law is far more injurious to the Government's revenues than it is to any taxpayer; and even those parts of the law which are well drawn and which taken alone command respect among taxpayers can easily be ruined in their effect by inserting, in other parts of the law, provisions which offend in either respect, because public opinion among taxpayers is what counts, and public opinion will not discriminate between good parts and bad parts. Acting like a single rotten apple in a barrel, ill-designed parts of a tax law can ruin the "good will" of the whole law.

E. The United States at present enjoys the fruits of a very general habit of voluntary compliance with the income-tax law.

In an attempt to discover how far the income tax is being paid voluntarily by taxpayers—that is, what proportion of the income-tax receipts is due to

amounts which taxpayers themselves admit on returns voluntarily filed, and pay in regular course—without requiring the Government to resort in deficiency letters or suits—the following figures were obtained. The table shows the total collections of income taxes (without reference to the taxable years as to which they were collected) in each of the ten fiscal years 1928 to 1937, inclusive, together with a breakdown for each year showing how much of the total represented current taxes and how much back taxes. Since in any one of the fiscal years mentioned the slowness of the process by which back taxes were collected resulted in the collection of very little *current* tax not voluntarily paid in, the two columns give a reasonably reliable basis for concluding what percentage of the total income tax receipts (in dollars) came in voluntarily and what percentage had to be the subject of specific governmental effort.

Income-tax collections

Fiscal year	Total current taxes	Total back taxes	Total collections	Percentage of total collections due to back taxes
1928	$1,896,737,500.54	$277,835,602.35	$2,174,573,102.89	12.78
1929	2,094,349,669.61	236,924,759.03	2,331,274,428.64	10.16
1930	2,178,758,304.22	231,500,926.06	2,410,259,230.28	9.60
1931	1,621,956,047.48	238,084,449.91	1,860,040,497.39	12.80
1932	867,975,089.75	188,781,607.79	1,056,756,697.54	17.86
1933	614,397,739.73	132,393,664.38	746,791,404.11	17.73
1934	676,438,386.70	140,586,953.02	817,025,339.72	17.21
1935	913,589,246.06	185,641,136.64	1,099,230,382.70	16.89
1936	1,199,380,712.84	213,557,591.05	1,412,938,303.89	15.11
1937	1,890,334,450.78	258,329,425.21	2,148,663,875.99	12.02

Our own feeling, based upon a study of these figures, is that over the whole period of ten years it is fair to conclude that about 85 per cent of the total collections were voluntarily paid and about 15 per cent came in through deficiency letters and litigation.

This means, we think, that while the tax laws must certainly arm the Treasury to deal effectively with those who are careless or ill-intentioned in tax matters, all the provisions should be drawn with constant recognition of the fact that the great volume of the revenue comes from the honest and careful. Any provisions of law designed to thwart the ill-intentioned must be carefully designed so as to put no new burdens of form or procedure on the voluntary group of taxpayers whose payments add up to around 85 per cent of the total income-tax receipts, or even on the others who have honest questions of law and fact to be determined.

This is particularly so since the ill-intentioned taxpayers, even under compulsion, produce such a small amount of tax. Consider this: If 85 per cent comes in on the basis of returns voluntarily made, and 15 per cent includes *all* the collections by deficiency letter and suit, then the amounts collected from the *ill-intentioned* must be relatively small, because any close observer of our income-tax affairs can see that of the total number of deficiency letters, only a few contain charges of fraud. Most of them grow out of genuine questions of law or fact, so difficult that Government experts find it hard to agree as to what is the right answer. The moral is plain—sound common sense warns us that no amount of impatience at the conduct of the small and nonproductive class of resisters can justify provisions of law which are likely to disturb the vast revenues which now flow smoothly from good citizens. Even when thieves are around, there is no sense in shooting into a crowd of law-abiding citizens.

F. The valuable governmental possession represented by the habit of compliance can easily be ruined by unwise tax legislation. In revising any tax law, it is just as important not to impair the status now existing between government and the income taxpayer as it is to promote affirmative improvements in the law. The following are among the elements which are important in maintaining the necessary favorable public opinion toward the income tax and keeping it outside the scope of controversy:

(1) Fairness.

(2) Simplicity.

(3) Certainty or foreseeability as to the amount of income tax due in a given situation.

(4) Proper balance as to relative importance of different provisions, judged by the "long-pull" effect on the actual productivity of the whole Act.

(5) Adherence in a reasonable degree to established habits of taxpayers as regards the calculation of net income and the reporting of tax.

(6) Avoidance of destructive effect on the earning power and business activity of taxpayers.

In connection with the item "Simplicity" just above listed, this Committee is convinced that complexity in a tax law is an encouragement to evasion. If a law is so framed that the average taxpayer cannot understand it without expert help, those who do understand it and who are ill-disposed will know that they can successfully excuse themselves by a plea of ignorance. Technical phrases sound like a foreign language to the average taxpayer, so that it is decidedly in the Government's interest to use, instead, language that can be understood. Complicated ideas can only be expressed in complicated language; therefore it is often in the Government's interest to adhere to simple schemes of taxation even though more complicated ideas would produce a larger theoretical tax.

For instance, consider the difference between the existing law as to contributions *in kind* for charitable purposes, and the change which is proposed in Section 23 (q) of the pending bill. Under existing law the amount which a taxpayer can use as an income tax deduction in respect of property contributed for charitable purposes (subject to a limitation not here material) is the *fair market value* of the property when contributed. This has been criticised because property has appreciated in value since its purchase, and this gives the taxpayer a larger deduction than if the amount of the deduction, under the law, had been the cost to him. The new proposal, instead of substituting *cost* as the amount to be deducted, sets up a system by which it is necessary to determine first the cost, then the fair market value, and then to discard whichever one of these determinations is the lower. This is an example of how a complicated idea necessarily produces a complicated text. If the Government insits on getting the best of it *either way*, it pays a price in complexity as well as in good will.

Thus in spite of the vast taxing powers which the Federal Government enjoys under the Constitution, it is nevertheless under powerful practical compulsions, conditioned by the habits and reactions of the citizens; the Government cannot exist without large amounts of revenue, and no sufficient continous flow of revenue can be maintained unless the Government itself, in drawing its tax legislation, obeys a great many rules, founded on the reactions of human nature—rules which the Government, for all its power, is powerless to change, and breaks at its peril.

THE STANDING COMMITTEE ON FEDERAL TAXATION
OF THE AMERICAN BAR ASSOCIATION,
EDWARD J. KEELAN, Jr., Massachusetts,
LOUIS A. LECHER, Wisconsin,
ROBERT N. MILLER, District of Columbia, *Chairman*,
HOWARD W. REYNOLDS, California,
WILLIAM A. SUTHERLAND, Georgia,
MABEL WALKER WILLEBRANDT, California,
G. A. YOUNGQUIST, Minnesota.

The CHAIRMAN. Mr. Sutherland, whom do you represent?

STATEMENT OF WILLIAM A. SUTHERLAND, ATLANTA, GA., COMMITTEE ON FEDERAL TAXATION, AMERICAN BAR ASSOCIATION

Mr. SUTHERLAND. I am a member of the Federal taxation committee of the American Bar Association.

The question that I am discussing does not relate only to taxes, but it relates to a very fundamental question about which I don't believe there should be any disagreement when it is fully considered. I believe that section 802——

Senator CONNALLY. If it does not refer to taxes then why bring it up here?

Mr. SUTHERLAND. It is in the tax bill.

Section 802 of this bill, which is identical, or substantially identical, with the provision of section 340 of the 1937 act——

Senator BULKLEY. We have no section 802 in here.

Mr. SUTHERLAND. Section 802 of the new bill. It relates to returns as to formation, et cetera, of foreign corporations. It must be that I have an earlier draft than you have.

The CHAIRMAN. Well, it is on page 349.

Mr. SUTHERLAND. It says:

Under regulations prescribed by the Commission with the approval of the Secretary, any attorney, accountant, fiduciary, bank, trust company, financial institution, or other person, who, on or after the date of the enactment of this act aids, assists, counsels, or advises in, or with respect to, the formation, organization, or reorganization of any foreign corporation, shall, within 30 days thereafter, file with the Commissioner a return.

The next section provides that the return shall be in the form required by the Commissioner, and here is one of the forms issued under the 1937 act. I would like to have this form attached to my testimony as an exhibit.

Now, I say, that that does not relate only to taxes, because it requires that that information be filed even though the formation of that corporation had nothing whatever to do with taxes.

Senator CONNALLY. Well, I know; but somebody has got to determine whether it has or not.

Mr. SUTHERLAND. This section was introduced unquestionably to get at these Nassau corporations which were used to avoid the payment of taxes. We are heartily in sympathy with the effort by the Government to stop tax avoidance by that means. We don't think it was proper, and we think legislation should have been passed to stop it.

Now, here is our objection to this section. We don't think that, because they found one rat in the barn, they ought to burn down the barn.

Senator CONNALLY. Well, they ought to look and see if there is another rat there.

Mr. SUTHERLAND. There had not been any legal prohibition of these foreign holding companies prior to the 1937 loophole-closing act. We believe that when Congress did pass legislation to stop up the hoophole, they could have relied, for information as to whether that act was being violated, upon the same source upon which they have relied generally to get information with reference to taxes due from taxpayers—that is, upon the taxpayers themselves. That is where the other information comes from.

The CHAIRMAN. Now, are you objecting to the form of that notice?

Mr. SUTHERLAND. We object, sir, to requiring an attorney to disclose anything with reference to his relations with his client.

Senator BULKLEY. Isn't that covered by section (b) of the next section—

Nothing in this section shall be construed to require the divulging of privileged communications between attorney and client?

Mr. SUTHERLAND. No, sir; we do not think it is covered. This has been so construed as to apply only to statements made by a client to his attorneys. We don't think that it is nearly broad enough. We don't think that an attorney ought to be required to disclose any

information which comes to him because of his relations with his client, regardless of whether it comes from a disclosure by the client himself. The requirement violates a principle of 400 years' standing in our law, and it is not necessary. Without having had a law covering that situation before, now, when they close the loophole, they go ahead and disregard the confidential relationship between client and lawyer. In order to get the information you want, you do not need to force the lawyer to violate his confidential relationship with his client.

Now, I don't think that the people who had been using those foreign corporations when they were legal are the kind of people who won't give the information that is necessary to permit the Government to see whether they are violating a law that is passed to stop the practice. There is not even any suggestion as to any reason why this kind of method was necessary to secure this information, any more than it is necessary to secure any other information about whether or not taxpayers are complying with the law and giving the Government the information that the Government needs.

The CHAIRMAN. Well, the reasons that were advanced as to why this applied to the formation of foreign corporations are very well known to you and everybody else from the investigation that was made by the joint committee last year that revealed the use of these Nassau organizations and organizations in other countries. It was put to the committee that it was very difficult to get this information from abroad, and so they first had notices sent out—I think they were modified—they modified those notices that were sent out by the Treasury Department—but that is why it was put in. Of course, we have heard discussion before on the question that a lawyer should not reveal any secrets of his client.

Mr. SUTHERLAND. Well, Senator, if it is proper to put this sort of regulation in here, I don't see why it would not be equally proper to require a lawyer to divulge information with respect to domestic corporations or with respect to contracts and wills. I don't see that there is any fundamental difference between the formation of a foreign corporation and the formation of any trust or other corporation, if it has any relation whatever to taxes. I think that the trouble is that they did permit this method of avoidance to go unquestioned for quite a time, and then, when they started to destroy that method of avoidance, they were overly anxious to wipe out the whole thing with one fell swoop and not take any chances on any little vestige of it being left.

Now, I am not saying that there is no taxpayer who will lie about the circumstances of the formation of a foreign corporation. But the fact is that most of the taxpayers in this country, however much they may take advantage of legal methods of tax avoidance, will answer truly questions which are asked on the returns, and I believe that there is no question but that you can get all the information you want by asking the necessary questions on the returns from the taxpayers themselves. At least, until that is tried, I don't see why we should go and break down something that is as fundamental in our system as the confidential nature of the relation of lawyer and client.

The CHAIRMAN. Well, we understand the point that you make in reference to that, and you would like for that to be amended?

Mr. SUTHERLAND. We would like for it not only to be amended but to be eliminated entirely, and we don't think any sort of amendment, other than a complete elimination, would be satisfactory, because we don't think a lawyer ought to be required to divulge anything which comes to him by reason of his relation with a client.

Now, may I say something to you here, because lawyers are appearing here frequently, and even one lawyer is apt to distrust another lawyer at least to the extent of thinking that he may be representing some selfish interest. This American Bar Association tax committee and other groups of lawyers throughout the country are striving, I believe, just as earnestly as is this committee, to see that the administration of the tax law is made as simple and as easy as it can be made and that there is as little friction as possible.

The CHAIRMAN. They are more successful than we are in writing the bills.

Mr. SUTHERLAND. I certainly do not mean to suggest that they are more successful. What I do want to say is that they have the same aim as the committee has, which is to make the bill clear and simple. Although you must realize that from a selfish standpoint the best thing in the world a tax lawyer can have is a confused tax law and ill will on the part of taxpayers toward the Government.

The CHAIRMAN. Is that all?

Mr. SUTHERLAND. Yes; that is all—except that I would like to refer this committee to the testimony of Mr. Robert N. Miller on this subject before the Ways and Means Committee of the House on January 19, 1938, pages 438-439 of those hearings.

(Subsequently Mr. Sutherland submitted the following exhibit for the record:)

UNITED STATES
INFORMATION RETURN

For time and place of filing this return see instruction 1 (a) and (b)	Treasury Department — Form 959 — Internal Revenue Service By persons who aid, assist, counsel or advise in, or with respect to the formation, organization, or reorganization of any foreign corporation (Under sec. 340 of the Revenue Act of 1936 as added by the Revenue Act of 1937) Print plainly name and address of person filing return -------------------- (Name) -------------------- (Address) -------------------- Business or profession --------------------	(Date received)

In furnishing the information requested below, attach additional sheets if spaces are insufficient

1. The name and the address of the person (or persons) to whom and the person (or persons) for whom or on whose behalf the aid, assistance, counsel, or advice was given --
----
2. A complete statement of the aid, assistance, counsel or advice given ----------
----
----

3. The name and address of the foreign corporation and the country under the laws of which it was formed, organized, or reorganized..................
4. The month and year the foreign corporation was formed, organized, or reorganized..................
5. A statement of how the formation, organization, or reorganization of the foreign corporation was effected..................
....
....
6. A complete statement of the reasons for, and the purposes sought to be accomplished by, the formation, organization, or reorganization of the foreign corporation..................
....
....
7. A statement showing the classes and kinds of assets transferred to the foreign corporation in connection with its formation, organization, or reorganization, including a detailed list of any stock or securities included in such assets, and a statement showing the names and addresses of the persons who were the owners of such assets immediately prior to the transfer..................
....
....
8. The names and addresses of the shareholders of the foreign corporation at the time of the completion of its formation, organization, or reorganization, showing the classes of stock and number of shares held by each..................
....
....
9. The name and address of the person (or persons) having custody of the books of account and records of the foreign corporation..................
....

AFFIDAVIT

I/we swear (or affirm) that this return (including any accompanying reports, schedules or statements) has been examined by me/us and is, to the best of my/our knowledge and belief, a true, correct and complete return, made in good faith, pursuant to section 340 of the Revenue Act of 1936, as added by the Revenue Act of 1937, and the regulations issued thereunder.

[CORPORATE SEAL]

....
(Name) (Title)

....
(Name) (Title)
(For signatures, see instructions 1 and 3)

Subscribed and sworn to before me this....day of........, 193...

....
(Signature and title of officer administering oath)

INSTRUCTIONS

1. INFORMATION RETURNS

(*a*) *Return under section 340* (*a*) (*1*).—Any attorney, accountant, fiduciary, bank, trust company, financial institution, or other person, who, on or after August 26, 1937, aids, assists, counsels, or advises, in *or with respect to*, the formation, organization, or reorganization of any foreign corporation shall file with the Commissioner of Internal Revenue, Records Division, Washington, D. C., within 30 days after giving such aid, assistance, counsel, or advice, an information return on this form. Such return must be filed in every case (1) regardless of the nature of the counsel or advice given, whether for or against the formation, organization, or reorganization of the foreign corporation, or the nature of the aid or assistance rendered and (2) regardless of the action taken upon the advice or counsel, that is, whether the foreign corporation is actually formed, organized, or reorganized.

If, in a particular case, the aid, assistance, counsel, or advice given by any person extends over a period of more than 1 day and not for more than 30 days, such person, to avoid the multiple filing of returns, may file a single return for the entire period. In such case, the return shall be filed within 30 days from the first day of such period. If, in a particular case, the aid, assistance, counsel, or advice given by any person extends over a period of more than 30 days, such person may file a return at the end of each 30 days included

within such period and at the end of the fractional part of a 30-day period, if any, extending beybnd the last full 30 days. In each such case, the return must disclose all the required information which was not reported on a prior return.

(*b*) *Return under section 340* (*a*) (*2*).—Any attorney, accountant, fiduciary, bank, trust company, financial institution, or other person, who, since December 31, 1933, and prior to November 24, 1937 (the ninetieth day after the enactment of the Revenue Act of 1937), has aided, assisted, counseled, or advised in the formation, organization, or reorganization of any foreign corporation, shall file with the Commissioner of Internal Revenue, Records Division, Washington, D. C., on or before November 24, 1937, an information return on this form. Such return must be filed in every such case regardless of the nature of the counsel or advice given, whether for or against the formation, organization, or reorganization of the foreign corporation, or of the nature of the aid or assistance rendered, if such formation, organization, or reorganization occurs subsequent to the giving of such aid, assistance, counsel, or advice and prior to the expiration of 90 days after the date of the enactment of the Revenue Act of 1937.

(*c*) *Requirements common to returns under section 340* (*a*) (*1*) *and section 340* (*a*) (*2*)—(1) *Employers.*—In the case of aid, assistance, counsel, or advice in, or with respect to, the formation, organization, or reorganization of a foreign corporation given by a person in whole or in part through the medium of subordinates or employees (including in the case of a corporation the officers thereof), the return of the employer must set forth to the full extent all information required by this return, including that which, as an incident to such employment, is within the possession or knowledge or under the control of such subordinates or employees.

(2) *Employees.*—The obligation of a subordinate or employee (including in the case of a corporation the officers thereof) to file a return with respect to any aid, assistance, counsel, or advice in, or with respect to, the formation, organization, or reorganization of a foreign corporation given as an incident to his employment will be satisfied if a complete and accurate return on this form is duly filed by the employer setting forth all of the information within the possession or knowledge or under the control of such subordinate or employee. Clerks, stenographers, and other subordinates or employees rendering aid or assistance solely of a clerical or mechanical character in, or with respect to, the formation, organization, or reorganization of a foreign corporation are not required to file returns by reason of such services.

(3) *Partners.*—In the case of aid, assistance, counsel, or advice in, or with respect to, the formation, organization, or reorganization of a foreign corporation given by one or more members of a partnership in the course of its business, the obligation of each such individual member to file a return will be satisfied if a complete and accurate return on this form is duly filed by the partnership, executed by all the members of the firm who gave any such aid, assistance, counsel, or advice. If, however, the partnership has been dissolved at the time the return is due, individual returns must be filed by each member of the former partnership who gave any such aid, assistance, counsel, or advice.

(4) *Returns jointly made.*—If two or more persons aid, assist, counsel, or advise in, or with respect to, the formation, organization, or reorganization of a particular foreign corporation, any two or more of such persons may, in lieu of filing several returns, jointly execute and file one return.

(5) If a person aids, assists, counsels, or advises in, or with respect to, the formation, organization, or reorganization of more than one foreign corporation, a separate return must be filed with respect to each foreign corporation.

(6) Where any of the information required to be furnished is withheld because its character is claimed to be privileged as a communication between attorney and client within the meaning of section 340 (b), the return must so state and must contain a complete statement of the nature and the circumstances of the communication on which a decision as to the propriety of the claim of privilege may be reached.

2. FORM OF RETURN

The returns prescribed by instruction 1 shall be made on this form. Each person should carefully prepare his return so as to set forth fully and clearly the information called for therein. Returns which have not been so prepared will not be accepted as meeting the requirements of the act.

3. VERIFICATION OF RETURN

This return shall be verified under oath or affirmation. The oath or affirmation may be administered by an officer duly authorized to administer oaths for general purposes by the law of the United States, or of any State, Territory, or possession of the United States, wherein such oath is administered, or by a consular officer of the United States. Returns executed abroad may be attested free of charge before United States consular officers. If a foreign notary or other official having no seal shall act as attesting officer, the authority of such attesting officer shall be certified to by some judicial official or other proper officer having knowledge of the appointment and official character of the attesting officer.

Where the person making the return is a corporation, the return shall be signed with the corporate name, followed by the signature and title of such officer or officers of the corporation as are empowered under the laws of the State or country in which the corporation is incorporated to sign for the corporation, in addition to which the corporate seal must be affixed.

4. PENALTIES

Section 341 of the Revenue Act of 1937 provides that any person required under sections 338, 339, or 340 to file a return, or to supply any information, who willfully fails to file such return, or supply such information, at the time or times required by law or regulations, shall, in lieu of the penalties provided in section 145 (a) for such offense, be guilty of a misdemeanor and, upon conviction thereof, be fined not more than $2,000, or imprisoned for not more than 1 year, or both.

The CHAIRMAN. Now, the next witness is Mr. Fulbright, R. C. Fulbright, of Houston, Tex.

STATEMENT OF R. C. FULBRIGHT, OF THE FIRM OF FULBRIGHT, CROOKER & FREEMAN, OF HOUSTON, TEX., AND WASHINGTON, D. C.

Mr. FULBRIGHT. We appear here in behalf of the Southern Pine Association, and the American Cotton Shippers Association, as well as other clients——

The CHAIRMAN. You have a brief?

Mr. FULBRIGHT. I shall file several brief statements as I proceed and will make my remarks very brief.

I may say, first of all, that it is unnecessary, I think, to identify those organizations with this committee because we have been up here a number of times before you, and you know that they represent, roughly, the lumber and the cotton merchandising industries in the South.

First of all, we desire to emphasize the desirability of this committee joining in the action that was taken on the floor of the House in eliminating the third basket. I am not going to discuss it. I take it for granted you are going to do at least that.

Secondly, we desire to go on record again, as we did in 1936, before this committee, as being opposed in principle to the undistributed net-income tax. We prefer to have a flat tax. If you have to raise it, all right. That was gone into by the speaker before your committee some 2 years ago, and the position of this organization has not changed at all on that. The subsequent experience that we have had with it only emphasizes the results that we prophesied would come out of it.

The CHAIRMAN. Do I recall your testimony as being that you would rather go as high as 20 percent rather than than have this undistributed-profits tax?

Mr. FULBRIGHT. I don't remember, Senator; I don't remember going that far. I think you are edging on me just a little bit.

Senator CONNALLY. I think, in fairness to the witness, and probably to some of the other witnesses—I think that was made by some witness as against the House bill which put all of the corporation tax on the undistributed profits and not in the form of the bill which was finally enacted.

Mr. FULBRIGHT. It is true that we undertook to defeat what the House had done in putting in an undistributed-net-income tax which was proposed in lieu of the normal tax, and what we got was both the normal tax and the undistributed-net-income tax. So we did not progress very far as a practical proposition.

One other result which I think this committee should consider is the simplification of the income-tax law. Today no corporation, however small or insignificant it may be, if it has any substantial income, can afford to undertake to file an income-tax return without hiring specialists and even the specialists cannot agree upon the interpretation of the language that has already been put in it, let alone that which is in the bill now before you which has been added to it.

We wish to address ourselves just briefly to a matter that was referred to by Mr. Ryan and Mr. Tumulty this morning with respect to section 707B, which relates to the striking out of the exclusion heretofore carried in the Stamp Tax Act of transferred or scratched sales. The subject is technical, and I am simply going to file a statement on it with the committee, and I would like for it to be incorporated with my remarks at this juncture.

(The statement is as follows:)

MEMORANDUM ON STAMP TAX ON SALES OF PRODUCE FOR FUTURE DELIVERY

Section 707 of H. R. 9682 reads as follows:

"SEC. 707. Stamp tax on sales of produce for future delivery.

"(a) Section 723 (c), as amended, of the Revenue Act of 1932 (relating to the date upon which the rate of stamp tax on futures contracts is reduced to 1 cent) is amended by striking out 'July 1, 1939' and inserting in lieu thereof 'July 1, 1938.'

"(b) Effective July 1, 1938, subdivision 4 of schedule A of title VIII of the Revenue Act of 1926, as amended, is amended by striking out 'not including so-called transferred or scratch sales.'"

The present tax on the sale of futures is 3 cents for each $100 in value of the merchandise covered, or fractional part thereof. Under the 1932 Revenue Act this 3 cents will be reduced to 1 cent on July 1, 1939. Subsection (a) of section 707 puts this reduction into effect as of July 1, 1938, or 1 year sooner. Subsection (b), however, strikes out the provisions excluding so-called transferred or scratch sales from the tax. Transferred or scratch sales are defined by regulation 71, articles 44 (a) and 125 (3) (c), as follows:

"ART. 44. *Transactions not subject to tax.*—(a) So-called 'transfer or scratch sales' or 'pass-outs' are not subject to the tax: *Provided*, That the purchase and sale are made at the same exchange, on the same day, at the same price, and for the account of the same person.

"ART. 125 (3) (c). The term 'transferred or scratch sale' includes 'pass-outs' or those transactions in which a person buys from another a certain quantity of any product at a certain price, and at the same session of an exchange sells to a third person the same quantity of the same product at the same price, and eliminates himself by instructing the person from whom he bought to deliver such product to the person to whom he sold; but no transaction in which a broker

or a commission member of an exchange receives a commission greater than that charged to a person who executes his own contracts shall be deemed to be a 'transfer' or a 'scratch sale'; * * *."

Discussion of the meaning of scratch sales is also contained in the opinion of the Supreme Court in the case of *Dupont* v. *United States* (300 U. S. 150, 81 L. ed. 570, p. 572), as follows:

"* * * A scratch or transferred sale is one in which there is an offsetting purchase and sale at the same price on the same day. Where a broker, in order to fill a customer's order, buys a larger amount and sells the excess to a third broker, directing the selling broker to deliver the excess to the broker who has purchased it, and directing the broker who purchases the excess to take delivery from the selling broker, the name of the intermediate broker is erased from the records of the exchange so that the sale of the excess appears as a sale direct from the one to the other of the two remaining brokers. The exemption also covers trading by a scalping broker who makes his profit in fractional movements on the exchange, buying and selling with great rapidity, thus often purchasing and selling the same amount of the commodity at the same price within a few moments or hours. By agreement amongst the members his name is scratched out of the records of the exchange and his temporary rights and liabilities do not appear upon its records. Accordingly the Treasury Regulations, in force since 1918, require that purchase and sale be consummated on the same day if the exemption is to apply, and that the intermediate broker instruct the broker who sold to whom to deliver to the other who bought from him."

The chief objection to the tax on future sales is that it definitely interferes with the liquidity of the futures market. Merchants who use the cotton futures exchange for hedging their purchases of cotton from the farmers not only must pay the tax on their own particular sale, but their ability to put in their hedge contract at the current market price is dependent upon the presence on the exchange of floor traders who are willing to buy contracts at the last quotation or a point below such quotation. The function of the "scalping broker," as he is called by the Supreme Court, is highly important in preventing extreme ups and downs of prices at which contracts are sold on a given day. Such brokers very rarely carry contracts over from one day to the next and are therefore often confronted with the necessity of selling out their contract at the same price at which it was purchased. In such cases they not only lose any commission or profit, but with cotton worth about $50 a bale they would be compelled to pay a tax of 50 cents on the transactions. When it is considered that they make a profit only upon a relatively small percentage of the transactions which they must enter into during the day, and that a point fluctuation in price gives them a profit of only $5, it is apparent that a tax of 50 cents on all transfer sales will be practically prohibitive.

It should be noted that no sale upon which a profit is made qualifies as a transfer or scratch sale, so at the present time the scalping brokers are compelled to pay the tax on any sales upon which they make a profit. The present tax of $1.50 per contract amounts to about one-third of the profit made from a one-point fluctuation.

It has been hoped that the tax would be eliminated in its entirety. The revenue produced by it is not very large and yet the tax is actually borne, in the case of cotton,, by the cotton farmers. This is true because the broker making the hedge sale charges the tax to the cotton merchant, and when the cotton merchant buys cotton from the farmer, he is compelled to take into the calculation of the price he can pay, the charge which the broker will make. When it is considered that the 10,000,000 people living on farms receive a per capita income of $50, the unfairness of this sales tax becomes apparent. This tax was originally imposed at a time when there was no regulation on the futures exchanges and when it was expected that the tax would act as a control of speculation. Since that time the Department of Agriculture has been given powers of strict regulation of the futures exchanges and is in position to control any socially undesirable speculation. As a matter of fact, insofar as cotton is concerned, it is fairly evident that there is practically no speculation at the present time. This is demonstrated by the small amount of open futures contracts on the New York Cotton Exchange, which is by far the largest of all cotton exchanges.

As reported by the Commodity Exchange Administration the open interests in all months in the New York market were 2,783,600 bales. Certainly there should be hedges in the market for that amount. This compares with the 5,058,847 bales of cotton held under loan by the Commodity Credit Corpora-

tion. On March 3 only 834 contracts covering 83,400 bales were sold. The tax on this at the new rate would amount to a little more than $400, which would hardly justify the expense of its collection.

The report of the committee indicates that there has been some abuse of the provision excluding transfer or scratch sales from tax. If this is the case, the Government is in position to cure it because under the rules and regulations of the Commodity Exchange Administration complete records and a very elaborate system of inspection is provided.

As a matter of fact, the Commodity Exchange Administration has recommended time and again that this tax be repealed because it is a definite burden upon a highly liquid market.

Cotton merchants are not interested in this matter because it will adversely affect the floor brokers. The merchants are interested in being able to sell their hedge contracts at a price as close as possible to that upon which they purchase the spot cotton. If they purchase spot cotton when the New York futures are quoted at 9.06, they expect to be able to sell their hedge contract for 9.06, or at very nearly that figure, by the time their wire has reached New York, but if floor brokers are eliminated then they will be able to sell their contract only when some outside speculator or some person having an opposite hedging interest has sent in a contrary order. The result will be a very great fluctuation between the prices at which contracts are sold and the efficiency of the futures markets as a hedging medium will be definitely interfered with.

If the tax is not to be eliminated entirely, then certainly subsection (b), which imposes it upon scratch or transfer trades, should be stricken out.

The CHAIRMAN. Well, just tell us what is your position. You need not elaborate on it.

Mr. FULBRIGHT. It is substantially the same as that outlined by Mr. Ryan this morning, namely, that this tax——

The CHAIRMAN. You would rather see it all stricken out? The House reduced it from 3 to 1 cent.

Mr. FULBRIGHT. My statement does not go quite that far.

The CHAIRMAN. You don't want it all stricken out?

Mr. FULBRIGHT. Section 707 (a) changed the date when the 3-cent tax should be reduced to 1 cent by moving it up 1 year.

The CHAIRMAN. They retained 1 cent?

Mr. FULBRIGHT. That is correct. What we are asking is the striking out of section 707 (b), which placed a tax on scratch sales, which always before had been exempt from tax.

The CHAIRMAN. You are dealing—only except as to the 1 year out?

Mr. FULBRIGHT. We have no objection to section 707 (a), Mr. Chairman, insofar as it represents a step in the right direction.

Senator CONNALLY. Well, the gentlemen this morning wanted to strike out all of the tax on future deliveries.

Mr. FULBRIGHT. Well, we would like to have that done, may I say, but, frankly, I don't believe we are going to be able to accomplish it yet.

The CHAIRMAN. Their decision was to strike it out.

That is why I asked you. As to this 3 cents, now, they wanted to strike the whole 3 cents out. The House reduced it from 3 to 1 cent and it inserted those scratch sales, which they say makes it worse than in the present law. Your position is that you don't want scratch sales, that you would prefer to have it all stricken out, but if you cannot get that you would want the House to amend it?

Mr. FULBRIGHT. Yes.

Now, the next matter that I wish to refer to is section 703, at page 302, which adds a tariff on imported pork products.

The CHAIRMAN. Well, are you for that or against it?

Mr. FULBRIGHT. We are against it, for this reason: The importation of pork products into this country is almost a negligible portion of the consumption of pork products in this country. We are particularly interested in the importation of pork products from Holland, for the simple reason that we barter cotton for pork.

In 1930, following the depression which came on us in 1929, our exports of cotton to Poland almost completely disappeared. Prior to 1929, Polish mills got all of their cotton, practically, from the South. This statement which I have here will show how that Polish business has developed under the very wise guidance and policy adopted by the State Department, and in that connection, Mr. Chairman, I am informed that there has been filed with this committee, or with you as chairman, a communication from the Secretary of State and another from the Secretary of Agriculture on this subject.

The CHAIRMAN. They were placed in the record a while ago.

Mr. FULBRIGHT. I just wanted to be sure they were in the record.

The CHAIRMAN. May I ask in that connection, because my mind does not retain it, whether we ship any wheat to Poland; as I recall, we do not.

Mr. FULBRIGHT. I do not think so, Mr. Chairman, but I am not an authority on wheat.

The CHAIRMAN. That is my recollection.

Mr. FULBRIGHT. I may also say the cotton purchases in Poland last year were in excess of $15,500,000. Our total imports from Poland in 1937 were approximately $19,000,000, about one-half of which was pork products, and to a good extent our exports of cotton to Poland have been made possible by barter arrangements for the exchange of cotton for pork. I would like to have this statement inserted in the record at this point, as part of my remarks.

(The statement referred to is as follows:)

STATEMENT OF R. C. FULBRIGHT IN OPPOSITION TO SECTION 703 OF H. R. 9682 IMPOSING ADDED DUTIES ON IMPORTED PORK PRODUCTS

For many years our southern cotton farmers supplied the entire requirements of the cotton mills of Poland. While the volume of this movement was not large comparatively, nevertheless it was an important factor with cotton produced in certain sections of the South.

Because of the general depression, which began in 1929, and on account of the inability of Poland to make remittances in gold for our cotton, the consumption of American cotton went down to nearly nothing. With the development of cotton culture in South American countries, that area became one of the sources of supply for the Polish mills. In 1930, for example, the exports of cotton from this country to Poland amounted to only $81,000.

Through the excellent cooperation of the State Department satisfactory trade relations are being reestablished with these countries by our cotton exporters. Barter arrangements by which pork products are exchanged for our cotton have been responsible for a considerable proportion of our cotton exports to those countries. A statement placed in the record on the floor of the House is to the effect that for the last fiscal year ending June 30. 1937, the value of our cotton exports to Poland was $11,896,000. From information developed by the cotton exporters it is estimated that the cotton purchases in Poland for 1937 were in excess of $15,500,000, and constituted more than half of the entire exports from this country to Poland.

In 1937 we received goods from Poland approximating $19,000,000 in value of which $8,910,000 or almost one-half was comprised of pork products. This constituted only about one percent of the domestic production.

At the present time arrangements are being perfected by cotton exporters in the South for supplying the cotton requirements of Poland through barter arangements, by which their pork products may be imported into this country. The effect of the House amendment embodied in section 703 will be to defeat all such arrangements and practically stop the exportation of our cotton to that country.

There is already a tariff duty upon these pork products of 3¼ cents per pound. This has been considered as a reasonable duty and has not been sufficiently high to prevent the barter arrangements in question. The effect of the amendment would be to increase this 6 cents per pound and instead of producing revenue will reduce the revenues accruing to the Treasury and it will also have the effect of making it more difficult for us to find markets for our cotton exports. This in turn will react against the southern cotton farmers whose markets have already been most seriously curtailed. We respectfully suggest that section 703 is in no sense a revenue measure and should be stricken from this bill.

Mr. FULBRIGHT. The last matter to which I wish to refer relates to the dissolution of parent holding companies. It is just a little different from the subject which has been presented to you so well by the American Bar Association, and yet it is the same in principle.

Prior to 1934 a group of affiliated corporations were treated for tax purposes as a single enterprise and they had the privilege of filing consolidated returns. It was a simple way of treating the matter. Intercompany transactions did not have to be scrutinized with any particular care where all of the companies were owned by the same interests. In 1934 the privilege of filing consolidated returns was abolished. This brought about a situation which made it evident to this committee that something should be done to permit the dissolution, or simplification of these involved corporate structures.

Accordingly, in 1936, this committee prepared an amendment to section 112, known as section 112 (b) (6), which permitted a tax-free dissolution of subsidiary companies, but protected the Government by carrying on the basis for loss and gain for the future as though there had been no such dissolution, and providing further that in the event there was a loss or gain ascertained, that that should be adjusted in the basis. However, it did not take care of the situation where a parent corporation should be dissolved and leave the various subsidiaries to operate independently; it just dealt with one side of the picture, and what we desire to do is add a section or subsection, which we suggest as 112 (b) (7), to permit the dissolution of a parent holding company where it holds all or substantially all of the stock of the subsidiaries.

That leaves the subsidiaries with the same interests owning them as owned them before. There is no gain or loss realized from such transaction and it carries out the policy which has been developed in the Government to do away with holding companies which, in many cases, have been built up against the public interests. Instead of dissolving the subsidiaries and leaving one giant holding company, it is sometimes preferable to dissolve the parent company and leave the subsidiaries to operate independently.

The CHAIRMAN. Have you a suggested amendment along that line?

Mr. FULBRIGHT. I have it in this statement which I now wish to file as part of my remarks, and it will give some concrete illustrations.

(The statement referred to is as follows:)

STATEMENT OF R. C. FULBRIGHT RELATIVE PROPOSED AMENDMENT TO PROVIDE FOR TAX-FREE LIQUIDATION OF HOLDING CORPORATIONS

A new policy of tax legislation with respect to affiliated corporations has been developed within the past 4 years. Prior to the Revenue Act of 1934 affiliated corporations were treated for tax purposes as a single enterprise, and were permitted to file consolidated returns covering all corporations included within the affiliation as defined by the statute.

This made for simplicity of administration of the taxing statutes. It was not necessary to make any critical examination of intercompany accounts and it was not necessary for affiliated corporations to give any special consideration to intercompany transactions so long as they were all in one enterprise and owned by the same ultimate beneficiaries.

During this period there developed numerous affiliated groups. In many cases the parent company merely organized subsidiaries to conduct its local business in particular sections of the country, but in many other cases holding corporations were formed as a convenient method of taking care of the securities or the financing of various affiliates. In some cases holding corporations were formed for the purpose of accomplishing liquidation of existing interests in operating companies.

As an illustration of this a concrete example may be cited. The X association (classified as a corporation under the Federal law) was engaged in a merchandising business which required the use of a very large amount of borrowed capital, and the maintenance of its credit was augmented by a provision in the articles of the organization of the association by which its shareholders were personally liable for all obligations of the association.

On account of failing health, one of the principal shareholders, who had helped build the business up from a small beginning, found it necessary to retire and desired to liquidate his interest and be rid of the unlimited liability which attached to the ownership of any interest therein. None of the individual shareholders were in position to purchase his interest and the association could not purchase the same without incurring additional liability which might adversely affect its credit. To obviate this, a holding corporation was formed to hold the shares of the association, except qualifying shares of the individual shareholders, and in this manner the other individual shareholders continued liable for debts of the association. The holding corporation then executed a contract to purchase the interest of the retiring shareholder and executed obligations running over a period of years in part payment for the interest so purchased. By this device the credit of the operating company remained unimpaired and the holding company had to look to dividends paid from the earnings of the operating company for funds to satisfy its obligations for the purchase of the outstanding interest.

This occurred several years before the law was changed which prohibited the filing of affiliated corporation returns. Since that time the holding corporation has liquidated its obligations and there is no longer any necessity for maintaining its existence. In the meantime, the stock of the holding company has become scattered among numerous individuals who were not formerly shareholders in the association.

It is now desired to dissolve the holding corporation, but this cannot be done without incurring a very heavy tax liability, although the dissolution would make no real change in the ownership of the enterprise. The same parties would continue to own the same proportionate interests after the dissolution as before.

Doubtless there are many other situations where for perfectly good and proper business reasons holding corporations were formed during the period when affiliated corporations were recognized as a single enterprise. Since 1933, however, a governmental policy of discouraging holding corporations has developed. This was brought about no doubt because of abuses which had arisen in the use of holding corporations, particularly in certain industries. When the 1936 act was being considered the Senate Finance Committee recognized the injustice which might arise because of the change in the policy of the law and added to the Revenue Act of 1936 a section known as section 112 (b) (6), providing for no gain or loss to be recognized where a subsidiary corporation is completely liquidated and its property or securities received by its parent corporation. The Government was protected by proper provisions to the effect

that there should be no change in the basis for loss or gain in the event of subsequent sale or disposition of the properties received in exchange. The purpose of the statute was to treat the transaction in a common-sense way recognizing the fact that such a dissolution was not in truth a distribution, but merely a type of reorganization or simplification of an existing enterprise. This permission was restricted to subsidiaries in which the parent company owns 80 percent or more of the stock and the assets of the subsidiary retained their same basis in the hands of the parent company after the dissolution.

The effect of section 112 (b) (6) has, therefore, been to permit subsidiary corporations to be molded into parent corporations but it does not in any sense take care of the need for some legislation which would permit the dissolution of holding corporations where the transaction does not, in fact, involve the realization of a gain or profit.

No doubt there will be many cases where the elimination of the holding corporation is desirable in the public interest as interpreted in the present governmental policy. This cannot always be done by liquidation of the subsidiaries. Besides, the liquidation of subsidiaries has the effect of concentrating all of the assets in one giant corporation, whereas by the liquidation of the parent corporation the various subsidiaries become separate and independent operating organizations.

In the 1937 act severe penal legislation was adopted with respect to personal holding corporations as defined therein, unless such corporations currently distributed all of their earnings. If such a corporation left undistributed only $1,000, it would have to pay 65 percent of this as a penalty tax to the Government. The administration sponsors of this statute were told that it would kill certain types of corporations which because of the nature of their business could not currently distribute all of their earnings, and taxpayers were given to understand that it was desired to get rid of such corporations.

However, numerous such enterprises have been carried on for many years and have gradually built up surpluses which are tied up in properties and it is desired that the enterprises be continued in some form without necessitating a complete disruption of such business. In order to bring this about it will be necessary in many cases to dissolve such corporations.

The American Bar Association has taken notice of this situation and presented to Congress a recommendation that the law be amended so as to permit the dissolution of such corporations without taxable loss or gain. There is little difference in principle in what is advocated by the association and this proposal to promulgate a section similar to section 112 (b) (6), but applying to holding corporations generally. However, there are many corporations which come within the definition of a personal holding corporation for application of the 1937 act which are not, in fact, holding corporations in the sense that they hold stocks of subsidiary corporations. The proposal here submitted involves only the class of holding corporations which are parent corporations and own all or substantially all of the stock of one or more subsidiaries. Our proposal is, therefore, not as broad as that made by the American Bar Association, but all of the arguments presented by that association in support of its proposal apply in like manner to this. In addition thereto, we have a definite precedent in the action which was taken by this committee in writing section 112 (b) (6) into the 1936 act.

The same considerations of policy which moved this committee to work out and procure the enactment of section 112 (b) (6) apply in the case of parent corporations where it is desired to eliminate holding companies and confine such corporate activities to operations by active companies.

Of course, if there should be any distribution of cash or property which would be in the nature of a realization of profit, the Government can be protected as it now is in the provisions of the statutes providing for tax-free reorganization of corporations. Such a proceeding is, in fact, a type of reorganization, but it is not technically a reorganization for the reason that a holding corporation may hold the stock of several subsidiary corporations operating in different sections or in different fields of activity. When the holding corporation is dissolved the stockholders of the holding corporation continue as stockholders of the respective subsidiaries and the enterprise as a whole will be carried on in the same manner as before, but it will not be recognized as one enterprise under our present law. For this reason it cannot technically come within the purview of the reorganization statute and it is necessary that the subject be specifically dealt with as was done with respect to the dissolution of subsidiary corporations.

There is attached hereto the suggested amendments necessary to carry out the plan here proposed. Section 112 (c) has also been modified so that in the event there is any other property distributed in liquidation of such holding companies, the gain, if any, upon the same will be taxed as in the case of other distributions in connection with the exchange of property. In addition to the provision for a new subsection following section 112 (b) (6), it is necessary to add a new subsection to section 113 so as to protect the Government against any claim that there has been a change in the basis in the case of such liquidations and so as to provide that any gain or loss which is recognized in such transactions shall apply to the basis in the event there is a future disposition of any of such securities.

SUGGESTED AMENDMENTS AUTHORIZING TAX FREE LIQUIDATION OF HOLDING CORPORATIONS

Amend section 112 (b) by adding thereto another subsection to be designated section 112 (b) (7) and to read as follows:

"SEC. 112 (b) (7). No gain or loss shall be recognized upon the receipt by stockholders of securities of subsidiary corporations distributed in complete liquidation of a parent corporation which on the date of the adoption of the plan of liquidation and at all times thereafter until the receipt of such securities was the owner of at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 per centum of the total number of shares of all other classes of stock in each such subsidiary corporation."

Amend section 112 (c) (1) by incorporating therein a reference to section 112 (b) (7), thereby making the same to read as follows:

"SEC. 112 (c) (1). If an exchange would be within the provisions of subsection (b) (1), (2), (3), (5), *or* (7) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property."

Amend section 113 by adding thereto a subsection to be designated section 113 (c) and to read as follows:

"SEC. 113 (c). Securities received by stockholders in complete liquidation of a corporation. If securities were received by the taxpayer in complete liquidation of a corporation within the meaning of section 112 (b) (7), then the basis shall be the same as in the case of the stock exchanged, increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the years in which the exchange was made."

Mr. FULBRIGHT. I did want to add this about the statute of 1937, which defined personal holding companies—that is, the one to which Mr. Miller addressed himself and made the suggestion dissolutions be permitted there which would be tax free. It had the effect of making various corporations personal holding companies which were in fact part of an operating enterprise. I think, for example, this illustration of a concrete case where an association which has been in existence for many years, built up from a small beginning and was classed as a corporation, about 10 years ago desired to buy out one of the members of the organization who had helped to build it up from the beginning; as a matter of fact, one of the principal owners failed in health and had to retire. The ownership of shares in it carried unlimited liability. The company was of such character that it had to keep its credit unimpaired, as it had to borrow very largely in excess of its capital, and the only way they could do that and preserve their credit unimpaired was to form a holding company to hold the stock of the operating company, except qualifying shares for the individual shareholders so as to keep their unlimited liability, and that holding company contracted with the re-

tiring stockholder to purchase his interest; it executed obligations running a series of years. It was all one enterprise. Now, they had no way to get anything to pay for that interest except from the dividends received from the subsidiary company, and when this act of 1937 was enacted, it automatically became a personal holding company and therefore subject to this penalty of 65 or 75 percent if it did not distribute what it earned.

Of course, in that situation, when they pay off what they owe, there is no longer any use for the holding company; they no longer want it and would like to get rid of it, but the situation is such they cannot without enormous tax liability, unless the amendment suggested by the American Bar Association or the amendment suggested here by me is adopted; either one of those would be sufficient.

It is our thought there are many holding corporations, however, that own subsidiary companies which would avail themselves of the privilege of simplifying their structures and breaking up the holding companies if they could, as parent corporations, dissolve. It seems to me it is necessary to protect the Government, as we have undertaken to do in these suggested amendments, in the adjustment of the basis, or, in the event there is found to be any loss on the transaction, to cause the distribution of the entire property.

The CHAIRMAN. Thank you very much.

The next witness is Mr. Murchison. (No response.) Did he file a brief? He stated that he represented the Cotton Textile Institute, but if no processing-tax amendments are proposed, he did not desire to be heard, but he did if there were, and I think it is only fair if such a proposition comes up, these people interested in the processing tax ought to be heard, as we should get both sides of the picture. Personally I hope no processing-tax amendments will be suggested.

Mr. Moreau, representing Aldred Investment Trust.

STATEMENT OF C. L. MOREAU, NEW YORK CITY, REPRESENTING ALDRED INVESTMENT TRUST

Mr. MOREAU. Mr. Chairman, I have a brief I would like to submit and also to discuss the important features of it for 3 or 4 minutes.

The CHAIRMAN. All right.

(The brief referred to is as follows:)

BRIEF SUBMITTED TO THE SENATE FINANCE COMMITTEE BY ALDRED INVESTMENT TRUST THROUGH ITS SECRETARY, C. L. MOREAU, AT PUBLIC HEARING OF MARCH 18, 1938

Title 1-A of the Revenue Act of 1937, the so-called "Loophole Law" defines a personal holding company as, roughly, (a) any corporation in which 80 percent or more of its gross income consists of dividends, interest, royalties, security and commodity transactions, and some other categories not related to the issue which I shall discuss and (b) if at any time during the last half of the taxable year of such corporation more than 50 percent in value of its outstanding stock is owned directly or indirectly by or for not more than five individuals. On such personal holding companies title 1-A imposes a surtax on undistributed adjusted net income of the sum of (1) 65 percent on the first $2,000; (2) 75 percent on the amount in excess of $2,000.

Certain fraternal, benevolent, building and loan, farmer and nonprofit-making associations, and banks, life-insurance, and surety companies are specifically excepted from the personal-holding-company status under the definition. The revenue bill of 1938 leaves these provisions practically unchanged.

In spite of the exceptions mentioned the definition of a personal holding company is so inclusive that there still remain subject to the classification and resultant surtax, organizations, which on the score of intention or action should not be liable to that status or penalty tax. I appear here for one of such companies, Aldred Investment Trust, of which I am secretary, to ask for relief. This Trust appears to be a personal holding company within the definition of the act as practically all of its income is from dividends and interest on securities and more than 50 percent of its only outstanding stock is owned by Aldred & Co., a partnership, now consisting of five partners, though within the life of the Trust there have been as many as 10 partners in the firm.

Aldred Investment Trust, a Massachusetts voluntary association, was organized December 1, 1927, as a bona fide operating financial organization. Its assets were acquired predominantly through the sale to the public of fixed interest bearing obligations in the form of 40-year debentures carrying common shares thus making all debenture holders shareholders as well. When its financing was completed in June 1928, over 80 percent of such financing had been accomplished through the issuance of debentures and there were approximately 2,000 such debenture shareholders. At this time there are more than 1,500 scattered throughout the United States and in some foreign countries.

This point, of source, of funds is emphasized as the admitted purpose of the tax was to prevent the avoidance of surtaxes on their individual incomes by individuals who transferred securities or other income-producing property to corporations which were controlled by themselves or members of their families, and did not distribute the income as dividends to shareholders. Obviously, this object would not be achieved, if the funds are largely obtained from the public through interest bearing obligations, instead of from the individual's own resources. By its very nature such a structure would entail distribution of the greater part of the corporate income to the public in the form of interest, and such interest would be taxable to the recipient. It is also pertinent to mention that the inducement to such form of tax avoidance back to 1927 was not great, as surtaxes under the 1926 law were roughly one-quarter of those in effect in recent years. So much for the intent of the organizers of the Trust.

As to policy in the matter of distribution of income, the record shows that since organization, all operating income with the relatively insignificant exception of $9,882 in the year 1936, was distributed in every year in which it was legally proper to do so. Thus:

During the years 1928 1929, and 1930 its aggregate net operating income was $440,695 and it distributed $453,300. During the years 1931 to 1935, while the Trust had a small operating income in each year, it was not in position to distribute because during that period its assets did not equal its liabilities inclusive of its fixed-debenture liability. Counsel advised that declaration of dividends under such circumstances would subject the trustees to serious legal liabilities.

In 1936 the assets versus liabilities position changed to the point that assets exceeded liabilities, and with a net operating income of $80,100 the Trust distributed $70,218, or close to 90 percent.

During 1937 the recession affected market prices to an extent which again reduced assets to a point below liabilities so that the Trust while having a net operating income could not legally distribute it.

In the matter of control, while the firm of Aldred & Co. owns more than a majority of the outstanding shares, it should be stated that the management of the Trust's affairs is vested in five trustees and that at all times, at least three of the trustees have been independent of Aldred & Co. At the present time and since January 1, 1938, there have been four such independent trustees.

From the beginning it will be seen that the conception on which the trust was organized was entirely innocent of any purpose of tax avoidance. Prima facie evidence of this lies in the fact that its funds were so predominantly drawn from the public. As to retention of income, it need only be said that the trust has, as a matter of record, distributed its operating income when it could legally do so. From organization to date, there is not the slightest trace of tax avoidance present in the history of this trust, yet it is included among companies formed for that purpose under the definition of title I-A of the 1937 act, and made subject to a punitive tax of 75 percent on its undistributed income for not doing that which in the situation mentioned would be an improper action by the trustees as a matter of general law. There is injustice present in this situation, and I believe it is entitled to your consideration with a view to granting relief.

Such relief can be given simply and effectively by amending title I-A, section 402 (b) "Exceptions," of the revenue bill of 1938 by adding to or inserting, in this paragraph which lists exceptions to the definition of a personal holding company, the following clause:

"Corporations organized prior to January 1, 1937, whose funds, including capital funds, were derived from the public to the extent of more than 70 per centum and which have had at all times since organization a minimum of 200 shareholders."

The date, percent of funds, and number of shareholders are tentatively submitted as suitable to proper limitation of the exceptions.

It should be stressed that we are not here dealing with a relatively small tax or even one such as the proposed "third basket" tax of 20 percent on closely held industrial corporations, but with an almost confiscatory tax of 75 percent. This rate is so high that it calls for especial care in the drafting of the law to see that its provisions do not confound the innocent with the guilty, as appears to have been the unintentional effect in the case I bring to your attention. The effect of the proposed amendment on tax revenue would, I think, be negligible. Not having access to income-tax records, I have no means of making an accurate estimate, but I should be surprised if it affected the tax status of more than a half dozen companies.

It is hoped that the suggestion will meet with favorable consideration of the committee, but if it should develop that there are valid and controlling reasons why relief should not be granted through this specific means, I believe there can be no objection to the following recommendation, which provides simply for deferment of distributions, or payment of the tax, in circumstances where declarations of dividends would be improper. As already explained, the trust is in such a situation at this time. The recommendation would be in the form of an additional paragraph, (d), to section 405, entitled "Undistributed Title I-A Net Income," as follows:

"(d) Deferred undistributed Title I-A net income applying to corporations with bonds, debentures, or other fixed interest bearing obligations outstanding: No surtax levied by section 401 of this title shall be assessable on the undistributed title I-A adjusted net income of such corporation in any year, when during the last month of the taxable year, it would be illegal for such corporation to declare dividends because the fair value of its assets does not equal its liabilities exclusive of its capital liabilities, but such undistributed title I-A net income for such year shall be carried forward to the following year and from year to year until such time as the fair value of assets of the corporation exceeds the liabilities exclusive of capital stock liability by the amount of such undistributed title I-A net income thus carried forward. In such event said corporation shall within thirty days make distribution of such deferred undistributed title I-A net income or pay the tax applicable thereto under section 401."

This suggested amendment appears to provide a simple remedy in the case of a corporation which comes under the provisions of the act but is innocent of any intention of improperly withholding dividend distributions and accomplishes this purpose without opening up avenues to others to escape its provisions. Taxable income is simply carried forward until it can be properly distributed, failing which distribution the surtax becomes due, and payable.

The trust asks for consideration by the committee, of the predicament in which the trust finds itself through no fault of its own, and of the simple means of rescuing it, which are herein proposed.

Mr. MOREAU. The matter of personal holding companies has been touched on by several of the witnesses here, but I think I can bring forward a fresh angle.

Briefly, the loophole law of 1937 imposes a tax of 65 percent on undistributed net income amounting to $2,000, and 75 percent on the balance of the undistributed net income.

Senator CONNALLY. Of all personal holding companies without regard to the number of stockholders?

Mr. MOREAU. I was coming to the definition of a personal holding company. It is an organization which receives 80 percent or more of its income from securities, rent, royalties, and so forth——

Senator CONNALLY. Regardless of the number of stockholders?

Mr. MOREAU. If the majority of the stock in point of value is held by 5 persons or less. There are several exceptions to the application of the stock——

Senator CONNALLY. Is that the so-called third basket?

Mr. MOREAU. No; I am speaking of personal holding companies which were brought in under the 1937 act, known as the Loophole Act. There are several exceptions made to the classification end of the definition, consisting of banks, fraternal and benevolent associations, insurance companies, and so forth; they do not touch on the character of organization I am about to speak of.

I realize the difficulty in drawing up a definition of a general nature of this kind which will be so accurately drawn as not occasionally to confound the innocent with the guilty. I appear here for Aldred Investment Trust, of which I am secretary, and which I think should be classified as a company innocent of any tax avoidance intention.

Aldred Investment Trust was organized in 1927 when, I may say, tax avoidance was not much of an issue because at that time personal surtaxes were only about 25 percent of what they have been the last year or two, and furthermore it derived its funds to the extent of more than 80 percent, when its financing was completed, from the sale of interest-bearing obligations to the public. By the very nature of its corporate structure it would not present the advantage of forming a tax-avoidance corporation, as that would be profitable only when the individual supplies the funds himself, because if the interest is payable to the public on a predominant portion of the funds obtained, that interest must be disbursed and is subject to the surtaxes of the individual when received.

I stress that point as it is quite important in this particular situation.

The trust also comes under the definition because more than a majority of its stock is controlled by the partnership, Aldred & Co., which at this time consists of 5 persons, although it did, in recent years, have as many as 10 partners.

While it is controlled by Aldred & Co., I should like to point out that since organization, the management of the trust has been vested in the hands of five trustees, as arranged for in the agreement and declaration of trust, and Aldred & Co. have at all times seen that the majority, or at least three of the trustees, has been independent of themselves.

As far as the distribution of income is concerned, the record shows that it has since inception distributed its operating net income when it could properly do so. During the years 1928, 1929, and 1930 we had operating income and distributed all of it. During the years 1931, 1932, 1933, 1934, and 1935, it also had a small operating income after payment of interest and expenses, but it was unable to properly distribute it because counsel advised us that the trustees would subject themselves to serious liabilities under the general law if they did distribute.

Senator CONNALLY. What is the excuse for having holding companies at all; why can't these people who own the property operate it themselves; why is it necessary to create a fictitious instrumentality to hold it for them?

Mr. MOREAU. This organization was formed back in 1927 and purchased securities from the funds is obtained with outstanding obligations that mature in 1967. Therefore it is not an easy matter to break it up.

Senator CONNALLY. No; but I do not see any use for it; the firm owns it, you say?

Mr. MOREAU. The firm does not own it, sir; it only owns it to the extent of about 63 percent of the capital stock. There are still quite a few millions of obligations outstanding, and those could only be bought in through call at a premium, and the situation does not so present itself at this time that that can be done.

As I was about to say, the trust has at all times, when it could possibly do so, distributed the operating net income, the point being that from 1931 to 1935, because of the drop in market prices of the securities in its portfolio, the value of its assets was reduced to a point below its liabilities, including its obligations, so it would have been improper under the general law to make any distribution at that time.

In 1936, the improvement in market conditions had brought about a situation where the assets exceeded the liabilities, and in that year the trust did distribute the net income which it had accumulated during the year.

In 1937, however, because of the drop in market price, again it found itself in the position where the assets did not equal the liabilities, and therefore it could not properly make any distribution.

I state here that, as shown by the history of the trust and the policy of the trustees, they are perfectly willing to distribute all operating income when they can do so properly.

I have two suggestions to make as to relief for this situation: The first involves the addition of a very short paragraph to section 402 (b), "exceptions," to title 1-A of the House bill 8362. To this I suggest the addition to the exceptions of [reading]:

> Corporations organized prior to January 1, 1937, whose funds, including capital funds, were derived from the public to the extent of more than 70 percent, and which have had at all times since organization a minimum of 200 shareholders.

I might say in this case the trust during the first year of its organization had over 2,000 shareholders, and I repeat that the funds obtained, to the extent of 80 percent, were from the public.

It seems to me, in view of the fact that no one in his right mind would attempt to evade taxes through the organization of an instrumentality of this kind, that the addition of this exception to the definition would cure the matter very simply. However, if it might be objectionable to change the definition, I have a second suggestion, which would be equally acceptable to the trust, which would in effect simply defer the collection of the tax, or distribution of the income until such year as it could properly make it. In other words, this provides that in the case an operating net income is present, we will say for this year, or the last 6 months of the period, that if the asset and liability position still remains so it would not be proper to distribute it, that that amount will be carried forward to any year thereafter when the position is corrected and the assets exceed the liabilities, and within 30 days of that time, if the amount is not distributed, the tax shall apply, and in that way the revenue of the Government would not be affected except that the collection of the tax would be delayed until it was proper for the trust to make a distribution.

The CHAIRMAN. Is there anything else, Mr. Moreau? You have filed your brief, have you not?

Mr. MOREAU. Yes, sir.

The CHAIRMAN. Thank you.

Mr. Pierce. (No response.)

The CHAIRMAN. I desire to place for the record a brief submitted by Mr. J. C. McAuliffe, of Atlanta, Ga., representing the Southern Toilet Goods Association.

STATEMENT OF J. C. MCAULIFFE TO THE SENATE FINANCE COMMITTEE ON BEHALF OF THE SOUTHERN TOILET GOODS ASSOCIATION

Let me say that some 25 or 30 small manufacturing concerns, each employing from 20 to 100 workers, are represented by this petition. In addition, quite a number of other small concerns not affiliated with the organization are affected.

The tax on cosmetics was originally levied in 1932 and has been subsequently extended up to this time. The manufacturers represented in this appeal are producers of low priced, which does not by any means imply cheap cosmetics, in the usually accepted terms of cheapness.

Since the enactment of the original law containers have advanced some 30 to 50 percent, the average being around 40 percent. The manufacturers in this group cater to the needs of a large percentage of the Nation's population who are in the low earning group and cannot afford expensive preparations. Unless they can obtain a low-priced article they must go largely without the use of these articles now generally regarded as adjuncts to sanitation, health, and cleanliness. Many of these products are, indeed, considered in the class of remedial agents, or preventive measures, a fact of which, I take it, many of your members are aware.

The manufacture and distribution of these popular-priced products is made possible only through careful management of experienced men, working under favorable conditions. It is difficult now to proceed with the enterprises and many of the personnel of the managements are poorly paid for their services, but they have carried on in an effort not only to maintain their enterprises, but to provide employment for their workers who have been trained in this line for years.

With the advancing price of containers, the increase in freight rates and other generally mounting costs, it is exceedingly doubtful if all these concerns can continue to operate without incurring losses which will seriously impair their capital investment. Suspension of any of these would cause direct unemployment to a considerable number of workers and indirectly would involve many others. This feature alone is worthy of the consideration of Congress.

The procedure in collecting this tax imposes many hardships. For example, the producer must pay the tax even on a bill of goods sold on credit even though it is never collected. In addition he must pay the tax on the salesman's commission, on the freight and on all other expenses. So far as I have been able to ascertain this is the only case in which all expenses are included in the taxable plan.

The producers composing this group realize the necessity for revenue and, strange as it may seem, are willing to pay all possible. They would, of course, be glad to see the tax entirely eliminated, but barring this the following is suggested:

Levy the tax on the bulk cosmetics, or, reduce the tax to 3 percent on articles retailing for 10 cents, or less, and to 5 percent on articles selling above 10 cents and less than 25 cents, or eliminate container cost from the provisions of the act, or, if either of these is considered incompatible then a reduction of 50 percent in the taxes as now existing, making the tax 5 percent, instead of the 10 percent now exacted, and in any event that clarifying provisions be inserted in the act.

It is known that a certain vagueness now clouds the provisions of the act as interpreted, some contention being made that the original plan was to tax only the bulk cosmetics. This claim is made by authorities intimately acquainted with the original purport of the bill.

This group is anxious to go on record as being in accord with a plan of equitable and fair taxation in support of the Government, but at the same time appeals to Congress to consider the hazardous situation in which the firms

engaged in this business now find themselves. The future revenue of the Government is to some extent jeopardized by the prospects of discontinuance of operation and the employment of many people is involved.

Reduction of the tax, or entire elimination on the 10 cents products, would cause relatively little loss of revenue. On the other hand it would insure provision for continued manufacture of these low-priced cosmetics and make them available to a large percentage of the population that much look to this source of supply for their needs and requirements.

There is precedent for the graduated tax plan, as illustrated in motion pictures, or theaters and entertainments.

Finally, in concluding, may I say that we are confident that this petition and plea is presented on the basic fundamentals of an equitable and fair proposition and we are confident that you will give not only your careful consideration to this appeal, but that you will recommend some remedial action in the matter that will give relief to this group that now so sorely needs the succor that this revision in the Revenue Act will give them.

The CHAIRMAN. Does anyone on the calendar for tomorrow desire to be heard now? (No response.)

The committee will recess until 9:30 tomorrow morning.

(Whereupon, at 4:05 p. m., the hearing was adjuorned until Saturday, March 19, 1938, at 9:30 a. m.)

REVENUE ACT OF 1938

SATURDAY, MARCH 19, 1938

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

The committee met, pursuant to adjournment, at 9:30 a. m., in the Finance Committee room, Senate Office Building, Senator Pat Harrison (chairman) presiding.

The CHAIRMAN. The committee will be in order.

I desire to state that because of the number of witnesses that have expressed a desire to be heard, and this committee has been working for 2 days on the hearings, it is going to be impossible to get through with all of them today. And so that being true, and the committee desiring to inconvenience least those away from home, we are going to take this morning to hear witnesses who are here from a distance, so that we might finish with them, and we will take the Washington witnesses on Monday. We dislike very much to do that, because we want to finish these hearings, but there are some things that are just impossible to do and give anybody any time at all to say anything. So this morning we are going to hear those gentlemen, within limitations, who are here from a distance, and the others we will just have to prolong the hearing for until Monday and get rid of you Monday morning. So those who desire to go and fish and play golf that live in town may do so.

Senator Hale, you had some gentleman here from a distance, I understood.

Senator HALE. Yes; Mr. Chairman. I am here today with a number of people from the northeast section of the country, who are very much interested in having eliminated from the bill subsections (c) and (d) of section 704, the amendment for the tax on lumber.

They are particularly interested in northern white pine and Norway pine, and Mr. Treen, the secretary of the Northeastern Lumber Manufacturers Association, Inc., has a brief with him, which he will file, and he will explain the situation to the committee, and then after that I would like to have the others heard for just a very brief few minutes.

The CHAIRMAN. Is Mr. Treen here?

Mr. TREEN. Yes, sir.

The CHAIRMAN. All right; Mr. Treen, you have a brief there that you wanted to file?

Mr. TREEN. Yes, sir. I have additional copies, too, if they are desired.

The CHAIRMAN. You have 10 minutes, Mr. Treen.

Mr. TREEN. Thank you.

STATEMENT OF E. W. TREEN, NEW YORK CITY, REPRESENTING NORTHEASTERN LUMBER MANUFACTURERS' ASSOCIATION, INC.

Mr. TREEN. Mr. Chairman and gentlemen, my name is Edward W. Treen, secretary-treasurer of the Northeastern Lumber Manufacturers' Association of New York, representing the northeastern white pine and Norway pine manufacturing industry.

The CHAIRMAN. What is that section?

Mr. TREEN. That is New England, New York State, and Pennsylvania.

The CHAIRMAN. I meant the section of the bill.

Mr. TREEN. That is——

The CHAIRMAN (interposing). I will find it. Never mind. You may proceed.

Mr. TREEN. We have with us the following gentlemen: Mr. J. G. Deering, president and general manager of J. G. Deering & Son., Biddeford, Maine; J. J. Farrell, president of the Farrell Lumber Co., Poland, N. Y.; R. V. Crowley, vice president of the Gardner W. Taylor Lumber Co., New York City; and Mr. Stanley Fessenden, president of the Fessenden Lumber Co., and president of the New England Lumber Association. We would like to have the opportunity, Mr. Chairman, of having those gentlemen make a statement for 1 or 2 minutes when I am concluded, if we may.

The CHAIRMAN. Very well. Let us get along with them as quickly as possible.

Mr. TREEN. Mr. Chairman, we refer to subsections (c) and (d) of 704, the amendment to tax on lumber of the revenue bill of 1938, which reads as follows:

> Section 601 (c) (6) of the Revenue Act of 1932 is further amended by inserting after the amendment made by subsection (a) of this section the following:
> "The tax imposed by this paragraph shall not apply to lumber of northern white pine (*Pinus strobus*), Norway pine (*Pinus resinosa*), and western white spruce."

We ask, Mr. Chairman, that this subsection, particularly as it refers to northern white and Norway pine, be stricken from the revenue bill. This amendment is directed principally at two species, white and Norway pine, particularly white pine.

White pine is not scarce in supply in the United States.

The CHAIRMAN. So we may get the issue clearly, you want northern pine and Norway pine stricken from the provisions of this section?

Mr. TREEN. That is right, sir.

The CHAIRMAN. You are not discussing the Engelmann spruce at all?

Mr. TREEN. No, sir.

The CHAIRMAN. All right.

Mr. TREEN. There are in the United States approximately 14½ billion feet of saw timber of northern white and Norway pine. There are in the New England States, New York, and Pennsylvania about 12 billion feet of that saw timber. The greatest volume of the domestic stand is in the Northeastern States. Our stand is in excess of the saw timber in the Dominion of Canada.

Senator BROWN. Do you happen to have the figures on the amount in Michigan?

Mr. TREEN. I have the figures here; yes, sir.

Senator BROWN. You will put them in the record?

Mr. TREEN. I will put them in the record, sir.

There is in the Dominion of Canada, Quebec, Ontario, Nova Scotia, and New Brunswick between ten and eleven billion feet of saw timber of northern white and Norway pine, according to the records of the Canadian Forestry Service, a less stand than we have in the Northeastern States alone.

Now, as concerns a comparison of production: Our production in the Northeastern States alone, which is equivalent to 67 percent of the entire United States of production of northern white pine and Norway pine, those two species has been greater, consistently greater than the Canadian cut, according to the records of the Canadian Forestry Service and the United States Department of Commerce.

Senator BROWN. You say the Northeastern States. Do you go as far west as Michigan and Wisconsin?

Mr. TREEN. No, sir; we do not.

Senator BROWN. You do not include them?

Mr. TREEN. No, sir; I mean New England, New York, and Pennsylvania in each case, and the greatest part of that is of course in the New England States.

The nature of this northeastern pine industry, Senators, is that there are over 50,000 men employed in this lumber industry in these Northeastern States. They are employed in about four ways, men that are employed all of the year round in the woods, men that are employed all of the year round in the mills, farmers and farmers' help who work in the woods during the winter.

We have seasonal operating conditions up there and in the winter in most cases we have to get the logs out or else we cannot get them out. In most cases these men work in the winter. We also have the help of men indirectly employed as they are cutting logs for the farmers, who sell the logs to the mills in that territory.

We have a good many sawmills up in that country. They are small, most of them, very small, compared with the great mills in the South and the Pacific Northwest. Outside of the metropolitan areas up there there is hardly a community that does not have a sawmill. This white pine in a great many instances is the lifeblood of these communities.

We have conservation in the Northeast. I just want to refer here to a study which was made by the N. R. A., and there is a table here, called the Average Drain Table, N. R. A. Report, which shows in the New England and in the Middle Atlantic region in timber the future supply is perpetual.

Senator TOWNSEND. You mean it grows back after it is cut over?

Mr. TREEN. It comes back and is growing faster at the present time than it is being cut.

I have a chart here which I would like to show to you, which was based on the Copeland report of the United States Forestry Service some few years ago.

Senator TOWNSEND. How long once you cut a thicket there before it grows back? I mean, how many years does it have to grow?

Mr. TREEN. Forty to sixty years.

In the northeast section this chart shows the drain and the cut, that which is destroyed by fire and insects, and the drain estimated will be less for the years 1930 to 1950 than the growth will be for the years 1930 to 1950.

Senator BROWN. What do you mean by that term "drain," is that excess of cut-over growth?

Mr. TREEN. No, sir. The drain is the cut.

Senator BROWN. The entire cut?

Mr. TREEN. The entire cut, and that which is destroyed by fire and the insects. That is known as the drain. It takes into consideration those three elements.

Senator DAVIS. Just a minute. I believe we have about three counties in Pennsylvania affected by white pine. Do you know the amount of timber we have in Pennsylvania?

Mr. TREEN. The entire amount of white pine?

Senator DAVIS. Yes.

Mr. TREEN. Yes, sir; I have those figures right here.

Senator DAVIS. Will you put them in the record?

Mr. TREEN. I can, yes; it is all laid out by States. Do you care to have me read it now, or shall I put it in the record?

Senator DAVIS. Just put it in the record.

I want to ask you this further question. Is not there a group of lumber people who formerly operated in Minnesota in white pine and have now moved to Canada, and they want to knock this excise tax out here so they can send Canadian white pine in here in competition with our own?

Mr. TREEN. That is our belief and understanding; yes.

Senator DAVIS. Mr. Chairman, after they have depleted our forests in the United States they go to Canada. While they are operating in the United States they want the excise tax, but when they go to another country they want it taken off.

Mr. TREEN. The statement made on the floor of the House I believe——

The CHAIRMAN (interposing). Do you want that put in the record? You do, don't you?

Senator DAVIS. It is immaterial to me.

Mr. TREEN. A statement was made on the floor of the House that in bringing in foreign timber we were conserving and practicing true conservation in the United States and saving United States timber. Apropos of that I would like to read from an editorial which appeared in the January 1936 issue of American Forests, published by the American Forestry Association.

> The theory that getting our lumber from Canada or other outside countries will solve our forest problem because it will save our own forests runs away from the real problem, which is one of land use. The solution lies in getting someone to grow timber on our forest lands continuously and permanently, and that, so far as private endeavor is concerned, will turn upon a reasonable assurance of markets for the wood products grown.
>
> Certainly opening the door for Canada to come in and take part of a lumber trade grown too small adequately to support American forest properties and their 400,000 wage earners serves no conservation or land-use ends. In fact, the course appears to be conservation in reverse in that the policy is likely to deter Americans from engaging in the commercial growing of forests, thereby hardening the problem of tax-delinquent lands which today is burdening hundreds of counties throughout the Nation. Neither is the course consistent with the administration's early gesture of promoting the growing of forests by pri-

vate industry. No owner of forest land can be expected to spend money growing trees if Canada or any other country may undersell him in his own local markets. That Canada apparently can do in northern markets by virtue of a lower wage scale. The effect, it seems logical to expect, will be to frighten American timber owners into liquidation of their forest properties and abandonment of any plans they may have for long-term timber cropping and permanent land ownership.

So far as wages are concerned, the wages in the Northeastern States at the present time in the lumber industry are 25 to 30 percent higher than they are in adjacent Canadian Provinces per hour. We had code wages in N. R. A. with a minimum of 27 cents an hour in the woods, and 30 cents an hour in the mills. Our wages are consistently in excess of that today.

The Canadian wages I have, which I will file here with the brief. And the wages show for Ontario in 1935 an average weekly wage of $11.15; New Brunswick, $8.16; Quebec, $8.61; they have minimum-wage laws in the Provinces at the present time.

Here is Ontario with $42.50 a month, plus board; Quebec, $45 per month, plus board; New Brunswick, average $40 per month, plus board, with a minimum of $34 plus board, right across the border from us where this lumber is coming from.

Our stumpage prices on Northern white and Norway pine are in excess of the Canadian prices.

According to the United States Department of Commerce the United States 1936 price on northern white pine stumpage was $5.67 per thousand and on Norway pine $3.86 per thousand.

The prices vary from $2 to $3 per thousand in Canada according to the stumpage location. Those are figures according to the department of mines and resources of Canada. There was an average of $2.50 per thousand. In some cases additional prices were put on because of quality and accessability. Those are two great factors in stumpage.

Senator BROWN. Tell me does this affect the reciprocal trade treaty between the United States and the Dominion of Canada?

Mr. TREEN. At the time this was heard last July and not reported favorably from the committee the statement was made by the chairman to the effect that this thing might conflict with the negotiations beween the Department of State and the Dominion of Canada.

Senator BROWN. As a matter of fact, the Canadian timber policy is generally against the shipment of raw forest products. By that I mean poles, wood, or logs being brought out of Canada for manufacture in the United States; is it not?

Mr. TREEN. I cannot answer that question, sir, directly, because I have not the facts on it. But I do know the Canadian Government, particularly the provincial and forest provinces, do consider the lumber industry the most important there, and almost subsidize the lumber industry up there.

Senator BROWN. They want to manufacture it in the Dominion?

Mr. TREEN. They would prefer to. In other words, it takes work away from the Canadian laborer if they do not.

At a meeting in Montreal in February one of the foresters of the Province of Ontario stated to the effect that in view of the critical situation in the lumber industry that the Government intended not to increase prices on Crown dues and Crown stumpage at that time.

The CHAIRMAN. You remember when this law was passed, of course?

Mr. TREEN. The revenue act?

The CHAIRMAN. Yes; 3 years ago, when there were a few gentlemen who represented some coal sections, some lumber sections, and sugar got into it, there were four articles, and copper, I think, got into it, and they put these propositions over; do you recall that?

Mr. TREEN. Yes, sir.

The CHAIRMAN. Were not the representatives of the northern pine in on that proposition then?

Mr. TREEN. This thing came up first in 1933 and the Northeastern Lumber Manufacturers' Association was not organized at that time, not awake and watching this thing, and that is the reason we did not participate in the thing before.

The CHAIRMAN. I did not mean you participated, but I meant some other gentlemen might have participated in it then and there was a little bad faith on the part of these other gentlemen who were in the understanding to leave you now, was there not?

Mr. TREEN. I would think so; yes.

Senator DAVIS. The principal argument at the last hearing that was had they stated they were only interested in the so-called pattern pine used for high-grade specialty uses in this country, was it not?

Mr. TREEN. That is right, Senator.

Senator DAVIS. I want to ask you if it is not a fact that the unit value for pine is less than $25 per thousand feet indicates a great deal of that material is of a lower grade and not the highest grade used for specialty purposes?

Mr. TREEN. It does indicate that the price of less than $25 a thousand indicates a lower grade, competing with siding, building, and boxing grades, for which knotty pine is used; yes, sir.

Senator JOHNSON of Colorado. What will the loss in revenue be?

Mr. TREEN. You mean in this proposal?

Senator JOHNSON of Colorado. Yes; to the United States Government.

Mr. TREEN. On this particular species it will probably run $150,000 a year.

Senator JOHNSON of Colorado. That would be a loss to the Treasury of that much?

Mr. TREEN. Yes.

Senator DAVIS. What would be the loss in wages to the workers and the American businessmen?

Mr. TREEN. This loss has to come out of stumpage, of which we have between 11 and 12 billion feet, and you put $1.50 on that, and it is $18,000,000, which comes right out of stumpage.

Senator BROWN. Of course, your proposition here is as to retaining the tariff now which is existing?

Mr. TREEN. Yes, sir.

Senator BROWN. You are fighting to increase the revenue to the United States?

Mr. TREEN. It would; yes. We wish to retain that $1.50 excise tax.

The CHAIRMAN. There never was much of a revenue problem in that.

Mr. TREEN. Not in this particular species; no, sir.

Senator DAVIS. It is an excise tax that is used as a tariff, is not that right?

The CHAIRMAN. That is right.

Senator JOHNSON of Colorado. Is it not true that the House cut off the $150,000 and you want it put back in by the Senate?

Mr. TREEN. Yes; we want the tax of $150,000 retained.

Senator JOHNSON of Colorado. And the House took it off?

Mr. TREEN. Yes, sir.

Senator JOHNSON of Colorado. And you want it the way it was?

Mr. TREEN. We want it the way it was; yes, sir.

Mr. Chairman, if this was directed at all the imported species it would be just foolish for us to come down here, but this thing is directed at the one species, northern white pine (*Pinus strobus*), and we think it is very discriminatory, unjust, and entirely unnecessary. This high-grade material is used for pattern work and fine trim, and sells for as high as $80 to $120 per thousand. And $1.50 is no bar to sale for that. It is conceded in making sales many times. The claim is that that is the only kind of material that comes in from Canada which we claim is not so.

The CHAIRMAN. Your time is up. You have a brief?

Mr. TREEN. I have a brief, and I have some other gentlemen here if you want to hear them.

Senator KING. You were addressing yourself to only one species?

Mr. TREEN. White and Norway pine, sir.

I also have some other information which I will file.

(The matter referred to is as follows:)

BRIEF IN REFERENCE TO H. R. 9682, PROPOSED REVENUE ACT OF 1938, SUBSECTIONS (C) AND (D) OF SECTION 704, AMENDMENTS TO TAX ON LUMBER

Gentlemen, The Northeastern Lumber Manufacturers' Association, Inc., 41 East Forty-second Street, New York, N. Y., speaking for the white and Norway pine manufacturing industry of New England, New York, and Pennsylvania, earnestly requests that the Senate Finance Committee eliminate from the revenue bill of 1938 subsections (c) and (d) of section 704, Amendment to tax on lumber, reading as follows:

(c) Section 601 (c) (6) of the Revenue Act of 1932 is further amended by inserting after the amendment made by subsection (a) of this section the following: "The tax imposed by this paragraph shall not apply to lumber of northern white pine (pinus strobus), Norway pine (pinus resinosa), and western white spruce grown in Manitoba, Saskatchewan, or Alberta."

(d) The amendment made by subsection (c) shall be effective July 1, 1938.

The excise tax imposed by section 601 (c) (6) of the Revenue Act of 1932 on imported northern white and Norway Pine and western white spruce is at present $1.50 per thousand feet, board measure. This represents a reduction of 50 percent, with the effective date of the present Canadian Reciprocal Treaty January 1, 1936, from the statutory rate of $3 per thousand feet, which was effective on all imported lumber. The intent of the above proposed amendment is to eliminate the $1.50 excise tax from the three species mentioned. The principal species involved are northern white pine and Norway pine, particularly the former, the western white spruce not being of great importance. The pine is imported from Canada.

I. Nature of the northeastern lumber manufacturing industry. The lumber manufacturing operators in the Northeast are relatively small. Some few companies employ from 100 to 300 men, but the majority directly employ from 6 to 25 men. There is hardly a county in the Northeast, outside of the metropolitan areas, which has not one or more sawmills which provide work for the commu-

nity, provide work for farm help during the cutting season which would otherwise be unemployed, and provide a market for the products of the farmers' woodlots.

Lumber manufactured in the Northeast is sold, as proven by Department of Commerce statistics, to the extent of over 90 percent of its total volume, in its territory in which produced. It is so limited for the following principal reasons:

1. No market to the north because of Canada, which produces more than enough of the same species to satisfy its own demands.

2. No market to the east because of the Atlantic.

3. No market west and south because transportation costs would not permit it to meet competition from other sections advantageously in those areas.

Outside of the Pacific Northwest and one or two sections in northern Michigan and Wisconsin, wages paid wood and sawmill labor average higher than in any other producing section. This might be expected as the northeastern area is primarily industrial.

II. Reasons why the elimination of subsections (c) and (d) of section 704, amendments to tax on lumber, Revenue Act of 1938, is requested:

1. A subcommittee of the Committee on Ways and Means of the House, at hearing on July 21, 1937, before which this association testified, refused to approve H. R. 7518, which bill proposed that which subsections (c) and (d) of section 704 of the present revenue bill would bring about.

2. The proposed amendment is sponsored principally by one company, which having depleted its northern white and Norway pine in this country, has transferred its cutting operations into Canada and is desirous of avoiding payment of the import excise tax on the Canadian pine shipped into the United States. As evidence, the following is quoted from a letter written by Mr. A. A. D. Rahn, vice president of Shevlin, Carpenter & Clarke Co., on February 8, 1937, to Senator Harrison, which letter is included (p. 14) in the report of the hearing on H. R. 7045, H. R. 7518, and H. R. 7934.

"Originally our white pine and Norway pine mills were located in Minnesota, but as the supply of these became depleted, we moved into Canada across the line, so that we would be able to supply our trade with Northern white pine and Norway pine, for which no other species could be substituted."

The record further shows (p. 32) a statement of Mr. Rahn, as follows:

"We shipped into the United States 40 percent of the white pine that comes into the United States."

Further, under questioning, Mr. Clark, of the proponents, testified as follows (p. 46 of report):

"Representative WOODRUFF. Whom do you represent?

"Mr. CLARK. The Shevlin, Carpenter & Clarke Co., of Minneapolis.

"Representative WOODRUFF. They are a lumber-manufacturing concern?

"Mr. CLARK. Yes, sir.

Mr. WOODRUFF. In other words, they are anxious to escape paying this excise tax on the lumber that they bring in from Canada?

"Mr. CLARK. Yes, sir.

"Mr. WOODRUFF. And it is just another attempt, isn't it, to avoid paying a tax?

"Mr. CLARK. It is their contention, sir, that these species of lumber in which they are interested are scarce in supply in this country; they are species of wood which would be imported anyhow, and therefore the imposition of excise taxes on these three species is a burden upon the American consumer, because he has to import these woods for specialty purposes. The American consumer is now compelled to pay the difference because of the imposition of the excise tax on these woods."

3. White pine and Norway pine are not scarce in supply in the United States. According to the Department of Mines and Resources, Canada, a 1935 estimate of the accessible saw timber of northern white and Norway pine in Ontario, Quebec, Nova Scotia, and New Brunswick, are 8,788 million and 3,002 million feet, board measure, respectively. These are the only Canadian Provinces in which these species grow to commercial size.

This association filed statistics with the Committee on Reciprocity Information when the present Canadian reciprocal treaty was under consideration which showed a stand of approximately 11,900 million feet of northern white and Norway pine alone in the New England States, New York, and Pennsylvania. The total American stand is approximately 14,500 million feet, according to the Copeland report of the Forest Service.

The total cut of northern white and Norway pine in the United States in 1935 was 377,876,000 feet, board measure. The Northeastern States produced 65 percent of that cut. White pine is our principal softwood species. The northeastern cut of these two species exceeds the Canadian cut, as the following indicates:

Year	New England,[1] New York, and Pennsylvania [1]	Ontario Quebec, New Brunswick, and Nova Scotia [2]
	Thousand feet board measure	*Thousand feet board measure*
1934	272,513	214,157
1935	249,550	240,931
1936	297,665	278,030

[1] Department of Commerce, Bureau of the Census.
[2] Canadian Lumbermen's Association.

4. Canadian white and Norway pine competes directly with domestic production.

Proponents have indicated that this Canadian pine is needed for specialty uses, is not procurable in the United States, and therefore does not compete with domestic production. White pine used for specialty use is high-grade material which sells from $80 to $120 per M. An excise tax of $1.50 per M is no bar to its sale. That amount is often conceded in making a sale.

Furthermore, the records of the United States Tariff Commission indicate conclusively that the majority of imported pine (over 93 percent of which is Canadian white and Norway) is not high-grade specialty material as witness exhibit A attached.

The only and correct conclusion to be drawn from the Tariff Commission's unit values of imported pine is that it includes a preponderance of lower grades used for building, boxing, and similar purposes and competing directly with domestic production. It competes with lumber from the South and West used for the same purposes.

Additional evidence that such is the case is the following quoted from a letter from a large manufacturer of white pine in Canada, much of whose production comes into the United States:

"As asked for, we give approximate percentages of the different grades:

White Pine:	*Percent*
C selects and better	2
D selects and better	3
Cuts (Nos. 1, 2, 3)	3
Nos. 1 and 2 common	20
No. 3 common	30
No. 4 common	25
No. 5 common	10
No. 6 common	8

"Different mills may vary somewhat from this, dependent on whether the stock cut is full-grown pine or younger timber, but this might be a fair average."

5. Canadian competition keen and Canadian operating costs less.

The northeastern lumber manufacturing industry is affected more by imported lumber than any other domestic producing section. Our principal species, white and Norway pine, spruce, eastern hemlock, birch, beech, and maple, are identically the same as the principal Canadian species in the eastern provinces. The Canadians have a surplus. That surplus seeks its outlet in the northeastern markets. The American manufacturer cannot ship into the Canadian markets as they have enough and to spare of this kind of lumber.

For instance, total imports of white and Norway pine in 1935 equaled 33 percent of northeastern production of the same species and 22 percent of the total United States production of the same. These are extremely high ratios, quite indicative that this $1.50 excise tax is no bar to sale. Imports of British

Columbia fir during 1935 were equal to only 1.3 percent of domestic production.
Stumpage costs of Canadian white and Norway pine are less, as witness:

	Northern white pine	Norway pine
	Per M	Per M
Average price, United States, 1936 [1]	$5.67	$3.86
Average price, Canada, 1936: [2]		
Ontario	[3] 2.50	2.50
Quebec	[3] 2.00	1.75
New Brunswick	3.00	2.00

[1] U. S. Department of Agriculture, Stat. Bull. No. 62: Stumpage and Log Prices, 1936.
[2] Crown dues.
[3] Subject to additional charges, depending on quality and accessibility.

Labor standards in the eastern Canadian Provinces are lower than in the northeastern United States. (See Exhibit B attached.) During the N. R. A. minimum wages in the woods and mills in the northeastern section were 27 cents and 30 cents per hour, respectively, with a maximum of 2,080 hours a year. Those standards have been maintained and are consistently higher in many instances.

Size and density of timber, topography, climatic, and other conditions affecting operations are the same in Canada as in the northeastern United States, so we have no compensating cost factors to offset lower stumpage costs and labor standards in Canada.

6. Conservation.

The future supply of timber in New England and the Middle Atlantic States (which includes New York and Pennsylvania) is perpetual. Outside of the south Rocky Mountain region, that is true of no other producing sections in the United States.

Number of years' supply at 1929–33

[Average drain (table IX (a), N. R. A. report)]

Region	Present supply (years)	Future supply (years)
New England	136	(1)
Middle Atlantic	16,530	(1)
Lake	33	40
Central	15	19
South	29	240
Pacific coast	100	252
North Rocky Mountains	124	315
South Rocky Mountains	126	(1)

[1] Perpetual.

White pine is today the most plentiful and fastest-growth softwood in the northeastern region. It is recognized as a great State, county, and community asset. It is a perpetual source of income for communities and families, for labor, and in sale of product. Any legislation which discourages the perpetuation of the species, through permitting the import of foreign material, costing less in the raw and produced at a cost which cannot be met by domestic producers takes away part of the lifeblood of many northeastern communities. This is intensified if the legislation is discriminatory through not being applicable to other principal imported species.

The following is quoted from an editorial appearing in the January 1936 issued of American Forests, published by the American Forestry Association [the italics is ours]:

"The theory that getting our lumber from Canada or other outside countries will solve our forest problem, because it will save our own forests, runs away from the real problem, which is one of land use. The solution lies in getting someone to grow timber on our forest lands continuously and permanently, and that, so far as private endeavor is concerned, will turn upon a reasonable assurance of markets for the wood-products growth.

"Certainly opening the door for Canada to come in and take part of a lumber trade grown too small adequately to support American forest properties and their 400,000 wage earners serves no conservation or land-use ends. In fact, the course appears to be conservation in reverse in that the policy is likely to deter Americans from engaging in the commercial growing of forests, thereby hardening the problem of tax-delinquent lands which today is burdening hundreds of counties throughout the Nation. Neither is the course consistent with the administration's early gesture of promoting the growing of forests by private industry. *No owner of forest land can be expected to spend money growing trees if Canada or any other country may undersell him in his own local markets. That Canada apparently can do in northern markets by virtue of a lower wage scale.* The effect, it seems logical to expect, will be to frighten American timber owners into liquidation of their forest properties and abandonment of any plans they may have for long-term timber cropping and permanent land ownership."

SUMMARY

For the reasons stated above and attached exhibits, the northeastern lumber manufacturing industry earnestly and respectfully requests the Senate Finance Committee to refuse to approve subsections (c) and (d) of section 704, "Amendments to tax on lumber in the Revenue Act of 1938."

The northeastern industry, from the standpoint of total national production, does not represent a large sector, but it must be considered that this proposed legislation does not propose the removal of the import excise tax from all foreign species competing with all American species. It is directed principally at one imported species and of that species, the greatest stand and the greatest production is in the Northeastern States. Why pick out this one? It is the area which receives over 70 percent of imported lumber. The principal active supporter of this proposal is one organization which would remove what reasonable protection our industry has (which protection is decidedly no bar to sale), against foreign competition which affects vitally the many thousands of men employed in the logging camps and mills of the Northeast.

We submit that the proposal is discriminatory, unnecessary, and totally unjustified by the real facts.

The northeastern lumberman cannot supply all the requirements of the northeastern market. He must sell his lumber in that market if he sells it at all, and all he asks is to be given that opportunity and to at least break even. Under adverse circumstances he has endeavored to keep his men at work and realize the aims of the administration. If this discriminatory proposal is approved, the discouragement and disillusionment will be tremendous. There is room for Canadian lumber and a large proportion of other domestic production in the Northeast. It is being sold in large volume, and the removal of this excise tax is not necessary to continue that volume.

In closing, we submit for your consideration this additional thought: That such proposals as this on which your disapproval is asked may tend to conflict with Department of State policy in respect to the existing treaty with Canada or the renewal of the treaty, the terms of which are now under consideration. This point, we know, was considered of extreme importance by the chairman of the subcommittee of the Committee on Ways and Means when H. R. 7518, mentioned above, was under hearing.

Respectfully submitted.

NORTHEASTERN LUMBER MANUFACTURERS ASSOCIATION, INC.,
E. W. TREEN, *Executive Secretary.*

EXHIBIT A

Comparison of unit value[1], imported pine and average sales prices, volume grades, domestic production

Year	Quantity	Value	Unit value
	M ft. b. m.		
1934	91,194	$2,163,484	$23.72
1935	88,794	2,120,891	23.90
1936	92,085	2,415,311	26.23

[1] U. S. Tariff Commission Report, May 1937.

Average prices f. o. b. mill, northern white pine, northeastern production

	No. 2 common[1]		No. 3 common[1]		No. 4 common[1]	Log run, square edge
	1 by 4 inch	6, 8, 10 inch	1 by 4 inch	6, 8, 10 inch	Random	
December 1935	$33.50	$35.50	$25.50	$29.50	$21.50	$25.50
December 1936	36.50	38.50	27.50	30.50	24.50	31.50
December 1937	36.50	40.50	28.50	30.50	23.00	31.50

[1] Predominating grades, especially No. 3 and No. 4 common in average mill cut of northern white pine, domestic or Canadian production.

EXHIBIT B.—*Provincial labor standards in logging and sawmilling industry*

Type of labor	Ontario	Quebec	New Brunswick	Nova Scotia
Woods	Minimum, $42.50 per month plus board. Board, 75 to 85 cents per day. Hours, no limit. Maximum days, 26 per month.	Minimum, $45 per month plus board. Inexperienced and incapable workers, $30 per month plus board. Board, 60 cents per day. Maximum hours, 60 per week. Maximum days, 26 per month.	Average, $40 per month plus board. Minimum, $34 per month plus board. Board, 50 cents per day. Hours, no limit.	None.
Mills	None.	None.	None.	None.

EXHIBIT C.—*Wages in lumber manufacturing industry*

IN THE UNITED STATES[1]

	Weekly
July 1935	$16.32
July 1936	18.69
July 1937	21.11
July 1938	17.70

[1] U. S. Bureau of Labor Statistics.

IN CANADA[1] FOR 1935

	Total employed	Total wages	Annual	Weekly
Canada	22,915	$15,461,548	$674.73	$13.00
Ontario	3,629	2,104,338	580.02	11.15
New Brunswick	1,974	837,875	424.45	8.16
Quebec	4,077	1,846,667	452.94	8.71

[1] Dominion Bureau of Statistics.

EXHIBIT 1.—*Imports, 1935, 1936, 1937 (M feet b. m.)*[1]

[Through northeastern custom districts, species identical with northeastern production]

SPRUCE

Year	Grand total, all districts	Northeast custom districts	Percent through northeast
1935	195,153	156,468	80
1936	305,306	234,869	77
1937	308,106	221,708	72

[1] U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce.

Exhibit 1.—*Imports, 1935, 1936, 1937 (M feet b. m.)*—Continued

PINE

Year	Grand total, all districts	Northeast, Duluth, and Superior custom districts	Percent through northeast
1935	88,794	83,028	93
1936	92,085	78,668	85
1937	83,042	71,390	86

BEECH, BIRCH, AND MAPLE

Year	Grand total, all districts	Northeast custom districts	Percent through northeast
1935	21,120	19,549	92
1936	37,761	33,761	89
1937	53,484	44,268	83

Exhibit 2.—*Lumber distribution, northeastern production, 1934*

(M feet b. m.) [1]

From	Connecticut	Maine	Massachusetts	New Hampshire	New York	Pennsylvania	Rhode Island	Vermont	Total
To—									
Connecticut	9,417	14,408	5,043	2,292	415	68			31,643
Illinois			163			1,940			2,103
Indiana				636		995			1,631
Maine		98,442		3,325	470	60			102,297
West Virginia and Maryland				125	39	2,522			2,686
Massachusetts	132	47,277	38,683	17,298	4,332	676	1,686	9,050	119,134
Wisconsin and Michigan			78		86	758			922
New Hampshire		8,593	3,001	92,997	455	2,828		4,343	112,217
New Jersey		922	76	3,620	1,085	710			6,413
New York	183	10,360	418	8,805	46,436	20,059		1,642	88,303
Ohio		43		372	447	9,546			10,408
Pennsylvania		207	48	375	1,535	92,990			95,155
Rhode Island		7,828	598	625	145		2,267		11,463
Vermont	214	2,314	1	1,407	2,112	830		29,800	36,181
Total									[2] 620,556

[1] Lumber Distribution and Consumption, 1934, U. S. Department of Agriculture, Forest Service.
[2] 96 percent of northeastern production distributed in northeastern territory.

Exhibit 3

Timber stand (board measure)	Maine	Massachusetts	New Hampshire	Pennsylvania	New York
Spruce	[1] 12,500,000,000	200,000,000	617,871,000	(2)	(3)
Balsam fir	4,000,000,000			(2)	(3)
Hemlock	2,400,000,000	200,000,000			
White pine	4,500,000,000	2,000,000,000	1,386,500,000	1,146,000,000	8,667,000,000
Hardwoods	6,100,000,000	800,000,000	677,499,000	4,751,000,000	17,462,000,000
Land area, acres:					
Softwoods	5,287,461	290,000	2,337,000	(4)	(4)
Hardwood	3,484,566	230,000	1,129,000	1,831,000	4,628,000
Mixed	3,827,974				

[1] Estimated from 25,000,000 cords reported, of which probably 50 percent is saw timber.
[2] All softwood (estimated 50 percent white pine).
[3] All softwood (estimated 25 percent white pine).
[4] Total.

Vermont figures not available, estimated 1,500,000,000 white and Norway pine.

EXHIBIT 4.—*Total stand—Saw timber*[1]*—Northern white pine (Pinus strobus) and Norway pine (Pinus resinosa)*

[Million feet board measure]

	Ontario, Quebec, Nova Scotia, and New Brunswick	United States [2]
White Pine	8,788	14,672
Norway Pine	3,002	

[1] Canadian figures from Department of Mines and Resources, Canada, 1935 estimate.
[2] Of this approximately 11,900 million feet is in New England, New York, and Pennsylvania.

United States stand data from Copeland Report.

Comparison of production—Northern white and Norway pine

[Million feet board measure]

Year	New England,[1] New York, and Pennsylvania	Ontario, Quebec,[2] New Brunswick, and Nova Scotia
1934	272,513	214,157
1935	249,550	240,931
1936	297,665	278,030

[1] Department of Commerce, Bureau of the Census.
[2] Canadian Lumbermen's Association.

EXHIBIT 5.—*Production*[1]*—Northern white and Norway pine*

[1,000 feet board measure]

Year	Total	New England, New York, and Pennsylvania	Percent of total cut	Other
1934	387,757	272,513	70	115,244
1935	378,269	249,550	65	128,719
1936	443,723	297,665	67	146,058

[1] Department of Commerce—Bureau of the Census.

EXHIBIT 6.—*Comparison of unit value*[1]*—Imported pine and average sales prices, volume grades, domestic production*

Year	Imports, quantity	Imports, value	Unit value
1934	91,194	$2,163,484	$23.72
1935	88,794	2,129,891	23.99
1936	92,085	2,415,311	26.23

[1] U. S. Tariff Commission Report, May 1937.

Average prices f. o. b. mill, northern white pine, northeastern production

	No. 2 common [1]		No. 3 common [1]		No. 4 common [1] random	Log run, square edge
	1 by 4 inches	6 inches, 8 inches, 10 inches	1 by 4 inches	6 inches, 8 inches, 10 inches		
December 1935	$33.50	$35.50	$25.50	$20.50	$21.50	$25.50
December 1936	36.50	38.50	27.50	30.50	24.50	31.50
December 1937	36.50	40.50	28.50	30.50	23.00	31.50

[1] Predominating grades, especially No. 3 and No. 4 common in average mill cut of northern white pine, domestic or Canadian production.

EXHIBIT 7.—*Comparison of stumpage prices—Identical species—Northeast United States and Canada*

[Thousand feet board measure]

	Northern white pine	Norway pine	Engelmann's spruce	Birch	Beech	Maple
Average stumpage price, 1936, United States [1]	$5.67	$3.86	$4.50	$6.46	$3.86	$6.75
Stumpage prices, 1936,[2] Canada:						
Ontario	[3] 2.50	2.50	2.00	2.50	2.50	2.50
Quebec	[3] 2.00	1.75	1.20	1.75	1.75	1.75
New Brunswick	3.00	2.00	2.00	2.50	1.50	2.00

[1] United States Department of Agriculture (Stat. Bull. No. 62), "Stumpage and Log Prices, 1936."
[2] Crown dues.
[3] Subject to additional charges, depending on quality and accessibility.

EXHIBIT 8.—*Provincial labor standards in logging and sawmilling industry*

Type of labor	Ontario	Quebec	New Brunswick	Nova Scotia
Woods	Minimum $42.50 per month plus board. Board: 75 cents to 85 cents per day. Hours: No limit. Maximum days: 26 per month.	Minimum $45 per month plus board. Inexperienced and incapable workers, $30 per month plus board. Board: 60 cents per day. Maximum hours: 60 per week. Maximum days: 26 per month.	Average $40 per month plus board. Minimum $34 per month plus board. Board: 50 cents per day. Hours: No limit	None.
Mills	None.	None.	None.	None.

(Mr. Treen submitted additional information, as follows:)

UNITED STATES DEPARTMENT OF AGRICULTURE,
FOREST SERVICE,
Washington, February 17, 1938.

Mr. EDW. W. TREEN,
Executive Secretary, Northern Lumber Manufacturers Association, Inc., New York, N. Y.

DEAR MR. TREEN: Your letter of February 11 addressed to Mr. Marsh has been referred to me for reply. As soon as the bulletin referred to in your letter is published we will send you a copy.

There is no recent bulletin nor publication that gives reliable estimates of the standing timber in the United States, by States and species. I presume that you are familiar with the national-forest survey which has been under way since 1930. We have covered the States of Oregon and Washington, part of the Inland Empire region, the Lake States, and several States in the South. Approximately 50 percent of the United States has been covered by field work.

Estimates of the timber in western Oregon and Washington are available by counties. Estimates are also available for several Southern States, and for Minnesota and Michigan. The Northwest will be covered just as soon as sufficient funds are made available to justify undertaking the work in that region.

I am enclosing two leaflets showing rough estimates of birch and maple. I am also showing by the following table the estimated amount of timber by species for Minnesota and Michigan as determined by the recent forest survey. This estimate is in millions of board feet, green chain lumber tally.

Species	Minnesota	Michigan	Species	Minnesota	Michigan
White pine	1,598	1,010	Yellow birch	93	3,771
Norway pine	998	187	Beech	....	1,326
Jack pine	2,263	169	Basswood	451	760
Hemlock	....	6,550	Elm	702	1,248
Balsam fir	350	606	Oak	762	1,211
Spruce	1,241	984	Poplar	2,367	955
Tamarack	137	78	Miscellaneous [1]	1,186	2,271
All softwood	6,587	9,584	All hardwood	5,867	18,965
Sugar maple	306	7,423	State total	12,454	28,549

[1] Including paper birch and red maple.

Minnesota has approximately 12.4 billion board feet and Michigan approximately 28.5 billion board feet. These estimates include all species, regardless of volume per acre, and for that reason a considerable portion of some species is not now operable. You can get the figures for Wisconsin by writing the director of the Lake States Forest Experiment Station, University Farm, St. Paul, Minn. We have not yet received the final figures, by species.

If you are interested in estimates for the Southern States, you can secure this information by writing the director of the Southern Forest Experiment Station, 400 Union Building, New Orleans, La. You can also secure the estimates for the West by writing to the director of the Pacific Northwest Forest Experiment Station, New Courthouse, Portland, Oreg.

Very sincerely yours,

R. D. Garver, *Director, Forest Survey.*

The Chairman. I wish you would get rid of these other gentlemen as quick as you can.

Mr. Treen. They will just talk about a minute.

Mr. Crowley?

STATEMENT OF R. V. CROWLEY, VICE PRESIDENT OF THE GARDNER W. TAYLOR CO., NEW YORK, N. Y.

Mr. Crowley. My name is R. V. Crowley. I am vice president of the Gardner W. Taylor Co. of New York.

Mr. Chairman and gentlemen, my company operates very largely in northern white pine. That one species of wood is our principal stock in trade and bread and butter.

Senator King. In New England or in New York?

Mr. Crowley. Both. We get our lumber from both New England and New York. And we cater to a rather high-class specialty trade among the larger industrials that demand a high-grade lumber.

Formerly we operated entirely in Canada. And having been brought up more or less on Canadian white pine we were always under the impression, and never believed, that the trade we catered to would ever be satisfied with any American white pine. We just automatically assumed that Canadian white pine was superior in quality, and that our trade, accustomed to it, would continue to demand it.

Senator DAVIS. Is the Canadian white pine superior to the American white pine?

Mr. CROWLEY. That has not been our experience, Senator.

I want to say that in 1929 the lumber we were getting up there was exhausted and the mill was dismantled, and on top of that came the depression, and for a couple of years we were not interested in buying lumber anywhere, as we still had enough stock. There was still $4.50 duty in excise tax on Canadian lumber and as our stocks became broken we had to supplement them. We began to look into various offerings of eastern white pine here in the United States, and to make a long story short there in 1929 we were getting our entire production in Canada for very high-class trade. And today and in fact for the past 2 years we have moved our operations over here into the northeastern United States. We are shipping the very same customers the very same grade for the very same purposes, and seem to have no difficulty at all in satisfying them as far as quality is concerned.

Senator KING. Let me interrupt you. I was interested in your statement that you had to close your mill because the supply was exhausted. Are you denuding and going to leave your country where you are operating now in northern Michigan nothing but old stumps and desert?

Mr. CROWLEY. No; that is a very attractive feature of the present outlook. That is as near as we can determine, and the forest records seem to bear me out.

Senator BROWN. Let me say to the Senator from Utah that I rather resent the statement that he makes about northern Michigan.

Senator KING. I got it from a Michigander.

Senator BROWN. The figures show that there is more tourist money spent in northern Michigan than there is in the majority of States.

Senator KING. And more lumber produced there than in any other part of the country.

Mr. CROWLEY. It appears that we have more nearly perpetual white pine in the northeastern United States than any other part of the country. In other words, northern pine, as it grows in the East, reproduces itself at a rate at least equivalent to the rate of drain, and probably in excess, and I do not believe that is true of any other section or any other wood in the United States. But it is true of northern pine in the Northeast. I believe the Forestry Service records bear that out.

The CHAIRMAN. Is there much reforestation going on up there?

Mr. CROWLEY. No; not what you would say would be a drop in the bucket at the present time.

Senator KING. You have not a plan there where when you drop one tree you replace it with others?

Mr. CROWLEY. Not at present; no.

Senator KING. You are denuding the forest without replenishing it?

Mr. CROWLEY. The natural replenishment takes care of it. It would be very uneconomical to try to do it artificially because the natural process is so perfect up there in the East.

The CHAIRMAN. It takes about 50 years to replace it?

Mr. CROWLEY. Yes; and in about 50 years you have got a new crop.

The CHAIRMAN. We have it down in my State; pine that replaces itself in 15 years.

Mr. CROWLEY. Sap pine?

The CHAIRMAN. Yes; loblolly.

Thank you very much, Mr. Crowley.

Mr. CROWLEY. Thank you, Mr. Chairman.

The CHAIRMAN. You are one of the concerns that did not move after they finished in Minnesota and went up into Canada, but you came down here?

Mr. CROWLEY. We did just the opposite, Senator, and we hope to stay in the United States if we have some protection.

The CHAIRMAN. Senator Murray has a statement.

STATEMENT OF HON. JAMES E. MURRAY, UNITED STATES SENATOR FROM MONTANA

Senator MURRAY. Mr. Chairman and members of the committee, I have been requested by the lumbermen of my State to come here this morning and make a statement in connection——

The CHAIRMAN (interposing). Senator, would you prefer—he has two or three gentlemen who wish to make a statement about a minute long—he finish and then you go on?

Senator MURRAY. Thank you.

Mr. TREEN. Mr. Stanley Fessenden, president of the New England Lumber Association, and president of the Fessenden Lumber Co., in Fessenden, Mass., which is an old company and is a company which has been operating for 100 years.

STATEMENT OF STANLEY FESSENDEN, PRESIDENT OF THE NEW ENGLAND LUMBER ASSOCIATION AND PRESIDENT OF THE FESSENDEN LUMBER CO., FESSENDEN, MASS.

Mr. FESSENDEN. Mr. Chairman, I would like to urge this amendment be stricken from the bill, as it will serve no good purpose and will work a hardship on 50,000 men working in the lumber industry in the Northeast.

That is all the time I will take.

The CHAIRMAN. Thank you, Mr. Fessenden.

Mr. TREEN. The next is J. G. Deering, president of the J. G. Deering & Son, Biddeford, Maine; very old pine operators in Maine.

Senator KING. I understood one of your men to state a minute ago that some of this pine sold at $180 a thousand.

Mr. TREEN. The high grade sells from $80 to $120 per thousand.

Senator KING. And you think a $1.50 tax would be destructive to the industry?

Mr. TREEN. No, sir; not on that type of material.

There is not a great percentage of that type of material developed

from the log, but that is again developed for only high-grade specialty use. But the unit is between $23 and $26 per thousand, which indicates the preponderance on the lower grades.

STATEMENT OF J. G. DEERING, PRESIDENT OF J. G. DEERING & SON, BIDDEFORD, MAINE

Mr. DEERING. Mr. Chairman, our costs are up approximately 40 percent over the last 4 or 5 years, and we are very much concerned over our ability to keep those costs within range and to keep employing men and keep going profitably.

Senator KING. What is the reason for your increased cost over 1929, for instance?

Mr. DEERING. Over 1929?

Senator KING. Yes.

Mr. DEERING. The large part of lumber costs are labor almost entirely.

Senator DAVIS. Has there been an increase in wages and labor?

Mr. DEERING. Oh, yes; substantially.

Senator DAVIS. Since 1929?

Mr. DEERING. Yes, sir. Wages are substantially higher with us.

Senator KING. Higher than in 1929?

Mr. DEERING. I think so; yes, sir.

Senator KING. Than 1928?

Mr. DEERING. In 1929 the lumber business was not good with us. It was very much depressed.

The CHAIRMAN. Thank you very much.

Mr. TREEN. Mr. Chairman, I have just one more gentleman. His name is Jerome Farrell, president of the Farrell Lumber Co., Poland, N. Y. This is in the Adirondacks just north of Ithaca.

STATEMENT OF JEROME FARRELL, PRESIDENT OF THE FARRELL LUMBER CO., POLAND, N. Y.

Mr. FARRELL. Mr. Chairman and gentlemen, I think this question has been pretty well covered by Mr. Treen, and the questions that have been asked by you Senators have brought out the real points, and I do not think there is anything I can add to it particularly outside of the fact that I am an operator in timber and lumber. I try to employ as many men as I can, and what I get from my lumber enables me to employ these men, and if we could not furnish the employment I am afraid they would have to go on relief.

Senator KING. How many men do you employ?

Mr. FARRELL. About 150.

Senator KING. Where?

Mr FARRELL. Up in the Adirondacks. Part of my operations is in white pine, part in softwood, and part in hardwood, and we have to make enough money so as to pay the labor and pay for the lumber.

The CHAIRMAN. Is the lumber industry now prosperous?

Mr. FARRELL. No; it is not. I reckon it is about like other industries which have been hit with the recession.

We had a pretty good year beginning in the fall of 1936, running up until summer of last year, but right now the lumber business is not very prosperous.

I do want to make this statement for your consideration, gentlemen: We in the Northeast feel that it would be unfair to pick on us in this proposition. It would necessitate in the end that we would have to close down some of our plants, some of our mills, because we are running pretty close, and while $1.50 does not seem like a lot on $30 lumber it is about 5 percent, and 5 percent on the gross oftentimes is the difference between keeping going and stopping.

Senator BROWN. Has this second-growth pine—one of the witnesses stated it grows naturally—does that grow as big as the original white pine in the Adirondack region?

Mr. FARRELL. In time probably it would, Senator, but it would take a long time.

One of the Senators here asked a question about planting. I think, through the Northeast, we have got a better system of the natural conditions obtaining as to natural regeneration.

It was my privilege to go over to Europe 2 years ago and make a study of the timber situation over there and the so-called use of the way of using the land for the best advantage. Now, I was told there by the people who had been operating that land for years that the best way was selective cutting, natural regeneration, and even in Germany and Czechoslovakia they have gotten away from planting. It is an expensive way; that is, they do plant some the same as we do here, but they go on the selective-cutting basis. That is what is happening up in the Northeast. You always leave a certain amount of growing timber. But, of course, it is the election of cutting properties. Of course, it should be and could be improved over the United States after we get to a point where we can afford to do it.

Senator BROWN. But the selection does not preserve the trees?

Mr. FARRELL. It does not in any country, Senator.

Senator BROWN. Are there any timberlands which are not State-owned and privately owned, but which are owned by the Federal Government?

Mr. FARRELL. There are not any owned by the Federal Government, but they are owned by the State and privately owned.

The CHAIRMAN. Do you get any cut of wood from the spruce in this timber for wood pulp?

Mr. FARRELL. You do from the spruce. I do not think white pine is used for wood pulp. We are getting wood pulp out of the South now.

The CHAIRMAN. Is your organization part of the National Lumber Manufacturers' Association?

Mr. FARRELL. Yes, sir; I am a director of the National Lumber Manufacturers' Association.

The CHAIRMAN. What is the attitude of the National Lumber Manufacturers' Association with reference to these two species?

Mr. FARRELL. Now, at a meeting in Chicago some 3 or 4 years ago this question was brought up and a resolution was introduced in the Chicago meeting that this excise tariff be taken off of certain species which grow in the Northeast.

I attended that meeting and after the resolution was seconded I asked to be heard. I asked first of those who introduced the resolu-

tion, who were apparently in favor of it, what their reasons were as to why it was introduced. There did not seem to be anybody who knew much about it.

And then I told our position on it as a representative of the northeastern section. The man who seconded the resolution withdrew his second and left it in that condition. In fact, it never came to a vote.

The CHAIRMAN. You are pretty persuasive.

Mr. FARRELL. That resolution specifically asked that the duty be removed.

Senator JOHNSON of Colorado. Was that a convention of lumbermen?

Mr. FARRELL. That was the national convention of the National Lumber Manufacturers' association.

It specifically asked that this excise duty be removed. After we talked about it a bit the man who seconded the resolution apparently was inclined to think, as I was, and a lot of other fellows thought the same way, and he dropped it right there, and it never came to a vote.

Later, at another meeting, at which I did not attend, there was another resolution presented by a gentleman. Mr. Treen, have you got a copy of it? I do not have my glasses on, and I am going to ask the secretary to read that resolution.

Mr. TREEN. This resolution, Senators, was passed by the National Manufacturers Association executive committee:

> The National Lumber Manufacturers Association will seek the continuance of the lumber excise tax; as stated in its original application on the Canadian trade agreement early in 1935, it has no objection to exemption from the tax of the three species there mentioned, namely, northern white and Norway pine and western white spruce; it is understood that the association itself assumes no responsibility regarding any such exemption and that the effort to secure it is the responsibility of interested parties; further, that to this position the National Lumber Manufacturers Association asks the adherence of the federated associations.

Mr. FARRELL. That is right.

Senator KING. You do not get comfort out of that resolution, do you?

Mr. TREEN. No. The onus is thrown back on us on that.

The CHAIRMAN. It mentions the interested parties there. In other sections other people may have been interested in this proposition because it was coming in competition with their species of lumber; is that true?

Mr. TREEN. That is true.

The CHAIRMAN. Is Mr. Compton in the audience? He was to be heard on lumber, and I thought while we had this matter up it might be well to have him here too.

I have already told the out-of-town people that we would not hear those which are the town people today.

Senator KING. Have you seen the maps, charts, and plats submitted by the Forest Service covering practically the whole United States, showing the devastation by you lumbermen—or, I beg your pardon, the lumber interests, as to the affairs of the forests of the United States, and the sequel of it is if this devastation continues pretty soon we will have no timber.

Mr. FARRELL. I have seen those maps, Senator.

Senator KING. Do you question them?

Mr. FARRELL. Like all the rest of those things, I sometimes think they are a little bit hysterical, and sometimes I think they are a little bit overdrawn. I am not here to question them.

I am a member of this conservation committee. I believe thoroughly in the theory of conservation. I believe thoroughly in the philosophy of land use. I believe we should protect our land forests.

I want to say at this time, if I may, that I believe, generally speaking, responsible lumbermen believe the same way I do. I do not see why they would not. Of course they are limited by being practical. They are limited by their pocketbooks as to what they can do. They have got taxes to pay and insurance to meet and other things. They have all of these things to pay.

Senator BROWN. I am glad you mentioned that subject of taxes. Is it not a fact that the tax policies of the States were a material factor in compelling the lumbermen to cut as they have? Have you in New York now what you call a severance tax?

Mr. FARRELL. No; we have not.

Senator BROWN. We have in Michigan, which I think has been very, very helpful.

Mr. FARRELL. I think so, too.

Senator BROWN. In other words, you pay no tax until you cut the timber.

Mr. FARRELL. In further answering your question, Senator, I think the lumbermen of our State are just as high a type as anybody.

Senator KING. There is no doubt about it.

Mr. FARRELL. When the time comes to do what they can within the limits of their pocketbooks. And when they get the tax situation straightened out I think it will be helpful.

Oftentimes the timber operator, as the Senator spoke, has to get money to pay taxes or else lose his land. It is a big question.

The CHAIRMAN. It will be approached and done probably after all the timber is gone. That is what happened in my State, Senator.

Mr. FARRELL. I do not think so, Senator.

The CHAIRMAN. We did not get a severance tax like some of these other States until after the timber was gone.

Mr. FARRELL. I want to say this in answer to your question, as coming from the northeast, that the records show, as has been brought out before, that the drain of timber, including pests, cutting, and fire does not exceed the growth, and I think the records, the same thing about which you spoke, show that.

Senator KING. We have in the West, places where mines have been exhausted. I have been in sections where there formerly was a lot of timber and now they are ghost cities. I think we have been profligate in destroying timber and that we will have to pay for it in the coming generations.

Mr. FARRELL. Yes. And you can amend that by saying that we have been profligate as to destroying all resources.

The CHAIRMAN. All right, Mr. Treen.

Mr. TREEN. I have no others to speak.

Mr. Deering operates upon a river and he tells me they are cutting no timber smaller than 8-inch top. That leaves other good stuff which they can go on later. Those pictures which I have left up there indicate that very conclusively.

STATEMENT OF HON. JAMES E. MURRAY, A UNITED STATES SENATOR FROM MONTANA—Continued

Senator MURRAY. Mr. Chairman, I have listened with a great deal of interest to the statements of the witnesses preceding me with reference to the pines referred to.

I am not able to say anything with authority as to northern pine, Norway pine, or western white spruce, but I do wish to say something with regard to Engelmann's spruce. We have an immense amount of Engelmann's spruce in our State and it is a very important industry, and we are very anxious to have the excise tax retained on it.

Engelmann's spruce, according to information that I get from the lumber people of my State, is in plentiful supply. Protection on lumber of this kind from foreign competition should be provided.

Senator WALSH. Was that lumber introduced and included on the floor of the House?

Senator MURRAY. Yes.

Senator WALSH. And the others were recommended by the committee?

Senator MURRAY. Yes. And it was put on without any study of the situation on the floor of the House, which goes to corroborate my idea that it should not be included.

Montana and the other Rocky Mountain States are very greatly interested in this. We produce more than 12,000,000 feet of Engelmann's spruce in Montana every year.

The imported Engelmann's spruce is estimated at 80,000,000 feet. The lumber interests of our Montana mills compete directly with that spruce. This may not be true with reference to the other species mentioned here, but my information with regard to these other species is that they are not produced in such quantities as to make it necessary that the excise tax should be retained on them.

There is an enormous amount of Engelmann's spruce timber in this country, not only to fill present requirements, but to take care of our needs far into the future.

Section (c) of the pending revenue bill provides for the exemption of northern white pine, Norway pine, Engelmann's spruce, and western white spruce lumber from the import excise tax which was originally enacted in the Revenue Act of 1932.

The domestic lumber industry, through the National Lumber Manufacturers Association, has stated that it does not object to the exemption from the tax of three of these species of lumber—northern white pine, Norway pine, and western white spruce; to the fourth, Engelmann's spruce, they do offer objections. The Western Pine Association, to which the lumber manufacturers of Montana belong, is one of the constituent members of the National Lumber Manufacturers' Association and takes the same position. They base this position upon their belief that reasonable and effective protective tariffs should be maintained only on those kinds of imported lumber which are plentiful in the United States.

Northern white pine, Norway pine, and western white spruce are not in plentiful supply in the United States, and the domestic industry, including the lumber industry of my State, has stated that it does not object to their exemption from the excise tax. Engel-

mann's spruce, on the other hand, is in plentiful supply, and import protection on lumber of this kind not only is highly desirable but is a real necessity. Montana and the other Rocky Mountain States are particularly interested in this matter. We produce more than 12,000,000 feet of Engelmann's spruce lumber in Montana every year. The imported Engelmann's spruce lumber, estimated at 80,000,000 feet, enters the markets of our Montana mills and competes directly with our own production. The same is not true of the other three species which it is proposed to exempt.

There is plenty of Engelmann's spruce timber in this country, not only to fill present requirements, but to take care of our needs far into the future. The Forest Service has estimated that there is in excess of 49,000,000,000 feet of Engelmann's spruce in the States of Montana, Colorado, Wyoming, Idaho, South Dakota, Utah, New Mexico, Arizona, Washington, Oregon, and California.

At the current rate of cutting, this virgin timber supply alone will last several hundred years, making proper allowance for regrowth the supply is perpetual. Being in such tremendous surplus supply, Engelmann's spruce offers a fundamentally different tariff problem than northern white pine, Norway pine, and western white spruce. The virgin-timber supply of these latter three species is almost exhausted. Imports are not undesirable, as there is a substantial domestic demand for wood of their peculiar qualities. The imports do not compete in any substantial way with the relatively small remaining domestic production.

The exemption of these three species as provided in section 705 (c) is reasonable and is largely noncontroversial. The inclusion of Engelmann's spruce in the exemption is unreasonable and highly controversial. It opens the entire subject of lumber tariff protection at a most inappropriate time.

The lumber industry has taken a very moderate position on the tariff. They have asked that tariff protection should be continued only where the competition is keen and direct. They have said that they have no objection to free entry of lumber, which, while competitive in a general way, is not subject to such direct and keen competition. It is reasonable, therefore, to ask that the words "Englemann's spruce" be stricken from section 705 (c) of the bill. It was inserted on the floor of the House after an extensive hearing before the Ways and Means Committee failed to justify its inclusion in the proposed exemption.

The CHAIRMAN. Where else do you find this Engelmann's spruce?

Senator MURRAY. In these other States, including Colorado and Wyoming.

The CHAIRMAN. I mean you find it mostly in the Rocky Mountain region?

Senator MURRAY. Yes; you find it mostly in the Rocky Mountain region.

The CHAIRMAN. And there is none found in Minnesota, Michigan, and in that section?

Senator MURRAY. According to my information that is true.

The CHAIRMAN. What is the attitude of the National Lumbermen's Association on this proposition?

Senator MURRAY. They recognize the fact that Engelmann's spruce is produced in this country in enormous quantities, and it is in

competition with the Canadian lumber, and if the excise tax is removed it would likely destroy the lumber industry so far as our State of Montana is concerned and the other States that are engaged in it.

My understanding also is that it is not cut in such quantities as to be any menace to the forest reserves of the country. As a matter of fact, the damages in Montana and in the Rocky Mountain area generally, I believe have been largely due to fires, and not to denuding the forests by the lumber industry. In my State great advances have been made in the protection and preservation of timber through the Forestry Department, and the C. C. C. camps have done a tremendous amount of work out there during the last year or two, and we anticipate that there will be much less damage done to our timber as has occurred in the past.

Senator BROWN. How big a tree is the Engelmann's spruce; from 12 inches or so about?

Senator MURRAY. I think something like that. It is not a large tree.

Senator BROWN. It is not used for pulpwood principally?

Senator MURRAY. No; not in my State.

Senator BROWN. We do not have that type in our State. It is largely pulpwood that we have, and a few very good ones are used for spars, poles, and things of that kind.

Senator KING. Where do the Rocky Mountain States find a market for spruce or lumber?

Senator MURRAY. They find it to a considerable extent right in the Rocky Mountain area, and also of course it is shipped out of there to the other States, but I think the most of it is used right in the western area. At least that is my understanding of that. I would not be able to absolutely verify that. But I do know that it is produced in enormous quantities there, and if this excise tax should be removed it would greatly endanger that business. And you can see from the quantity that is cut there that it is an important industry and employs a great many men and would result in some considerable unemployment.

I believe that in view of the fact that it was not intended by the committee that this Englemann's spruce should have the excise tax removed and that the amendment was put in on the floor without any thought or consideration that it ought to be exempted now in this committee.

Senator BROWN. Is your attitude any different on the western white spruce in here?

Senator MURRAY. My understanding is with reference to that that we do not have that in enormous quantities.

Senator BROWN. You are not particularly interested?

Senator MURRAY. I am not. I believe from the men who have spoken here before that with reference to that lumber it would be advisable to—I mean to say with reference to the National Lumbermen's Association——

Senator BROWN (interposing). To take off the tariff?

Senator MURRAY. Yes; to take it off on that.

The CHAIRMAN. There seems to be no objection raised yet as to the western white spruce then.

Senator MURRAY. No; not so far as I know.

Senator BROWN. Probably we have not any material quantity.

Senator MURRAY. Thank you.

The CHAIRMAN. Thank you very much, Senator.

If you have any further data in your brief you can file it.

Is there anyone else on the lumber business that we have not heard who was on this calendar?

Is Mr. R. C. Winton here? Mr. Winton does not seem to be here.

Senator WALSH. I saw him come in a few moments ago.

The CHAIRMAN. Is Mr. Winton in the audience?

Senator WALSH. Yes; come forward, Mr. Winton.

The CHAIRMAN. All right; Mr. Winton, you are from Minnesota?

STATEMENT OF R. C. WINTON, PRESIDENT OF THE WINTON LUMBER SALES CO., OF MINNEAPOLIS, MINN.

Mr. WINTON. My name is Robert C. Winton. I am president of the Winton Lumber Sales Co., of Minneapolis, Minn. I am also director of the Winton Lumber Co., operating at Gibbs, Idaho, and of The Pas Lumber Co., at The Pas, Manitoba. I represent also Shevlin-Hixon Co., with sawmills at Bend, Oreg; the Monarch Lumber Co., at Great Falls, Mont.; and Shevlin, Carpenter & Clarke Co. and Shevlin Pine Sales Co., at Minneapolis, Minn.

As director of the national association, I appear in support of the position taken by that association in support of section 705 (c) of the revenue bill, which provides for the removal of the excise tax on northern white pine, Norway pine, and western white spruce.

The CHAIRMAN. You say as director of the National Lumbermen's Association?

Mr. WINTON. Yes.

The CHAIRMAN. What do you say as to this resolution which was read here a few moments ago?

Mr. WINTON. I did not hear it.

The CHAIRMAN. The resolution in substance was not in accord with the adequacy of this provision.

Mr. WINTON. The association must have been misquoted, because I am on the executive committee of that association and I have talked recently with the secretary, who is on his way here and whom I thought would speak on this point. They are not opposed to the exemption of these three species. Over 98 percent of the membership of that association, which comprises over 1,000 sawmills and employs about a half a million men, are on record on that. And there are 12 or 15 constituent associations in favor of this matter.

In view of the limited time allotted to me, I shall not be able to cover in detail much of the data I have assembled. I shall, however, leave with members of the committee the copies for their information and request that it be printed in the record.

The CHAIRMAN. I want to say that I am corrected. The witness stated at one meeting he opposed the proposition and that it did not pass, but Senator Brown tells me that at a subsequent meeting it did pass where he was not present.

Senator BROWN. That is right.

Mr. WINTON. Yes, Senator; we have taken that thing up many times since and each time have confirmed that position, excepting one association in the Northeast, which only produces about 1.2 percent of our lumber.

I have had 20 years' experience in the lumber business—for 5 years I worked in the woods and sawmills; for about 15 years I have been in charge of our sales. I just want to touch the high points as to the position we have.

The CHAIRMAN. Did your plant in Ontario handle——

Mr. WINTON (interposing). Our plant is not in Ontario, but I represent a company in Ontario. Our plant is in Manitoba, Canada.

The CHAIRMAN. Does that plant and the one you represent in Ontario handle the white pine of Canada, or the Norway pine?

Mr. WINTON. Yes, sir. The plant in Ontario handles white pine and northern pine.

Our plant in Manitoba handles western white spruce.

Senator BROWN. Is this Fort Frances plant just north of Vermont?

Mr. WINTON. No; it is many hundred miles. It must be 1,500 or 1,800 miles west of Vermont, right north of Minneapolis.

Senator BROWN. All right.

Mr. WINTON. And it has very little to do with the New England market.

Senator WALSH. Is most of this lumber imported into New England from Canada?

Mr. WINTON. As to the species I am familiar with, there is practically none of our white spruce that goes into New England, and I believe almost no white pine goes into New England from those mills which I represent.

Senator WALSH. What does go into New England of these four?

Mr. WINTON. New England is only able to produce about 20 percent of the lumber it consumes. Eighty percent has to be brought in from somewhere else, mostly from other States. But the United States supplies of these species are not enough.

As to the total lumber that is imported from Canada by Northeastern States—including New York and Pennsylvania—only 6 percent of their total imports comes from Canada. As a matter of fact, the largest lumber-producing State in the East—Maine—exports more lumber than she imports.

The CHAIRMAN. Of the same kind?

Mr. WINTON. I have the figures here.

Senator WALSH. Of the same kind it imports?

Mr. WINTON. This is of all kinds of lumber. I have not broken those figures down, but I can do it.

Senator KING. Then we are exporting lumber to Canada?

Mr. WINTON. New England is exporting lumber to Canada. She wants it both ways.

Senator KING. She is exporting more than importing from Canada?

Mr. WINTON. It seems to me that is true. That might not be true of the whole of New England, but that is true of the State of Maine. The National Retail Lumber Manufacturers' Association also has asked for an exemption of these three species, and they have about 25,000 members scattered all over the United States.

I am here to express the hope that this committee will concur in the vote of the House Ways and Means Committee and in the vote of the House, whereby the removal of the excise tax on northern white pine, Norway pine, and western white spruce has been provided for in section 705 (c).

As reasons for urging the exemption of these woods from the excise tax, I submit the following:

First. There is practically united endorsement of the lumber industry. The exemption of these three species is recommended by (*a*) the National Lumber Manufacturers' Association who endorse the exemption—and they represent 1,000 sawmills and 300,000 to 500,000 employees throughout the United States—because they have found these species are relatively scarce and commercially nonexistent in the United States; and by (*b*) the National Retail Lumber Dealers' Association who endorse it—and they consist of about 25,000 United States retail dealers—because of material benefit to consumers, dealers, and Government alike, in view of the new housing program and contemplated expansion in Navy building, where these special woods are largely used.

Second. Next, the favorable recommendations of the Government department. Both the State and Treasury Departments have stated that they have no objection to the removal of the excise tax on these three species.

Third. The Tariff Commission made investigations in 1936 and found that—

1. The forests have been depleted of these three species in the United States, and therefore imports must be made to supplement inadequate domestic supplies.
2. In uses where highest quality is a primary consideration imports are demanded in preference to other species of domestic woods.
3. These high-grade imports do not compete with the low grades of the same species.
4. If imports were greatly cut down the consumers would have to substitute other less desired woods.

In view of the fact that these forests are being depleted, as the Tariff Commission finds, these imports should be allowed to come in without penalty. It is a crime to deplete entirely our remaining stands of these woods when they can be to an extent conserved if more imports are permitted.

Senator KING. Pardon me. When was that report made by the Tariff Commission?

Mr. WINTON. In 1936. I will furnish you with excerpts from their report.

Senator WALSH. Is that in your brief?

Mr. WINTON. I can get those.

Senator KING. Is it in your brief, the Senator asked you.

Mr. WINTON. Yes, sir.

Senator KING. Those excerpts?

Mr. WINTON. Yes, sir. I could give you fuller ones. but I think you will find them sufficient.

Fourth. Imports bear a small ratio to United States production. The total imports of all kinds of spruce and pine from Canada in 1937 amounted to only 1.1 percent of the total American lumber production in 1937.

Fifth. The revenue involved is insignificant. It is estimated from Tariff Commission figures that only about $145,000 in excise tax was collected on Canadian imports of these three species of lumber in 1936, the last year for which figures are available.

Sixth. The opposition is negligible. The only opposition registered to removal of the excise tax on these three species is from the Northeastern Lumber Manufacturers' Association, representing a

region which produces but 1.2 percent of the total United States lumber production.

(*a*) The Northeastern States (New England, New York, and Pennsylvania) produce only 20 percent of the lumber they consume. So they must ship in 80 percent of the lumber they require for their own consumption.

(*b*) As a matter of fact, the total lumber imported from Canada by the northeastern States amounts to only 5 percent of the total northeastern consumption. Maine actually exports to Canada more lumber than she imports from Canada.

Seventh. Answers to opposition's contentions:

(*a*) They have claimed that "50,000 men are employed in the northeastern lumber operations." If that be true, then, on the basis of their production, it would take over 4,000,000 men to produce the entire lumber output of the United States—whereas we know that, at the most, 500,000 men do the work.

In fairly efficient lumber operations with which I am familiar, in other States, only 5,000 to 7,000 men would be required to produce the amount of lumber which the Northeast claims it takes them 50,000 men to produce.

(*b*) Wages paid, United States and Canada: It is alleged that sawmill wages in the New England States are 30 to 50 cents per hour, and 17 to 25 cents per hour in Canada. I have here wage schedules paid at sawmills and planing mills at Fort Frances, Ontario, and The Pas, Manitoba, where northern white pine and western white spruce are produced, respectively. I shall file these wage schedules with the committee. Now, I wish to point out that the wage scales indicate higher wages are paid in the Canadian mills than the alleged scale of 30 to 50 cents per hour paid in the Northeastern States. The Canadian wages run from 35 cents to $2.15 per hour.

Senator KING. Why such a disparity?

Mr. WINTON. It depends on the job. That is, the schedule of wages paid in the mill from the common laborer up to the millwrights.

Senator DAVIS. How many are getting $2 an hour?

Mr. WINTON. I said $2.15. There are only three or four of them out of 45 or 50.

Senator KING. Those of the higher technique.

Mr. WINTON. Yes. And if you average the thing up you will find wages are much higher in the mills I represent——

Senator KING (interposing). That is the mills in Canada?

Mr. WINTON. That is the mills in Canada are higher than in the Northeastern States.

(*c*) Stumpage costs: The Northeastern Association has contended that stumpage prices for northern white pine in the New England States are much higher than those in Canada.

According to United States Forest Service figures, stumpage prices for northern white pine in the New England States, in 1934, averaged $5.37 for 1,000 feet.

According to Department of Lands and Forests, Ontario, the cost of Canadian stumpage for the same year was about $5.77 per 1,000 feet.

Eighth. No administrative difficulties: With respect to administering this section, I should like to state that experts of the Customs Bureau have given the matter considerable attention and agree that there will be no difficulty in distinguishing the species of wood exempted from the excise tax.

I understand the procedure will be for the Customs Bureau to ask the State Department to have consular invoices issued on the lumber, and these invoices will contain a description of the species and the point in Canada from which it is being shipped into the United States.

Conclusion: I hope, therefore, that the Finance Committee and the Senate may retain in the revenue bill this section 705 insofar as it provides for the removal of the excise tax from northern white pine, Norway pine, and western white spruce.

Senator KING. Senator, when I was running a sawmill we paid a sawyer $100 a month; the other $75. There is that disparity between a sawyer and the others. The sawyer and the engineer get more than the others.

Senator VANDENBERG. You have not said anything about Englemann spruce?

Mr. WINTON. No, sir. I have not said anything about Englemann spruce because the position of the National Lumber Manufacturers' Association is that it is in opposition to removing the excise tax from Englemann spruce. The opposition is based on the large residual stand remaining of Englemann spruce in this country.

There is somewhere between 48 and 50 billion feet, according to the Forest Service, of that species, and if we keep on cutting at the rate we are doing, we will never get through cutting. The position of the National Association is that they are not for protection of species in scant supply. These are the three that I have mentioned. They are in scant supply.

Senator VANDENBERG. You would leave the tax on Engelmann's spruce?

Mr. WINTON. That is the position of the National Lumber Manufacturers' Association.

Senator VANDENBERG. That is your position?

Mr. WINTON. That is the position I take, too.

(The brief referred to by Mr. Winton is as follows:)

BRIEF

PRESENT UNITED STATES TARIFF AND EXCISE TAX ON IMPORTS OF NORTHERN WHITE PINE, NORWAY PINE, AND WESTERN WHITE SPRUCE LUMBER

Tariff.—Lumber of the species named in paragraph 401 of the Tariff Act of 1930, viz, fir, spruce, pine, hemlock, and larch, has been dutiable at $1 per thousand feet since the enactment of the 1930 act.

Excise tax.—In addition, this lumber was made subject to a revenue tax of $3 per thousand feet by the Revenue Act of 1932, whereby the Congress imposed excise taxes upon lumber and certain other articles, such taxes being in addition to any other tax or duty already imposed by law.

Thus, the total tariff and excise tax on imports of northern white pine, Norway pine, and western white spruce amounted to $4 per thousand feet until the reciprocal trade agreement was entered into with Canada.

Canadian trade agreement.—By this agreement, effective January 1, 1936, the duty on lumber described in paragraph 401 above was reduced from $1 to 50

cents per thousand feet, and the excise tax imposed under the Revenue Act of 1932 was reduced from $3 to $1.50. Hence, under the agreement, the total tariff and excise tax upon lumber imports from Canada of the three species named, has been $2 per thousand feet on northern white pine, Norway pine, and western white spruce.

MEMORANDUM IN RE: EXEMPTION OF NORTHERN WHITE PINE, NORWAY PINE, AND WESTERN WHITE SPRUCE FROM IMPORT EXCISE TAX

Reasons of Support of Section 705 (c) of H. R. 9682

SUMMARY

(1) *United endorsement of the lumber industry.*—The exemption of these three species is recommended by:

(a) The National Lumber Manufacturers Association (1,000 sawmills and 300,000 to 500,000 employees throughout the United States), because these species are relatively scarce and commercially nonexistent in the United States; and by

(b) The National Retail Lumber Dealers Association (consisting of about 25,000 United States retail dealers), because of material benefit to consumers, dealers, and Government alike, in view of the new housing program and contemplated expansion in Navy building, where these special woods are largely used.

(2) *Favorable recommendations of the Government Departments.*—Both the State and Treasury Departments have stated that they have no objection to the removal of the excise tax on these three species.

(3) *Tariff Commission investigations* (in 1936) found that:

(a) The forests have been depleted of these three species in the United States, and therefore imports must be made to supplement inadequate domestic supplies.

(b) In uses where highest quality is a primary consideration, imports are demanded in preference to other species of domestic woods.

(c) These high-grade imports do not compete with the low grades of the same species.

(d) If imports were greatly cut down, the consumers would have to substitute the other less desired woods.

(4) *Imports bear small ratio to United States production.*—The total imports of all kinds of spruce and pine from Canada in 1937 amounted to only 1.1 percent of the total United States lumber production in 1937.

(5) *Revenue involved is insignificant.*—It is estimated from Tariff Commission figures that only about $145,000 in excise tax was collected on Canadian imports of these three species of lumber in 1936.

(6) *Opposition is negligible.*—The only opposition registered to removal of the excise tax on these three species is from the Northeastern Lumber Manufacturers Association, representing a region which produces but 1.2 percent of the total United States lumber production.

(a) The Northeastern States (New England, New York, and Pennsylvania) produce only 20 percent of the lumber they consume. Therefore, they must import 80 percent of the lumber they require for consumption.

(b) The total lumber imported from Canada by the Northeastern States amounts to only 6 percent of the total northeastern consumption. Maine actually exports to Canada more lumber than she imports from Canada.

(7) *Answers to opposition's contentions.*—

(a) *Men employed.*—It is claimed that 50,000 men are employed in the northeastern lumber operations.

Actually, in very efficient lumber operations in other States, only 5,000 to 7,000 men would be required to produce such an amount of lumber as the Northeast produces.

(b) *Wages paid, United States and Canada.*—It is alleged that sawmill wages in the New England States are 30 to 50 cents per hour, and 17 to 25 cents per hour in Canada.

Wage schedules filed with the Finance Committee show Canadian wages running from 35 cents to $2.15 per hour.

(c) *Stumpage costs.*—The Northeastern Association has contended that stumpage prices for northern white pine in the New England States are much higher than those in Canada.

According to United States Forest Service figures, stumpage prices for northern white pine in the New England States in 1934 averaged $5.35 per 1,000 feet.

According to the Department of Lands and Forests, Ontario, the cost of Canadian stumpage for the same year was about $5.77 per 1,000 feet—and to this must be added freight rates into the United States, running from $8.66 to $11 per 1,000 feet.

FAVORABLE RECOMMENDATIONS OF THE LUMBER INDUSTRY

United endorsement of the lumber industry.—Practically the entire United States lumber industry have urged the Senate and House to exempt northern white pine, Norway pine, and western white spruce from the excise tax.

(1) The National Lumber Manufacturers' Association, representing practically all lumber producers and manufacturers (1,000 sawmills and from 300,000 to 500,000 employees throughout the United States) have gone on record with the Finance Committee on behalf of such exemptions. (See attached excerpts.)

The following associations [1] comprise the National Association:

West Coast Lumbermen's Association.
Western Pine Association.
Southern Pine Association.
Southern Hardwood Producers, Inc.
Southern Cypress Manufacturers' Association.
California Redwood Association.
Northern Pine Association.
Veneer Association.
Northern Hemlock and Hardwood Manufacturers' Association.
Maple Flooring Manufacturers' Association.
American Walnut Manufacturers' Association.
Appalachian Hardwood Manufacturers, Inc.
Douglas Fir Plywood Association.
Mahogany Association, Inc.

(2) The National Retail Lumber Dealers' Association, consisting of about 25,000 retail lumber dealers in the United States, endorse the amendment to exempt the three species from the excise tax, and have urged the Senate Finance Committee to adopt the amendment. (See endorsement attached.)

RECOMMENDATIONS OF THE GOVERNMENT DEPARTMENTS

(1) The State Department recommended:

"There would, of course, be no objection from the viewpoint of the trade agreement with Canada to the removal of the import tax on northern white pine, Norway pine, and western white spruce."

(2) The Treasury Department has recommended:

"The proposed legislation (i. e. to exempt the three species from the excise tax) is not in conflict with the President's program."

EXCERPTS FROM RECOMMENDATIONS OF THE NATIONAL LUMBER MANUFACTURERS' ASSOCIATION TO THE SENATE FINANCE COMMITTEE

(The association represents 1,000 sawmills and from 300,000 to 500,000 employees)

(1) *Favoring repeal of the excise tax on northern white pine, Norway pine, and western white spruce*—

The National Lumber Manufacturers' Association, since 1935, has recommended:

"with respect to species of lumber relatively scarce or commercially nonexistent in the United State, i. e., northern white pine, Norway pine, and western white spruce, that the import duties and taxes be reduced to the extent which the law permits.

[1] The Northeastern Lumber Manufacturers' Association, also a member of the National Association, is the only dissenting association. It represents the northeastern region, which produces only 1.2 percent of the total United States lumber production.

"The exemption of northern white and Norway pine and western white spruce is reasonable and largely noncontroversial."

(2) *Opposing repeal of the excise tax on Engelmann's spruce*—

The National Association has asked that:

"reasonable and effective protective tariffs be maintained on imported lumber of species in surplus supply in the United States, and on imported lumber directly supplanting lumber of species in surplus supply in the United States.

"The Ways and Means Committee bill recommended the exemption from the tax of the three species above mentioned. The House by amendment added Engelmann's spruce. "This additional exemption is undesirable. Engelmann's spruce is available in this country in large surplus timber supply. It is plentiful in Montana, Colorado, Wyoming, Idaho, South Dakota, New Mexico, Arizona, and in Washington, Oregon, and California.

"The Forest Service estimates the timber supply (of Engelmann's spruce) as in excess of 49 billion feet. The market for its products is limited. At current rate of cutting, the virgin lumber supply alone of Engelmann's spruce is sufficient for several hundred years.

"It is distinctly a surplus species. In that respect it is fundamentally different from northern white and Norway pine and western white spruce, of which the virgin timber supply in the United States is almost exhausted. * * *

"The annual domestic production of western white spruce lumber is less than 2 million feet, and of Engelmann's spruce 40 million. * * *

"The exemption of Engelmann's spruce for the reasons stated is unreasonable and highly controversial."

(3) *Conclusion*—

"This reasonable position of asking protection for surplus species where it is needed, but of not asking protection for scarce species where it is not needed, now has general support throughout the industry. * * *

"To the exemption of the scarce woods, northern white pine, Norway pine, and western white spruce lumber from this tax, we have no objection. Engelmann's spruce, however, is in large timber surplus in this country. The proposal to exempt it raises entirely different issues involving the merits of the entire lumber tariff.

"We urge that the committee eliminate the words 'Engelmann's spruce' from section 705 (c) of the bill."

FAVORABLE ENDORSEMENT OF NATIONAL RETAIL LUMBER DEALERS' ASSOCIATION

(Representing 25,000 retail lumber dealers)

WASHINGTON, D. C., *March 14, 1938.*

Hon. PAT HARRISON,
Chairman, Senate Finance Committee, Washington, D. C.

DEAR SENATOR HARRISON: On behalf of the National Retail Lumber Dealers' Association, representing retail lumber dealers all over the United States, we wish to join with the National Lumber Manufacturers' Association in urging the retention of section 705 (c) in H. R. 7518, which section exempts northern white pine, Norway pine, and western white spruce from the excise tax of $3 per thousand feet, as provided by the Revenue Act of 1932.

Hearings were held upon this provision by the House Ways and Means Committee, which subsequently reported it favorably to the House. Last week the House voted its approval of this exemption, which is recommended by practically the entire lumber industry.

Both the State and Treasury Departments have no objections to the exemption of this lumber from the excise tax.

These three species of lumber are specialty woods, and since their supply in this country has been depleted, as studies from the Tariff Commission definitely indicate, American dealers have been compelled to import their supplies from Canada. By reason of the trade agreement with Canada, we are now enjoying a reduction in the excise tax on lumber from $3 per thousand feet to $1.50.

The total excise taxes collected on these three species in 1936 were approximately $145,000, so that the revenue now realized is insignificant as compared with the penalty which is imposed upon American consumers.

In view of the new housing program sponsored by the administration, as well as the contemplated expansion in Navy building, it is our belief that the removal of the excise tax entirely upon these species of wood will materially benefit consumers, dealers, and the Government alike. It is hoped, therefore, that the lumber provision may be retained by your committee in the pending revenue bill.

Very truly yours,

NATIONAL RETAIL LUMBER DEALERS' ASSOCIATION,
FRANK CARNAHAN, *Secretary*.

TARIFF COMMISSION FINDINGS INDICATE NEED FOR REMOVING THE EXCISE TAX FROM NORTHERN WHITE PINE, NORWAY PINE, AND WESTERN WHITE SPRUCE

(Excerpts from U. S. Tariff Commission, Supplemental Report, entitled "Concessions Granted by the United States in the Trade Agreement With Canada," published 1936)

(1) DEPLETION OF NORTHERN WHITE PINE AND SPRUCE

There is definitely an exhaustion in supply of the better grades of this lumber in the United States, as is substantiated by conclusions of the Tariff Commission in a study made of United States growth, production, and imports of these species. In its report [1] in 1936, the Commission, in discussing the production of lumber in the United States, made the following statement (p. 91):

"The United States has extensive forest resources of softwood species. In the case of northern pine, however, the forests have been depleted to the extent that virgin stands are scarce, and the United States is behind Canada in timber from which a higher percentage of the better grade of lumber can be produced. The same is true in a smaller degree of eastern spruce. The condition with respect to these two species is connected with the fact that with the growth of population, the timber resources of the older regions have been depleted and production of lumber has moved southward and westward."

The report proceeds to point out that the largest producing areas—the North Pacific States and the Southern States—are far removed from the principal consuming area, the northeastern region (which is composed of the Middle Atlantic and the New England States); and these large producing areas have no objection to the exemption of just these three species from the tariff and excise tax.

The larger lumber-consuming States produce only a small percentage of the lumber required in their industries and necessary for local consumption. Their only recourse thus is to import lumber from other States. In the case of those species which are depleted in this country (such as northern white pine, Norway pine, and western white spruce), and which are necessary for local industries, imports must come from Canada.

(2) IMPORTS ARE SUPPLEMENTAL AND PREFERRED

In its discussion of the different species of wood now imported into the United States from Canada, the Tariff Commission, in the same report (p. 96), states:

"Grades of imported northern white pine are similar to northern white pine produced in the Lake States, but the New England product, cut from the remaining inferior stands, contains a much higher percent of the low grades. Because of the relative scarcity of domestic northern white pine through forest depletion, therefore, imports may be said to be largely supplemental. In uses where highest quality is a primary consideration, imported and Lake States white pine is demanded in preference to other species of domestic pines, such as Idaho white pine and sugar pine, which to some extent are used for similar purposes. Substantial quantities are dressed before importation, but more than half of the pine lumber imported is rough.

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[1] Concessions granted by the United States in the Trade Agreement with Canada. Washington, 1936.

"Imported spruce is chiefly eastern spruce which enters the New England and New York markets. In New York it is chiefly used for scaffolding, furring, and industrial uses. In New England it has become established by long use as a wood for more general purposes. Much of the spruce from Canada is imported in the rough and is dressed or otherwise worked in domestic mills after importation."

In connection with the above statement with respect to imported spruce, it should be noted that western white spruce does not enter into the New York and New England markets.

(3) COMPETITIVE CONDITIONS

In its treatment of competitive conditions in the lumber markets of the world the Tariff Commission (p. 105) reported:

"*Spruce and white pine.*—Competitive conditions with respect to spruce and white pine, the principal species imported from eastern and central Canada, are quite different than for Douglas fir imported from British Columbia. High-grade white pine has special uses. The stand of white pine of such grade in the United States has been greatly depleted and imports are supplemental to inadequate domestic supplies. The imports do not compete with the low grades of white pine.

"New England and New York formerly had large stands of spruce and local consumers have acquired a preference for that species, especially in New England. These stands are now inadequate to supply domestic requirements. If imports were greatly cut down the consumers would have to substitute other less desired domestic woods."

UNITED STATES PRODUCTION AND IMPORTS, SAWED TIMBER AND LUMBER, SOFTWOODS, 1931–37

Year	United States production [1]	Imports from Canada [2]		Ratio of imports of spruce and pine to United States production
		Spruce [3]	Pine [4]	
	Board feet	*Board feet*	*Board feet*	*Percent*
1931	13,851,951,000	111,244,000	40,535,000	1.08
1932	8,745,636,000	90,818,000	43,114,000	1.5
1933	11,898,873,000	146,435,000	102,626,000	2.09
1934	12,735,358,000	124,088,000	86,959,000	1.6
1935	16,247,981,000	153,653,000	82,785,000	1.4
1936	20,241,731,000	252,380,000	82,989,000	1.6
1937	20,495,000,000	260,742,000	75,017,000	1.1

[1] Production figures are taken from U. S. Tariff Commission report, "Imports, Exports, Domestic Production and Prices," published May 1937. The 1937 production figures are estimates of the National Lumber Manufacturers Association.

[2] Canada supplies in excess of 90 percent of total imports of softwood lumber and timber. These import figures are taken from "Foreign Commerce and Navigation of the United States" for 1931-37, printed by Bureau of Foreign and Domestic Commerce.

[3] Spruce imports, according to the Tariff Commission, are almost wholly of eastern species, which substantiates the allegation that western white spruce (which is exempted under the pending revenue bill) is only about one-fifth of the spruce imported.

[4] Pine imports include jack and Norway, so that the percentage of northern white pine and Norway pine (the species exempted) to the United States production is even less than indicated above, year by year.

REVENUE INVOLVED IN SECTION 705 (c) IS INFINITESIMAL

The amount of revenue involved by exempting northern white pine, Norway pine, and western white spruce from the excise tax of $3 per thousand feet is infinitesimal, as reference to a recent report of the United States Tariff Commission indicates.

The total gross revenue collected, in 1936, by the United States from tariff duties, including import excise taxes, was $400,558,000.[5]

[5] See p. V, United States Tariff Commission's Report, entitled "Imports, Exports, Domestic Production, and Prices," published May 1937.

Of this amount only $945,950—just 2.33 percent of the total gross revenue from import excise taxes—was collected on all imported lumber.

And since the revenue collected from the three species for which exemption is provided by section 705 (c) of H. R. 9682 are but a small part of that $945,950 collected on all imported lumber, it is obvious that the revenues involved are negligible in comparison with the gross revenues collected.

The exact amount realized from the importation of the three species is difficult to determine. Even if one used the estimate—said to be a fair approximation—that a total of $145,000 was collected on these three species, it is apparent that only about one-sixth of the revenues collected on imported lumber—that is, one-sixth of the 2.33 percent of the total gross revenues—accrues from those three species.

And it is expected that what revenue might be lost to the United States by reason of the exemption from the excise taxes of these three species would be largely offset by the increase in revenues which would result from the collection of additional duties under section 705 (a) of the bill, which prohibits any deduction being made, when estimating board measure, on account of planing, tonguing, and grooving. The collection of the excise taxes, as well as the tariff duty, on the rough, green lumber measurement of imported lumber and the continuance of the tax upon timber, together should yield sufficient assessments to offset any losses of revenue resulting from the exemption of northern white pine, Norway pine, and western white spruce.

NEGLIGIBLE OPPOSITION IN THE LUMBER INDUSTRY TO THE EXEMPTION OF NORTHERN WHITE PINE, NORWAY PINE, AND WESTERN WHITE SPRUCE, FROM THE EXCISE TAX

	United States lumber production [1]	
	1936	1937
Southern Pine Association	7,113,000,000	7,336,000,000
West Coast Lumbermen's Association	6,670,000,000	6,322,700,000
Western Pine Association	4,396,000,000	4,729,000,000
California Redwood Association	470,700,000	504,800,000
Southern Cypress Manufacturers Association	191,900,000	213,600,000
Northern Pine Association	83,400,000	89,800,000
Northern Hemlock and Hardwood Manufacturers Association	288,500,000	311,600,000
Northeastern Lumber Manufacturers Association	284,500,000	315,000,000
Appalachian Hardwood Manufacturers Association	77,300,000	95,200,000
Total association reports	19,575,300,000	19,917,700,000
Other softwoods not reported	666,700,000	567,300,000
Total softwood produced (1936 census figures)	20,242,000,000	20,485,000,000
Total hardwood produced	4,113,000,000	4,165,000,000
Grand total	24,355,000,000	24,650,000,000

[1] As estimated by the National Lumber Manufacturers Association from reports of the different associations and later corrected from Bureau of the Census figures.

The National Lumber Manufacturers Association, representing practically all lumber manufacturers throughout the entire United States, have already gone on record in the hearings held before the House Ways and Means Committee as not opposing the exemption of northern white pine, Norway pine, and western white spruce from the excise tax.

But one regional group in the National Association, namely, the Northeastern Lumber Manufacturers' Association, has manifested any opposition to the exemption of northern white pine, Norway pine, and western white spruce from the excise tax. Yet the Northeastern Association represents only a very insignificant portion of American lumber production, as reference to the above table indicates.

As noted from these figures, the total United States production of lumber in 1936 was 24,355,000,000 board feet. In that year the Northeastern Association produced 284,500,000 feet, which represents 1.1 percent of the total United States production in 1936.

Similarly, in 1937, according to the estimates of the National Association, the total United States production of lumber was 24,650,000,000 feet. Of this amount the Northeastern Association produced but 315,000,000, or 1.2 percent of the total United States production in 1937.

Thus, the only opposition registered to the exemption of the three species of lumber named is from a region which produces (according to its own figures and the figures of the Census Bureau) but 1.2 percent of the total production of lumber in the United States.

NORTHEASTERN CONSUMPTION, PRODUCTION, AND IMPORTS SOFTWOOD LUMBER, 1934

According to official figures of the United States Census Bureau and the United States Forest Service, the New England States (including New York and Pennsylvania) consumed 2,135,275,000 board feet of softwood lumber in 1934.

In that same year these Northeastern States produced only 436,894,000 feet, or but 20 percent of the lumber which they consumed.

Thus, the New England States must import 80 percent of the lumber they require for consumption. However, it should be noted that only 6 percent of the New England consumption comes from Canada, the remaining imports coming from other parts of the United States.

The following tables, computed from the official reports referred to, indicate in percentages:

(1) The insignificance of production in the New England States to consumption.
(2) The large percentage of lumber which they must import.
(3) The small percentage of lumber imported from Canada.

States	Percentage of consumption State produces	Percentage of consumption State imports	Percentage of consumption imported from Canada
Total for New England	20	80	6
Maine [1]			5
New Hampshire [1]			2
Vermont	78	22	16
Massachusetts	16	84	10
Rhode Island	6	94	4
Connecticut	5	95	3
New York	2	98	6
Pennsylvania	8	92	0.9

[1] Both these States produce more than they consume.

It should be noted that Maine, while deriving 5,884,000 board feet of softwood lumber from Canada in 1934, exported to Canada 8,486,000 feet.

In 1936 Maine imported 11,324,000 board feet from Canada, and the same year exported to Canada 14,786,000 feet.

CLAIM THAT "50,000 MEN ARE EMPLOYED IN NORTHEASTERN LUMBER OPERATIONS" IS BEYOND REASON

Allegation.—It has been alleged by the Northeastern Lumber Manufacturers' Association that over 50,000 men are employed in the Northeastern States (Pennsylvania, New York, and New England).

Facts.—These States, in 1937, produced 315,000,000 board feet of lumber.[1]

Now, comparing production figures attained in Minnesota (and other lumber States) in the production of species like those in the Northeastern States:

We should expect a production of 300 feet or more per man per day in logging.

We should expect 500 feet or more per man per day in sawing it into lumber or piling it in the yards to dry.

We should expect 500 feet or more per man per day in planing and shipping this lumber.

This would mean that 7,700 men, working 300 days per year, would produce 315,000,000 feet of lumber in Minnesota—as contrasted with 50,000 men which it is alleged are employed in the Northeastern States to produce the same quantity of lumber.

Conclusion.—Logging conditions and methods are generally very similar. The figures computed above are quite conservative. Actually, in very efficient lumber operations, less than 5,000 men, on full-time employment, would be required to produce such an amount of lumber.

If the contention of the Northeastern manufacturers were true, then, on the basis of their production, it would take over 4,000,000 men to produce the entire lumber output of the United States, whereas we know that, at the most, 500,000 men do the work.

WAGES PAID IN NORTHERN WHITE PINE AND WESTERN WHITE SPRUCE LUMBER INDUSTRY—UNITED STATES AND CANADA

Contention.—It is alleged that sawmill wages in the New England States are 30 to 50 cents per hour; that sawmill wages in Canada are 17 to 25 cents per hour; and that the northeastern woods and mill labor generally are paid 20 to 30 percent more than the average Canadian wage.

Facts.—(1) Because of the different wage schedules prevailing in different parts of the United States in the lumber industry, it is difficult to arrive at any average wage or hours of work per day, for this country, in order to compare them with those for Canada.

(2) I have here, however, wage schedules paid at sawmills, planing mills, etc., at Fort Frances, Ontario, and The Pas, Manitoba, where northern white pine and western white spruce are produced, respectively.

As generally representative of the wages paid, may I point out the wages received by some of the men:

	Fort Frances, Ontario	The Pas, Manitoba
Sawyers	$1.12½ per hour	82½ cents per hour.
Setters	61 cents per hour	47½ cents per hour.
Edgermen	61 cents per hour	50 cents per hour.
Trimmermen	47½ cents per hour	47½ cents per hour.
Millwrights	61 cents per hour	55 cents per hour.
Engineers	60 cents per hour	$125 per month.
Common labor	43 cents per hour	35 cents per hour.

NOTE.—Each of these men—even common labor—is paid a higher wage than the alleged wage of 30 to 35 cents paid in the Northeastern States. In the operation of these particular northern white pine mills in Canada, there are 90 different wage classifications, running from 43 cents per hour to $2.15. In the operation of these particular western white spruce mills in Canada, there are 93 different wage classifications, running from 35 cents per hour to $1.02½.

(3) As to wage scales effective on logging operations, I have before me another schedule for northern white pine operations in Canada, showing 24 different wage classifications, running from $67.50 to $133 per month.

The average of these wage classifications approximates $85.35 per man per month.

The average of all men in the western white spruce logging operations at The Pas, Manitoba, except those employed in supervisory capacity, is $75 per month.

[1] It should be noted in this connection that the Northeastern States produced only 1.2 percent of the total United States lumber production in 1937.

Fort Frances, Ontario, wage schedule on 8-hour-day basis (without contractors), effective April 16, 1937, to April 15, 1938

	Mill No. 1
Sawmill:	
Boom, gator	$0.55
Boom	.47½
Foot of slip	.47½
Log deck	.47½
Sawyers	1.12½
Setters	.61
Riders	.47½
Tail sawyers	.47½
Bull ring	.47½
Edgerman	.61
Edgerman's helper	.47½
Stripper	.43
Stripper behind gang	.47½
Slasherman, head	.43
Slasherman, tail	.47½
Levers	.53
Resawyers	.47½
Resawyer's helper	.43
Resawyer behind	.59½
Saw fuller:	
Trimmerman, head	.59½
Trimmerman, tail	.47½
Oiler, head	.50
Oiler	.47½
Millwright:	
Regular	.61
Chas. Julin	.65½
Carl Hafdahl	.65½
Engineer's helper	.60
Engineer	.60
Fireman	.57½
Filer	2.15½
Filer's helper:	
Armstrong	.69½
Crawley	.61
Traviss	.56½
McClure	.56½
Watchman	.43
Common labor	.43
Shop:	
Machinist	.87
Blacksmith	.60½
Blacksmith helper	.50
Wagon repairer	.57½
Horseshoer	.60½
Lath mill:	
Foreman	.95½
Bolt shover	.50
Bolt puller	.50
Lath shover	.50
Lath puller	.50
Graders	.53
Stock pickers	.43
Hauling and piling (contract)	.10
Green lumber:	
Green-lumber graders	.56
Green-lumber scalers	.56
Green-lumber chain foreman	.56
Chainmen	.47½
Green-lumber teamsters	.47½
Green-lumber pick-up team	.48
Stackers	.47½
Machine pilers, day	.50
Machine stackers, day	.47½

Fort Frances, Ontario, wage schedule on 8-hour-day basis (without contractors), effective April 16, 1937, to April 15, 1938—Continued

	Mill No. 1
Green lumber—Continued.	
Bar pilers	$0.47½
Green-wood teamsters:	
4-horse team	.50
Single team	47½
Tram carpenter	.47½
Foundation men	.47½
All common labor, wood	.43
Pickers and pilers of slabs, edgings, etc	1.53
Picking short wood at mills, per cord	.51
Dry lumber:	
Scalers and graders in cars and yard	.48
Lloyd	.53
Orvick	.56
Moxness	.65½
Planing mill graders	.50½
Loaders on wagon	.43
Teamsters	.43
Teamsters double crew	.47½
Loaders in cars	.43
Teamsters retail	.48
Retail men	.50½
Planing mill and dry shed:	
Machine feeders	.47½
Machine feeders (2 men)	.50
Graders behind machine	.50½
Common trim saw	.43
Planing setter	.68
Setter's helper, Wade	.53
Planing mill:	
Helper (shop)	.61
Engineer	.60
Fireman	.57½
Oiler	.50
Resawyer	.50
Molderman	.53
Shed grader	.65½

Fort Frances, Ontario, wage scale—Season 1937-38

LOGGING OPERATIONS

		Schedule[1]
Second cooks	calendar month	$90.00
Meat cutters	do	80.00
Blacksmiths	do	120.00
Handy men	do	105.00
Handy man's helper	do	85.00
Barn boss (40 or more horses)	do	82.00
Barn boss (less than 40 horses)	do	74.00
Cookees	do	67.50
Bullcooks	do	70.00
Saw filers, large camp	26-day month	82.00
Saw filers, small camp	do	75.00
Four horse teamster	do	80.00
Loaders	do	75.00
Hookers on jammer and lever men	do	70.00
Single teamsters	do	75.00
Swamper	do	67.50
Sawyer	do	72.50
Landing man	do	70.00
Chain tender and skidway man	do	67.50
Truck drivers	calendar month	110.00
Tractor drivers	do	120.00

[1] These wages include $25 per month for board.

Fort Frances, Ontario, wage scale—Season 1937–38—Continued

		Schedule[1]
Harness maker	calendar month	$133.00
Warehouseman	do	110.00
Warehouseman's helper	do	67.50
Garage men	do	85.00–120.00

NORTHERN WHITE PINE STUMPAGE COSTS, UNITED STATES AND CANADA

Contention.—It is alleged, by the Northeastern Manufacturers' Association, that the northern white pine stumpage prices average almost $6 per month in the Northeastern States; that they average only $2 to $3 in Ontario, Canada.

Facts.—According to figures of the United States Forest Service (Stumpage and Log Price for Calendar Year 1934), stumpage prices for northern white pine during that year averaged $5.37 in the New England States.

According to telegram (dated Mar. 2, 1938) received from the Department of Lands and Forests, Toronto, Ontario, the average stumpage price for red and white pine in Ontario in 1934 was $5.57.

By further telegram on March 3, 1938, the Department at Toronto wired: "My wire yesterday gave averages of licenses, including those old ones where Crown has only interests to extent of simple Crown dues. If limited to licenses involving bonus and dues, averages somewhat higher than those quoted."

Hence, if the Government bonus, as well as the Crown dues, are included in the cost of Canadian stumpage of northern white pine the price per thousand feet is about $5.77. In other words, in addition to Crown dues, the Canadian Provinces charge a bonus upon lumber when cut, which bonus is determined somewhat by the prevailing price of lumber. Such bonuses run from $2–$2.50–$3, sometimes even as high as $5 per thousand feet, depending upon the location of the timber—and this bonus must be paid the Provincial Government in addition to the Crown dues.

Thus, depending upon the location of the stands of timber, the prevailing price at the time it is cut, etc., stumpage prices in Canada for northern white pine may be even higher than the $5.77 computed for 1934. And as stated, this figure is even higher than the average stumpage prices for the Northeastern States.

Finally, it must be remembered that in addition to the stumpage costs and to the cost of cutting the trees and converting the logs into lumber, the following freight must be paid on Canadian lumber imports of northern white pine:

From Fort Frances, Ontario	Rate per 100 pounds	Rate per 1,000 feet
To—	*Cents*	
Buffalo, N. Y	43	$8.60
Rochester, N. Y	47½	9.50
New York City	52	10.40
Boston, Mass	54	10.80
Pittsburgh, Pa	43	8.60

SELLING PRICE OF NORTHERN WHITE PINE, UNITED STATES AND CANADA

(1) *United States.*—The unit value of general imports of pine, according to the reports of the Tariff Commission, varies over recent years from $23 to $26 per 1,000 feet.

(Generally imports of pine include, in addition to northern white and Norway pine, a great deal of pack pine, which is of a cheaper grade and which, therefore, brings down the average value of all pine imports.)

(2) *Canada.*—The average price realized by a representative mill at Fort Frances, Ontario, for northern white pine lumber was as follows:

Year:	Per 1,000 feet[1]
1924	$33.83
1926	31.13
1928	30.46
1930	31.83
1937	30.72

When there is added to these figures a freight of almost $11 per thousand feet on northern white pine from Fort Frances, Ontario, to New York City, it is obvious that the Canadian imports of northern white pine do not undersell the domestic production of the specie.

USES OF THE THREE SPECIES

(1) CHARACTERISTICS AND USES OF NORTHERN WHITE PINE

Briefly, the botanical characteristics of virgin northern white pine are large cells with relatively thin walls; slow annual growth; almost no differentiation in cell structure between spring and summer wood; and a large percentage of heart wood. As a result, virgin northern white pine is of a particularly soft texture; holds nails and screws without splitting; when properly seasoned, does not warp, twist or check; is resistant to the effects of climatic change and to weathering; has a low coefficient of expansion and contraction with changes in temperature and humidity; and holds paint, varnish, and glue better than any other wood.

Pattern making is an excellent example of the special adaptability of virgin northern white pine to a use for which other species of lumber cannot well be substituted. The qualities which make virgin northern white pine preeminent for pattern making are, first, its soft texture and straight grain, which makes it possible for the pattern maker to work it evenly without it showing any tendency to split or splinter under his tools; and second, the fact that patterns made out of well-seasoned virgin white pine are permanent assets which never shrink, twist, warp, or change their form in any particular.

The United States Navy uses large quantities of virgin northern white pine for patterns in the Washington Navy Yard. A stock of more than 300,000 northern white pine patterns is maintained in storage for use in case of emergency. No other wood could be shaped for patterns and kept in storage for long periods without a tremendous loss in warped and split pieces, and so forth. It is essential to use virgin northern white pine for this purpose. With the tremendous naval expansion program in the offing, it is important that the maximum quantity of such lumber be available to shipyards, both private and Navy, and at as low a price as possible. This, then, is further reason why the tariff duty and excise tax upon this "specialty" wood should be reduced to the maximum extent permitted in the new trade agreement with Canada.

Northern white pine is still in demand for the manufacture of sash and doors, but much of the output of the so-called shop lumber, which in the past was used for this purpose, is now used for the making of patterns for foundry molds.

A few authoritative comments with respect to the quality and uses of this specie of lumber may well be quoted at this point:

J. H. Bridge, president of the Maumee Pattern & Manufacturing Co., Cleveland, Ohio, states: "We use a great quantity of white pine in our wood-pattern manufacturing and find that the Canadian white pine is unequaled * * *."

George W. Wandeke, president of the Schill Pattern Co., Toledo, Ohio, states: "We believe that it is not a question of the Canadian white pine competing with the American lumber as the first named is better in every way for use in making of patterns * * *."

J. A. Holzapfel, of the Globe Pattern & Manufacturing Co., Jackson, Mich., states: "We find that Canadian white pine cannot be equaled in quality for pattern lumber. We have used other lumber, but none proves as satisfactory * * *."

D. T. Broderick, vice president of the Forest Lumber Co., Pittsburgh, Pa., states: "In our dealings over a period of years with the users of pattern lumber

[1] Selling price, per 1,000 feet, f. o. b. Fort Frances.

it has been our experience that they prefer—in fact, most of them insist upon—the *Pinus strobus* white pine. This is a true Canadian white pine, and the pattern manufacturers claim it is far superior for their purpose than the white pine which we get in this country."

Many others have testified as to the great desirability of virgin northern white pine for pattern making. For example, Roger E. Simmons, of the United States Forest Service, in Wood Using Industries of Pennsylvania, page 91, states: "It (*Pinus strobus*) is, however, the predominant pattern wood, not alone in Pennsylvania but throughout the country at large."

Virgin northern white pine also possesses a combination of characteristics which make it particularly valuable as a container in the case of certain chemicals and in the case of certain other commodities, such as high-grade leaf tobacco, the value of which is so great that complete protection to the articles contained therein is economy at any price. The fact that this wood is unusually weather resistant; the fact that the excessive nailing which certain boxes require does not cause it to split; the fact that the well-set knots do not check or come out; and, lastly, the fact that combined with these other qualities is an extreme lightness in weight, which reduces delivery costs to a minimum, make virgin northern white pine particularly desirable for many special uses.

(2) NORWAY PINE—SIMILAR TO NORTHERN WHITE PINE

All that has been said of northern white pine, generally, applies to Norway pine. The two pines grow in mixed stands, and building lumbers therefrom are marketed together as northern white pine, because commercial grading rules for northern white pine permit the inclusion of Norway pine in the common grades of northern white pine.

Norway pine has many physical and chemical properties in common with northern white pine. However, Norway pine is coarser in grade and texture; has more strongly marked annual rings; is heavier and stronger; and is somewhat more resinous. Generally, Norway pine has "fine, straight grain, medium sapwood, is moderately hard, fairly dense, of medium weight, moderately strong, stiff, non-lastic, fairly brittle, readily split and easily seasoned, easy to work, and keeps its shape."

Norway pine is used especially for the following purposes to which it is particularly well adapted; agricultural implements, boxes and crates, car construction and repair, caskets, and coffins, playground equipment, gates, fencing, wire, and cable spools, mine-shovel boards, stepping, scaffolding, ladders, and stove boards.

(3) WESTERN WHITE SPRUCE

Western white spruce has many characteristics which are essential for certain types of boxes and crates, which distinguish it from other woods. For example, it is odorless, and hence is very much in demand where it is important to use an odorless or tasteless wood, as for egg boxes, butter boxes, candy boxes, and poultry boxes. All other softwoods have distinctive odors, and have resin or sugar deposits in their fiber which affect the flavor of food when used in the construction of food containers.

Likewise, the peculiar characteristics of this spruce make it valuable for use in refrigerators, particularly commercial ice boxes, kitchen cabinets, certain types of woodenware and novelties, insulation in refrigerator cars and as running boards on freight cars, for dairymen's, poulterers', and apiarists' supplies, cable and wire reels, cleats for plywood boxes, certain kinds of fixtures and furniture, musical instruments, and a variety of other special uses for which its peculiar characteristics especially fit it.

Western white spruce is the preferred wood for scaffold construction, because of its strength and lightness, and where safety is of the greatest importance, as in chemical and industrial plants. A safe thickness of spruce planking need not be as thick as any other specie, and the saving in weight means a considerable saving in money on large scaffolding jobs where heavy planks would require two or three times as much upright strength for safe support.

Western white spruce weighs from 500 to 800 pounds per thousand board feet less than most other softwood species. The following table shows the weight per thousand board feet, of a number of the more popular species. The saving which can be made in weight (and therefore freight) by using western white spruce is obvious.

Weight per thousand feet

Kinds of lumber:	Pounds
Douglas fir	2,500
Hemlock	2,500
Sitka spruce	2,500
Short-leaf yellow pine	2,400
Fir and larch	2,200
Eastern spruce	2,100
Ponderosa pine	2,100
Idaho white pine	1,900
Western white spruce	1,650

As manufacturers must pay freight on containers at the same rate as on the contents, weight is often a deciding factor, not only in the selection of wood, but in the ability of the manufacturer to enter the competition of many markets.

A few of the many additional qualities which make Western white spruce the wood par excellence for many purposes are:

1. It saves waste because of its small knots.
2. It nails more easily and holds nails close to the end of the boards without splitting.
3. It has a soft texture which prevents slipping.
4. It is white and bright in color.
5. It contains no pitch or resin.
6. It paints well.

The CHAIRMAN. Thank you very much.

I wish those from out of town, who are here before the committee, would rise.

All right, Mr. Eisner.

Mr. EISNER. Yes, sir.

The CHAIRMAN. Mr. Eisner, you have 10 minutes, and you can file your brief.

STATEMENT OF MARK EISNER, REPRESENTING THE TOILET GOODS ASSOCIATION, NEW YORK

Mr. EISNER. Our briefs are filed.

If it pleases the committee, I appear representing the Toilet Goods Association, which is the trade association of the toilet-goods industry, in its desire to have removed or modified the 10 percent on toilet preparations.

As the bill came up to the Senate from the House, the tax on toilet soaps, tooth paste, and dentifrices has been removed, and there are only in that bill the two items of commerce that are remaining at 10 percent, one on toilet preparations and the other on firearms. We have been left at this exhorbitant rate of tax.

Now, this committee is entirely familiar with the fact that in the last 2 years the tax on jewelry and the tax on furs has been removed. At least the tax on furs is removed in the pending measure; and I thought it might be illuminating to the committee to have a visual exhibit of what remains taxable at 10 percent, when a $100,000 necklace is untaxed, and a $50,000 sable coat, to be worn possibly by an expatriate, is untaxed.

Senator CONNALLY. It is untaxed?

Mr. EISNER. Yes; it is untaxed.

Senator CONNALLY. It pays an import tax?

Mr. EISNER. No; no. I mean a coat made here.

Senator CONNALLY. You spoke about an expatriate. They would have to buy theirs abroad.

Mr. EISNER. No; I mean if she came over to this country and bought one here.

Senator CONNALLY. I see. [Laughter.]

Mr. EISNER. That is what I mean. They do come over to this country.

Senator CONNALLY. Oh, yes; they come back to get their dividends? [Laughter.]

Mr. EISNER. Yes, sir. I have here, which I will leave with the committee, some exhibits.

Here is a baby oil which is taxed at 10 percent [indicating].

The CHAIRMAN. Have you got one for each member of the committee? [Laughter.]

Mr. EISNER. I do not know whether it is babies in esse or babies in posse, Mr. Chairman, but I will be very glad to do that.

I will leave this [indicating] for the clerk of your committee, who is the father of a new infant, if I am not mistaken.

Here is another baby oil taxed at 10 percent [indicating].

Here is a baby talcum powder taxed at 10 percent [indicating].

Let us bear in mind while talking about these items that are taxed at 10 percent that here is albolene which is taxed at 10 percent, which is used in every hospital in the United States [indicating].

Here is another baby product [indicating]. Here is an item which is hand lotion, bought at the 5-and-10-cent store, used by—I think the statistics show—80 percent of the housewives of the United States who do their own washing, to avoid roughening of the hands, which is taxed at 10 percent.

The CHAIRMAN. What does that retail at?

Mr. EISNER. This is 10 cents a bottle.

The CHAIRMAN. Ten cents?

Mr. EISNER. Yes, sir.

And here is face powder, a cosmetic, and this is a 10-cent package bought here in Washington [indicating].

And here is a baby cream that is taxed at 10 percent [indicating], and every mother needs baby cream, just as she needs baby powder and baby oils.

Senator KING. Is this tax of 10 percent sort of compelling wives and daughters to go back to primitive days, oxcart days, when they did not have these things? Is this not a sort of an attempt to revive atavistic tendencies?

Mr. EISNER. I do not think it is an attempt on the part of Congress, but possibly the effect might be the same.

Here is a 10-cent article, which is more pertinent to the gentlemen here assembled, because it is an after-shaving lotion [indicating]. Members of Congress who use it do not buy it to make themselves more beautiful. They buy it to relieve the skin after a particularly hard shave.

Senator WALSH. Mr. Eisner, I suppose if this tax is removed, the size of all of these packages will be increased for the consumer?

Mr. EISNER. There is not any doubt about it. Those sizes have been reduced by the manufacturer because they cannot afford to make them any larger.

Senator WALSH. The repeal of the tax would not mean an additional profit to the retailers or the 5-and-10-cent stores?

Mr. EISNER. No. We would get a larger package, get more business, and employ more people.

In terms of dollars and cents, here is what this tax means: The tax under 603 in 1937 yielded $17,000,000. But the House has eliminated—the Ways and Means Committee first doing so—the tax on toilet soaps fixed at 5 percent. That accounts for over $6,000,000. So that in 1937 the tax on this type of article yielded ten or eleven billion dollars, but I think, if the committee will consult their experts, they will learn as the result of a decision of the court of appeals, as to which certiorari was denied in the Supreme Court, we collected in 1937 and also 1936, two to three million dollars in back taxes, going all the way back to 1932. And therefore, when I say that superficially we seemed to have collected $11,000,000 on this tax in 1937, it is only superficial, and actually the 1937 tax might have been around seven or eight million, and might have been less, but the tax resulted in tremendous inequalities among manufacturers.

Let me give you an example to show you why. If, for example, Senator Harrison were to manufacture these articles, buying his raw materials, putting them together, packaging them, advertising them for sale, sending out his salesmen, he would pay his tax upon the price he gets from his retail outlet or from the wholesaler, which since it includes his selling and advertising expense, is a higher price. I, on the other hand, may go to a manufacturer and say, "Put up this cosmetic for me." And he does it. And I get it and all the tax he pays when he sells it to me is on the compounding of the raw materials, for which he has not advertising expenses, no selling expenses, and none of the costs which Senator Harrison had. I pay the low tax, and advertise and sell the product at a higher price but pay no more tax. I have all the costs Senator Harrison has, but no more tax is paid, but only the one tax. And that is on the sale to me.

I might go to a manufacturer and say, "Make up a batch of this cosmetic for me." He pays the tax. If, however, I tell him to make it up with a violet odor, then I am the manufacturer, according to the Bureau, and then I have got to pay the tax, including all advertising and selling expenses.

Macy's Department Store goes to a manufacturer and says "Make up this article." They make it up, and there is no advertising or selling or distribution expense. There is one tax paid. They sell it at retail and make a profit, which the manufacturer cannot do.

Montgomery Ward has the latest idea on the subject. They advertise they will sell to you all the ingredients, you put them up in your own home, and if you want to you can sell it among your friends. Montgomery Ward pay practically no tax on those ingredients. They charge practically no tax to the person who buys through the mails. And I do not think this committee is so disingenuous as to believe the ladies and gentlemen who buy those materials from Montgomery Ward to think that when they put them up for sale that they are going to pay any tax on those sales.

Senator KING. You would not want to tax any retail sale, would you?

Mr. EISNER. No, sir; I am not asking for a retail tax. I am going to make some suggestions, Senator King, and they are in a line of reduction of taxes here. I am coming to that in just a half minute.

By statistics we find as a result of the tax, and we have sent out a questionnaire, that one manufacturer pays 420 percent of his net income in excise tax; in other words, the excise tax was 420 percent of his net income, and in several cases I have known of it to be 250 percent of the net income.

Senator CONNALLY. And in those cases they treat it as a tax and it is just like they treat the labor costs and it just goes into his overhead?

Mr. EISNER. Oh; but he cannot pass it. In most cases, Senator, the tax is incapable of being passed.

Do you think Woolworth is going to pay on an article that sells at 10 cents, and that you can pass the tax to them, and charge the consumers 11 cents? You know they won't do that.

Senator VANDENBERG. You said they did that by reducing the size of the articles?

Mr. EISNER. I do not say they all do that. That has been done. To that extent the tax may be passed by some.

But we have about 2,500 manufacturers in this country, and of the 2,500 manufacturers very few command a market that they are able to reduce the size of the articles and pass the tax along.

Senator CONNALLY. The party you are talking about paid 420 percent tax. If you took that tax off, it would be profiteering to let them have that 420 percent and the net cost, too?

Mr. EISNER. No. Suppose he sells $1,000,000 and his net income is $20,000. You then would have to pay a tax of $100,000 at 10 percent on your million. So your tax would be $100,000 and the net profits are after that tax has been deducted, of course. But it would not be profiteering. Someone might get the benefit of that. But the trouble is we do not make that money. We have a number of cases like the one I mention in my brief here, where a concern loses money that pays $80,000 in excise taxes. Any number of them are losing money and paying excise taxes.

When this bill was passed in 1932 it was merely part of the general manufacturers' sales tax. It is the survival of that tax.

And on the floor of the House, Congressman Crisp, the chairman of the committee, was asked whether it was intended to tax salesmen's commission, and Congressman Crips said, "No; no selling cost is not intended to be taxed." This is the survival of that original tax; and I am sure the Congress did not intend to tax these costs, but they have taxed these costs.

And now I will suggest, if it please the committee, a few remedies. Assuming the tax yields the Government $10,000,000 in a good year, such as in 1937, the year 1938 being a terrible year so far, and I convey that with the utmost confidence in my figures, as I am secretary and director of one of the largest concerns in the industry, and we are, to speak plainly, losing our shirts so far this year, but assuming $10,000,000 would be the yield in 1938, I would offer the committee a number of suggestions, which you will find contained in our brief, and one was this: Take the concern that goes through all the processes, including selling and distributing and advertising, and the other manufacturer who does not do any of that, but buys in bulk merchandise, as I submitted to Congressman Vinson, at his request, and in accordance with recommendation 63 of the Ways and Means Subcommittee, which recommendation of the subcommittee was disregarded, and which was a carefully drawn bill which would put the

tax on the selling price of whoever owned the trade name, mark, or brand, and that would place it uniformly, it would eliminate all of the inequities, and I said, "If we do that, you will get a yield of 50 to 75 percent more in tax than you have now," but we want a reduction in rate to compensate. I think Mr. Parker knows about that. It is included in the brief.

The CHAIRMAN. What did they do about that?

Mr. EISNER. They did not do anything with reference to that suggestion, Senator. I was very much disappointed.

I saw Congressman Vinson. He said, "That is fine. Draw up an amendment." I said, "I will go back to New York and do it." He said, "There is no time for that. Draw it up and leave it here on my desk." I worked all day. I left it with him, but maybe my time was too short, but your time is not too short.

The CHAIRMAN. But our time is not too long.

Mr. EISNER. It is never too long to right something that is wrong.

The CHAIRMAN. That is what everybody thinks, and such things keep us up here 6 months, and I think it would be wise to get this bill out.

Mr. EISNER. I think the quicker you get it out the better it will be for the United States.

The CHAIRMAN. We have a lot of witnesses here on cosmetics and other subjects which are important, but I think it is better to have one person on one subject than to have a number on a subject.

Mr. EISNER. Yes. I realize you have other angles to consider, such as the retail druggists, and I know that labor wants to be heard, and I cannot speak for them.

The CHAIRMAN. We have just got word that Mary Pickford wants to be heard, and, of course, you have got to hear Mary.

Mr. EISNER. That is interesting.

But, Senator, I ask when you come to this section to bear it in mind and consider it with furs and jewelry, and you have even taken the tax off kodaks when the Eastman Kodak Co. showed a profit of $22,000,000 last year. But, of course, we do not care who taxes is taken off of except that we want it off of cosmetics.

The CHAIRMAN. I think the committee thoroughly understands your proposition.

Mr. EISNER. May I let Mr. Johnston take care of these exhibits.

The CHAIRMAN. Yes; I think he would be very glad to receive them.

Senator KING. Give me one of them?

Mr. EISNER. Which one?

Senator KING. Oh, no. I meant your recommendations. Are all your amendments here? [Indicating.]

Mr. EISNER. This is the main amendment. [Indicating.]

(The brief submitted by Mr. Eisner is as follows:)

BRIEF SUBMITTED BY TOILET GOODS ASSOCIATION

STATEMENT

In the matter of the 10 percent tax on toilet preparations under section 603 of the Revenue Act of 1938

The House has eliminated from section 603 of the Revenue Act of 1932 the tax on toilet soaps, tooth pastes, dentrifrices, etc., but makes no change for the remaining items in the section.

According to the report of the Subcommittee on Ways and Means (see table No. 10 of that report), the tax on toilet preparations exclusive of tooth pastes and soaps yielded $11,677,000 in 1937; soaps and tooth pastes, etc., yielded $6,642,000. Therefore the bill, as passed by the House, carries an apparent yield of a little over $11,000,000. Chairman Doughton, speaking on the floor in opposition to an amendment which would eliminate this $11,000,000, stated that the revenue loss if the amendment were adopted would be $17,000,000. This statement was erroneous on the basis of his own subcommittee's report, because the amendment would be responsible only for the $11,000,000, the committee having already eliminated $6,000,000. However, of the $11,000,000 collected in 1937 from toilet preparations (other than soaps, dentrifrices, etc.), at least $2,000,000 consisted of back taxes, going back to 1932 and collected as a result of the decision of the Circuit Court of Appeals Second Circuit, in the case of *Bourjois* v. *McGowan*. No comparable volume of back taxes will be collected in 1938, and on the assumption that 1938 business will be as good as 1937 business, which would indeed be a rash assumption, the collections will not exceed on the most sanguine expectations $8,000,000.

In this memorandum there will be offered by a harrassed industry six alternatives which would remedy conditions which prevail in the industry solely because of the tax. We earnestly commend these alternatives to the attention of the committee.

We refer to the fact that if the House bill were to be concurred in by the Senate the only groups paying 10 percent would be toilet preparations and firearms. An admitted luxury like jewelry has previously been exempted and now the House exempts furs. The mere statement of the last two exemptions from tax strips of all reason, justice, and excuse the retention of a 10-percent tax on toilet preparations, which we submit is an unbearable burden when levied upon the wholesale price of any product sold in the severe competition obtaining in this industry.

THE TAX DISCRIMINATES AMONG MEMBERS OF THE INDUSTRY IN A FANTASTIC MANNER NEVER CONTEMPLATED BY THE CONGRESS WHICH ENACTED IT

The foregoing statement is readily justified by the facts. The tax is upon the selling price and included in the selling are perforce all of the manufacturer's costs, including advertising and selling expenses as well as hoped-for profit, if any.

The result is a wide disparity depending on method of merchandising: One manufacturer advertises extensively. His advertising expense is, therefore, taxed 10 percent. Another manufacturer does not advertise at all. His product can be sold much cheaper and his tax made correspondingly less. Another has salesmen who sell from door to door, selling at retail. His tax is not upon his retail selling price, but upon a manufacturer's price which the Commissioner of Internal Revenue must determine as best he can (section 619).

Mail-order houses have toilet preparations made up for them and a very small amount of tax is paid because the basis is the selling price of the manufacturer to the mail-order house. On the other hand, a concern which does its own manufacturing and selling pays a tax upon all its costs, plus advertising and selling expense and profit.

The latest and possibly one of the most serious blows to the manufacturer is a method innovated by Montgomery Ward & Co., whereby it sells the ingredients to its retail trade for home manufacture. Montgomery Ward & Co. pay little or no tax on raw materials and its customers pay no tax. Even if the customer of the mail-order house were to sell the completed product among his or her friends, to make a little pin money, none will be so foolish to believe that any tax will be collected and paid.

Congress never intended to tax selling and advertising costs. It intended to pass a tax which would be precisely what it was called, namely, a manufacturer's excise tax. It was not to be a sales tax. The Treasury Department refuses to allow selling and advertising expenses to be deducted, but apparently Congress thought they would be.

It will be recalled that the manufacturer's excise taxes were what was left of the manufacturers' sales tax bill which was defeated in 1932.

House Report No. 708, dated March 8, 1932, stated as follows: "Section 604 provides rules for determining the sale price which is the basis of the tax. In

general this should be the manufacturer's or producer's price at the factory or place of production."

Representative Crisp, in speaking for the Ways and Means Committee sponsoring the 1932 act, was asked on the floor by Representative Harlan, "Does the manufacturers' price that is contemplated include salesmen's commissions?" and in his answer Mr. Crisp stated unequivocally:

"Mr. CRISP. The selling cost is not intended to be added." (Congressional Record, vol. 75, pt. 5, 72d Cong., 1st sess., p. 5693).

Thus it is seen that the burden of the tax as it now exists under its present interpretation falls most unevenly and is dependent upon the method of operation of each individual taxpayer; none of which Congress intended.

The bill not only fails to relieve the industry and the public of this tax but actually recommends its increase as to certain taxpayers.

STATISTICAL SUPPORT OF THE FOREGOING STATEMENTS

A questionnaire was addressed by the Toilet Goods Association to its members with the assurance that the information would be regarded as confidential. The members were asked to supply, with reference to the year 1936, three simple percentage computations:

a. The percentage which the taxpayer's net income bore to the gross sales of the company;

b. The percentage which the taxpayer's net income bore to the net worth of the company;

c. The percentage which the excise tax bore to the taxpayer's net income.

Under "c" fantastic results appeared. In one case the excise taxes amounted to 420 percent of the net income. In two cases the excise tax was 250 percent of the net income; in another case 217 percent, and in another 215 percent; still another 199 percent, and then the percentages ran to lower figures, but always showing that the tax paid was inordinately great as compared with the net income of the company. In some instances where the tax ran around 36 percent to 75 percent of the net income there had been no segregation of net income from taxable sources from net income from nontaxable sources. If there had been, the ratio of excise taxes to net income would have been considerably higher. In one case the concern lost money but paid to the United States $80,000 in excise taxes.

It should be borne in mind that the members of the Toilet Goods Association in the main are the leaders in the industry who should be the most successful, but there are thousands of smaller manufacturers throughout the country who are not members of the association and who are feeling the burden of the tax to even a greater extent than the leaders.

HAS THE TAX BEEN PASSED ALONG?

This question naturally suggests itself. In some few instances the answer is "yes." In the majority it is "no." Where it was passed on and prices have been increased sales fell off. One company which added the equivalent of its tax to its selling price dropped in sales 25 percent, or $1,000,000 less sales for the year of the addition as against the previous year when there was no tax.

BUT THE VAST MAJORITY HAVE NOT PASSED AND CANNOT PASS THE TAX

Take the situation of a manufacturer who sells to the 5-and-10-cent stores or to the 25-and-50-cent stores. These concerns tell the manufacturer that their business depends on narrow margins of profit, and therefore large volume; that they will not accept the passing of the tax upon the ground that the increased price destroys their profit; and that they cannot accept the passing of the tax and in turn increase the retail selling price to make up for it, because the 5-and-10-cent stores will not sell an article for over 10 cents, nor will the 25-cent store sell an article for over 25 cents. Their goodwill depends upon a strict adherence to a fixed unit price.

THE TAX IS ON NECESSITIES

The House bill has recommended the removal of the tax on toilet soaps, presumably upon the ground that they constitute a necessity for promoting cleanliness.

Many toilet preparations have an equal if not a greater claim to exemption than soaps. They are certainly as necessary to cleanliness and have other health-

promoting qualities besides. They are essential articles used in hospitals and other institutions. This is known to anyone familiar with hospitals and especially with the care of babies. Besides hospitals and use for babies, etc., many preparations are used in prisons, reformatories, and institutions for the insane.

Hon. Austin H. McCormick, head of the department of correction in New York City, states that several thousand dollars' worth of taxable toilet preparations are purchased in the New York City penal institutions. Face powders and creams are used in hospitals, penal and reform institutions, and asylums for the insane. The reason is obvious; whether a person be a criminal or a curable insane person, whatever can be done to integrate him or her with the accepted customs, usages, and habits of the normal outside world must be done. Why tax the means of such integration?

Creams are advertised and used for cleansing purposes and have the quality of greater penetration than soaps. Many creams and astringents taxed as cosmetics have a definite, remedial effect upon skins lacking in oil or excreting excessive oils.

The appearance of a person with a skin too dry and scaly, or one too greasy, is offensive. Just because a cream is classified as a cosmetic it is taxed as such and subject to excise taxes, whereas if it was classified as a medicinal cream it would not be subject to excise taxes. Many kinds of lipstick, while improving the appearance of a person, likewise prevent chapping of lips and keep them in as healthy condition as soap and water do to other parts of the body. Articles taxed as toilet preparations are in fact as essential to daily external needs as food to internal needs.

Substantial proof of the fact that these articles are regarded as necessary is the circumstance that they are widely sold in the 5-and-10-cent stores and in all of the other lower-price stores in the country. If it is true that in times of depression luxuries are the first class of articles to be dispensed with, the fact that the tax on these articles has been a revenue producer throughout the depression indicates that the public regards the articles as necessities, and the continuation of the tax is therefore a tax on necessities. Therefore, we insist that the products mentioned, and others of a similar character, should be treated the same as soaps and freed from this tax upon cleanliness.

SUGGESTED ALTERNATIVES

While it is submitted that the tax should be removed, it is conceivable that alternatives should be offered to this honorable committee, and we therefore do so.

We have already referred to the fact that a concern owning a trade name for a product can have the goods manufactured and packed for it and pay a tax only upon the sales price to it. Therefore, when the owner of the trade name advertises and sells the product there is no tax on his selling price, which includes advertising and selling expense. On the other hand, a concern which goes through every step in the process from manufacturing the raw materials into the finished product, packing, advertising, and selling it, must pay a tax which will include all of these costs and which tax is, of course, much larger per unit than obtains in the first example.

Because the subcommittee of the Ways and Means Committee proposed in its recommendation No. 63 to clarify the provisions of this particular tax, there was drafted at the suggestions of Mr. Vinson a series of amendments which would have placed the tax squarely and uniformly upon the sales price obtained by the owner of the trade-mark, name, or brand, regardless of who performed the actual manufacturing process. Thus the tax would "follow the label." On this basis there would result to the Government an increase of 50 to 75 percent over the amount of tax now collected, and all that was asked of Congress was a reduction in the rate of tax to 3 percent or at the outside 5 percent, in which case there would be practically no loss in revenue if the suggested method were adopted. We annex to this memorandum as an appendix the amendments we propose as this alternative, and bearing in mind that at all times we hope for the elimination or reduction of the tax, we make the following additional alternative suggestions:

(1) Let the tax be retained at 10 percent but permit the selling and advertising expense of the manufacturer to be deducted from the selling price before computing the tax.

(2) Reduce the tax but make the tax "follow the label" as provided in the amendment heretofore referred to and annexed to this memorandum.

(3) Retain the 10-percent rate but make the tax "follow the label" in accordance with the suggested amendment, but allow as an offset against the selling price the manufacturer's advertising and selling expense.

(4) Allow a credit of 50 cents against the taxable price at which the article is sold.

This last suggestion would eliminate the tax from the low-priced articles which are sold in the lower-price ranges which supply people of poor or moderate circumstances, while having practically no effect upon the high-priced perfumery admittedly in the luxury class.

(5) Eliminate the tax upon articles in the health or cleansing category, such as baby talcs, baby oils, creams, face powders, hair tonics, etc.

THE EFFECT OF ANY OF THE FOREGOING CHANGES

We confidently predict that a reduction in the rate of tax will be increased sales, which will take up the slack and yield additional income taxes as well. It will increase employment of labor, and a number of the manufacturers have expressed their willingness to give a specific pledge to Congress in this regard.

Respectfully submitted.

TOILET GOODS ASSSOCIATION,
Rockefeller Plaza, New York City.

MARK EISNER,
Counsel.

APPENDIX

1. Section 603 is to be amended by reducing the tax from 10 percent to ——— percent.

2. At the end of section 603 there shall be added a new paragraph, as follows:

"The person, firm, corporation, or association, owning or controlling directly or indirectly, the trade-mark or marks, trade name or names, brand or brands (whether or not affixed to the article or its container or wrappings, or however otherwise the same may be indicated), shall be deemed the manufacturer, producer, or importer of the article regardless of who may perform its actual manufacturing and processing in whole or in part."

As used in this section, ownership or control of trade-mark, name or brand shall include the right to use or employ the same, whether conferred by license or permission, expressed or implied, agreement or agency relationship, or by any other manner or means.

The tax shall be paid upon the sale of an article by the manufacturer, producer, or importer as herein defined.

3. The applicable portions of section 619 are amended to conform with the above, and are then to be inserted, as amended, in section 603 after the foregoing, as follows:

The price for which an article is sold except where such price is determined pursuant to subdivisions (a), (b), and (c) hereof shall be the selling price at wholesale received by the manufacturer, producer, or importer as herein defined:

a. If an article is sold and distributed in the usual channels of trade by a person, firm, or corporation other than the manufacturer, producer, or importer as herein defined, the tax under this title shall be based on the wholesale price at which the article is so sold.

b. If an article is (1) sold at retail; (2) sold at retail by the person, firm, corporation, or association owning or controlling directly or indirectly the trade-mark or marks, name or names, brand or brands, under which the article is sold, or which may be affixed to the article or its container or wrappings or however otherwise indicated; (3) sold on consignment; the tax under this title shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Commissioner.

c. In the case of (1) a lease, (2) a contract for the sale of an article wherein it is provided that the price shall be paid by installments, and title to the article sold does not pass until a future date notwithstanding partial payment by installments, or (3) a conditional sale, there shall be paid upon each payment with respect to the article that portion of the total tax which is proportionate to the portion of the total amount to be paid represented by such payment.

d. The provisions of section 610 of this title shall not apply to the tax under this section.

The CHAIRMAN. Mr. Wertheim?

STATEMENT OF MAURICE WERTHEIM

Mr. WERTHEIM. Gentlemen, it may be a far cry from lumber and cosmetics to a general statement in regard to the tax, but I venture to make it.

I have before me Senator Harrison's statement in last Sunday's Times, and I beg to submit, in my opinion, there can be no simpler or saner program than that contained in that statement. They would be my own proposals, namely:

1. Repeal of the undistributed-profits tax, coupled with a strengthening of section 102.
2. A flat rate for capital gains of about 15 percent.
3. Broadening of the income-tax base.
4. Cutting surtax rates in the higher brackets.

I am an investment banker and the business of investment bankers is to furnish capital to industry.

Senator LONERGAN. I would like to ask you this question.

The CHAIRMAN. Go ahead, Senator.

Senator LONERGAN. You are an investment banker?

Mr. WERTHEIM. Yes, sir.

Senator LONERGAN. Does that mean you purchase commercial paper or you make loans to industry, or furnish money, or new issues, or——

Mr. WERTHEIM (interposing). The latter.

Senator LONERGAN. You furnish money for new issues?

Mr. WERTHEIM. Yes, sir.

Senator LONERGAN. On an underwriting basis?

Mr. WERTHEIM. Yes, sir.

In a sense, therefore, it is against my interests to urge the repeal of the undistributed-profits tax because with it industry needs bankers to furnish it more money than without it. Nevertheless, I am more interested in its repeal and particularly in urging the strengthening of section 102, than in the other features of the tax law, merely because I think that the undistributed-profits tax is the outstanding example of ill-conceived legislation.

Senator VANDENBERG. I had the same idea you had when the undistributed-profits tax was first enacted. Did it cause considerable additional borrowing by corporations?

Mr. WERTHEIM. Not immediately, but very soon thereafter.

Senator LONERGAN. Is there much borrowing by industry now?

Mr. WERTHEIM. There is not much borrowing because market conditions are such that the public is not prepared to receive it.

Senator LONERGAN. Is there any hesitation on the part of those who control capital to loan to industry?

Mr. WERTHEIM. I think so.

Senator LONERGAN. You think so. And the reason is why?

Mr. WERTHEIM. Lack of confidence, in my opinion.

Before passing to that, however, let me say just a few words on the other three suggestions.

Senator Harrison closed his statement as follows:

I have a conviction, if there is a sit-down strike upon the part of capital because of fear or the uncertainties of investment, that we should break it up,

if possible, and that effective work should be done toward removing some of the barriers that are checking the flow of capital and credit into new investments and new industries.

"If there is a sit-down strike on the part of capital:" Certainly there is no concerted strike of capital, if there is an unwillingness on the part of capital to invest in industry—and I think there is—one must recognize that it is a situation which has been forced on capital by the manner in which our tax laws are drawn. Capital is forced to go on a sit-down strike if you remove the profit motive; and if the strike is not here now, it certainly will be here very shortly unless our tax laws are changed.

Senator KING. Would you expect any person who had means to invest in the securities which might be issued by industries and that are engaged in electric-light production, and so on, in view of the contributions which are being made, gifts, and otherwise, by the Federal Government, to go into competition with private utilities?

Mr. WERTHEIM. I think that it would destroy a great deal of the incentive.

Senator VANDENBERG. Do you think a change in the tax law is all that is necessary to restore confidence in this country?

Mr. WERTHEIM. I do not; but I think it is helpful, Senator.

If there is one thought more important than any other that I would leave with you today it is the deep implication of lowering further the reservoir of investment capital needed for the legitimate growth of existing industries and the development of new ones. In an article which I wrote on the undistributed-profits tax which was published in the February issue of Harper's Magazine, I said:

We know that there are only three sources of capital—individual savings, corporate savings, and the Government. The first, reduced through increasingly high income taxes and estate taxes, and discouraged by the capital-gains tax, is now being rapidly eliminated as a source of industrial capital and driven into tax-exempt securities. Now the second is being attacked. Soon there will be no source left but the Government. We have already seen in the depression how a Reconstruction Finance Corporation had to be called into existence to make up for the gradual impairment of other sources.

Senator BROWN. I do not see how the Government is the source of capital. It is merely an agency by which private capital is induced to loan to the Government, and the Government in turn loans it to the industry.

Senator KING. Do private industries loan it to the Government? Does not the Government take it by taxes and then loan it to the people?

Senator BROWN. No; they are taking it by borrowing rather than by taxes. They borrow from the same two people you spoke of at the other two sources.

Mr. WERTHEIM. I think, Senator, you are misunderstanding me slightly. The profit motive makes the withdrawal, and then to substitute for that the Government must come into the picture and supply through the R. F. C. and other agencies the capital that is needed.

Senator BROWN. They borrow it from the same two sources which you spoke of merely as an agent.

Mr. WERTHEIM. It may be an agent, but it borrows by giving its own capital.

Senator KING. It borrowed it, but it had to make it up from other sources.

Mr. WERTHEIM. Yes. [Reading:]

> In the next long depression, if these forms of taxation continue, the Government will probably have to play an even greater leading role. It should be apparent that such a development is not consistent with a balanced Budget or with the continued private ownership of industry. President Roosevelt admitted as much in a recent Budget message. R. F. C.'s and P. W. A.'s are bound to remain with us, and hence unbalanced Budgets as well, if all private sources of saving are dissipated.

This seems to me to be elementary and applies not only to the undistributed-profits tax but equally to the capital-gains tax. If that were to stay as it is now or even as proposed in the new House bill, most of us would find it more profitable in the end to go out of business rather than sit in on a game where if you win you might make, say, 50 percent more or less, but if you lose, you lose 100 percent. Businessmen who figure know that this is bound to lead to disaster in the end. In effect, the Government is saying to capital, "Heads I win, tails you lose." If you wish capital to function, you must eliminate that dilemma.

Our present tax laws have produced a vicious circle. Taxes have become so punitive that capital will not play, and the result is that there will be less profits to tax and, therefore, less revenue. If you continue on that principle, there is only one alternative for you after that, namely, more punitive taxes to raise not only the difference but also to raise for the Government the actual capital to replace that which you have forced private interests to withdraw from industry. It is an impossible task under a capitalist system. Either you encourage capital to play or you go directly toward a socialized economy.

Of course, there must be injustices in every tax bill. You cannot cover up all loopholes for tax avoidance, nor can you tax punitively every malpractice. I think it is obvious that a too great zeal in this direction loses sight of the major interests of a national economy. This has come to be the British point of view, and I recommend that we adopt it as ours, for they have struggled with the income-tax problem longer than we have and found this to be the best solution.

A good illustration is in regard to the tax avoidance which, among other things, the undistributed-profits tax was calculated to prevent. In this connection I quote again from my recent article:

> Since England has a problem just like our own, namely, a large disparity between normal corporate tax and individual surtax—25 percent as against a top of 66½ percent—the English experience may be the most interesting. Back as far as 1919—19 years ago—the subject was thrashed out before a royal commission, and it was decided then that the interests of the national welfare were best served by encouraging corporations to build up reserves, even at the possible risk of losing some revenue in surtaxes. Contrary to the general impression, the British have no undistributed-profits tax. They have not even the equivalent of our section 102.

The same theory applies to the capital-gains tax. Is it more important to punish a few speculators or to see what capital flows easily and naturally in the amount which our country requires every year for normal progress? In which way does the Government secure more revenue? By taking big slices out of capital gains and thus discouraging capital or by being required to raise for itself the untold millions that an enlarged R. F. C. and P. W. A. will require? If I

were allowed to make only one criticism of the House bill now before you, I would say in the words of Shakespeare: "Think not so closely upon the event." The bill does not see the forest for the trees.

In respect to matters other than the undistributed-profits tax, I have the following brief recommendations to make:

(*a*) Capital gains: A low flat rate, and if you should decide—as I do not advise—to distinguish between short-term and long-term capital gains, by all means make it possible to offset the losses of one group against the losses of the other. If you have only one group of capital gains, by all means allow losses either to be offset against regular income at the same rate or allow them to be carried forward for a 5-year period. If you are out to encourage capital, do not snipe at small things.

(*b*) Broadening the income-tax base: This would be the most constructive thing you could do in order to increase, as Senator Harrison has said, "tax consciousness upon the part of the people." It should be used to provide the revenue for all the bad features of the tax bill you will cut out, and you will find it a double-edged sword, because it will not only provide revenue but is bound in the end to decrease the expenses of the Government.

(*c*) Cutting surtax rates in the higher brackets: There is no need for me to dwell on this since the statistics of the Treasury in the years when it was tried speak more eloquently than I could. This is no effort to shift the burden of taxes on the poor; you will get more taxes from the rich by reasonable rates than you will by excessive and punitive rates.

Now, in regard to the undistributed-profits tax, I claim there is no logical reason to retain what Senator Harrison has called "the present skeleton of it, which remains to haunt business." Obviously the provision of the present bill, which is supposed to retain the principle of the undistributed-profits tax, is no cure for tax avoidance. It is not even an attempt to touch that problem. It should be perfectly obvious to you that if the present bill becomes law all that the tax avoider will do will be to figure which is better, to have his corporation pay in effect an extra 4 percent corporation tax or pay surtax on his dividends, and you know the answer to that. The ineffectiveness of this measure makes it quite apparent to the country that it is a sop to the inventors of the act, and because of its ineffectiveness it discredits them more than it vindicates them. If it is desirable that the principle be vindicated there is a far better way to do it, and that is through the strengthening of section 102

The reason I say this is that section 102 deals with the one single objective of the act which is defensible, and that is tax avoidance. I have made a very deep study of the history of the act, and, as you know, there were only three real objectives which were alleged for it other than tax avoidance, and they have all been discredited by our experience. First, the prevention of oversaving by corporations; second, the equalization of corporation and partnership profits; and, third, giving to stockholders a greater voice in the management of corporate business. I need say very little about these three. It was fashionable to assign corporate oversaving as a cause of the depression of 1931 to 1933. No one has as yet had the temerity to ascribe to it the recession or depression of 1937 and 1938. In fact, it is the other way around; we now know that the tendency of the undistrib-

uted-profits tax is to prevent business from patronizing the heavy industries.

As to the equalization of corporation and partnership taxation, we know now that that was a red herring, since no bill, except perhaps the original House bill of 1936, even came near doing it. The same is true of giving stockholders greater voice in the management of corporate business for which the remedy is certainly not a pressure tax on dividends.

No; the only principle of the undistributed-profits tax which is valid is its attack on tax avoidance through the piling up of corporation surpluses "unreasonably." "Unreasonably," that is the important word; and the undistributed-profits tax was doomed because it made no distinction between the reasonable and unreasonable accumulation of surplus. At this moment you have before you a measure which suggests in effect that if a corporation needs to retain earnings, then the more it retains the more it is to be penalized by taxation. No one can successfully defend the proposition that the only way to penalize unreasonable retention of earnings is to penalize those reasonably retained. That is the crux of the quarrel between business and Government. Do you wish to perpetuate it by the weak memorial to unsound logic contained in the bill before you?

To vindicate the salutary part of the principle of the undistributed-profits tax, you have a real way before you in the strengthening of section 102. Instead of condemning itself by a sop, the administration would be vindicating itself by a strong and logical approach to the subject, as was indicated by the two Democratic members of the Ways and Means Committee, Messrs. McCormack and Lamneck, in their separate report. One should always remember the significant title of section 102 which is "surtax on corporations improperly accumulating surplus."

How section 102 can be best strengthened is a matter for lawyers and your experts. Some say that if a determined effort were made to enforce it even as it is, it could be done and I have heard that even under its present provisions, the Government has won 9 out of the 16 latest cases. I agree with Messrs. McCormack and Lamneck that one of the best ways to strengthen it would be to eliminate from it the burden of proof which now rests with the Government to prove "purpose to avoid surtax." An excellent suggestion is also contained in the majority report of your committee on the 1936 bill requiring every corporation whose retained income is more than 40 percent or more than $15,000 whichever is greater, to include in their return, a statement fully explaining reasons for accumulating the earnings or profits. You said at that time "the Treasury, if it has in its possession such a statement, is in a better position to check from year to year the nature of the accumulation and the intention of the stockholders and the corporation." Your majority report also suggests that the 3-year statute of limitations on assessment and suit in the matter be increased to four, which as you said is of the greatest importance, when taken in connection with a requirement for a statement of reason for accumulation.

The revenue implications of strengthening section 102 as against retaining the suggested weak vestige of the old act and by that I mean this 4-percent credit should be most attractive to you. Without actual enforcement of section 102, earnings to the extent of 100

percent can be improperly retained under the proposed act by in effect paying a 4-percent increased corporation tax. If instead, unreasonably accumulated earnings are forced out as dividends through a strengthening of section 102, they would yield income taxes and surtaxes up to 79 percent.

Finally as I said in my article "A proper handling of the undistributed-profits tax and the capital-gains tax problems will do more to restore business confidence than anything else that can be done at this session and if the Government is successful in that effort, it need not be concerned about small deficits in this or that tax. All tax yield I think will be certain to jump and all relief expenditures to be reduced. If, on the other hand, the Government fails to restore business confidence, no taxes, however punitive, will balance its Budget."

Quite apart from the above matters of outstanding importance, I should like to say one word in the interests of charity. I think the amendment proposed to section 23 (o) will secure very little or no more revenue to the Government and will do incalculable harm to our charities and educational institutions. Remember, besides, that in the long run if they are not supported privately, you will some day be asked to raise the money they require. My views on this matter are contained in a short memorandum, which I am asking to be included in the record as a part of my remarks:

In the interests of charitable and educational institutions of this country, I should like to protest the addition made to section 23 (o), which provides, that in the case of a contribution or gift made in property other than money the allowable deduction shall be limited to the adjusted basis of the property in the hands of the donor or fair market value of the property at the time of the contribution, whichever is the lower.

The majority report of the House Committee on Ways and Means (p. 19) in regard to this matter reads:

> It is, therefore, to the donor's advantage to make contributions in securities or other property which has appreciated in value and in this way avoid tax upon the unrealized capital gain.

May I call the attention of your honorable body that this is no argument for the change since the donor giving away securities to charity still would pay no tax upon the unrealized capital gain, because the charity would sell them and they are not taxable.

The Ways and Means Committee report goes on to say:

> There is no justification in principle for the allowance of a deduction for the amount of unrealized appreciation which has never been included in taxable income.

I do not think it proper, and I do not think you will think it is proper to base any argument for this change on the question of principle, since the entire system for many years in force, limiting the deduction for contributions to 15 percent of the taxpayers' statutory net income, is an arbitrary method. To figure the value of the contribution as proposed at the lower of cost or market value, is equally arbitrary and I am sure you will agree that no justification in principle can be found therefor.

I submit that the change made by the House in the section will not lessen tax avoidance on charitable contributions but is merely aimed at lessening the allowable deduction for such contributions. This might

result in slightly higher income-tax revenue, but it would so result only if the same amount of securities is given to charities. The obvious effect of the provision, in my opinion, will be to reduce these contributions, so that the proposed change will be of no benefit from the standpoint of revenue and charitable and educational institutions will suffer. The entire idea of allowing a deduction for contributions is to stimulate charitable giving. Why add this section to discourage it?

The CHAIRMAN. Thank you very much.

Senator KING. Your opinion is that the recommendation made in the former report, which I had the honor to prepare, should require them to ascertain the amount and the purpose for which they are retaining those profits?

Mr. WERTHEIM. Yes, sir.

Senator KING. Having that from year to year the Treasury would be able to determine unreasonably large sums which had been retained by corporations.

Mr. WERTHEIM. They would have a very good line on it.

Senator KING. And that would be the basis for retaining section 102?

Mr. WERTHEIM. Yes, sir.

The CHAIRMAN. Have you any more suggestions?

Mr. WERTHEIM. I have one more suggestion in the case of charity.

The CHAIRMAN. All right.

Mr. WERTHEIM. Finally, I think it is clear that our charitable and educational institutions must be taken care of by private individuals, or the Government in the last analysis. This thought is confirmed by the Ways and Means Committee in their report (p. 19), where the following statement is made:

> The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations for public funds, and by the benefits resulting from the promotion of the general welfare.

In addition, it is my opinion that the small amount of income tax yield you might save through this proposed change will hardly compensate the Government for the increased expense it may be called upon to bear as a result.

I do not like that and I do not think any of us should like it in the interest of charity.

The CHAIRMAN. Thank you very much, Mr. Wertheim.

Senator KING. Have you got a copy of your brief?

Mr. WERTHEIM. Yes, sir.

Senator KING. I will be glad to get one.

The CHAIRMAN. We now hear Mr. Wood, of Cleveland.

Senator KING. That is a fine statement.

Mr. WERTHEIM. Thank you, sir.

Senator VANDENBERG. If you have got another copy, I would like to have it.

Mr. WERTHEIM. I will send you one, Senator, if I may.

Senator VANDENBERG. That showed a whole lot of thought.

Senator KING. A very fine statement.

Senator LONERGAN. Thank you very much.

The CHAIRMAN. We will now hear Mr. Wood, of Cleveland, Ohio.

STATEMENT OF P. J. WOOD, REPRESENTING THE INDEPENDENT THEATER OWNERS, COLUMBUS, OHIO

Mr. WOOD. My name is P. J. Wood.

The CHAIRMAN. You represent the Independent Theater Owners.

Mr. WOOD. I represent the independent theaters of Ohio, and I am from Columbus, Ohio.

Senator KING. These that are not in the Hollywood circle?

Mr. WOOD. I will even take those in too, Senator.

Senator KING. All right.

Mr. WOOD. This is a request for modification of section 500–A of the Revenue Act of 1926 as amended, there is imposed a tax of 1 cent for each 10 cents or fraction thereof of the amount paid for all admissions except that where the admission is less than 41 cents the tax shall not apply. We recommend that the foregoing section be amended increasing the exemption from "less than 41 cents" to "less than 51 cents."

The CHAIRMAN. What is your recommendation on that?

Mr. WOOD. Our recommendation is that the exemption be raised 10 cents to less than 51 cents.

The CHAIRMAN. What is the loss of revenue by virtue of it?

Mr. WOOD. The revenue today is around $19,000,000, of which more than 70 percent comes from that classification, from 65 percent and upward.

The CHAIRMAN. Then we would lose by virtue of making the change, how much in your estimation?

Mr. WOOD. I would say you would lose from the amusement tax around five or six million dollars, which would substantially equal or be equivalent by the addition in income taxes.

The CHAIRMAN. All right. Proceed.

Mr. WOOD. We are not suggesting this amendment for the purpose of bringing ourselves larger profits but to enable thousands of small theaters to, in some measure, recover the higher film rentals and increased wages and other operating costs, all of which are causing many theaters to operate at slight or no profit.

Under the law, as it stands today, it is impossible for the great mass of small theaters to meet these increased operating revenues by reason of the fact that the first-run maximum-admissions rate (outside of the city of New York and a few of the other large cities) is "pegged" at 40 cents. First-run prices in cities such as Columbus, Cleveland, and Cincinnati (and towns of similar size in the other States) is the "measuring stick" for the rates charged by the subsequent run or neighborhood houses. In Columbus, for instance, there is a differential of 15 cents between the maximum first-run price and the maximum subsequent or neighborhood-run price. At the present time, the maximum subsequent-run price in Columbus is 25 cents.

If the law were amended as above suggested, it would permit the first-run theaters in towns like Columbus to increase their maximum rate to 50 cents and the subsequent runs would follow with a 5-cent increase; and surrounding smaller towns could do likewise. The Government would be the beneficiary of these increased rates by receiving increased income taxes from several thousand theaters and other places of amusement.

To show just what the probable effect of an increase in the exemption would be on a typical theater operation, and what increased tax-revenue would be secured by the Government, the following statement shows the actual income and expenses of a first-run theater for the year ending September 30, 1937, in a city in New York State with a population of 328,000. The top admission now charged is 40 cents. Compared with these figures is a detailed statement of the same operation at a top admission of 50 cents, assuming that all factors such as weather, attractions, and attendance were the same:

Present admissions price scale

Admissions	Number	Amount
10 cents	92,005	$9,200
15 cents	201,662	30,249
25 cents	532,239	133,060
40 cents	272,788	109,115
Miscellaneous	2,135	1,094
Total	1,100,829	282,718

Income:	
Admissions	$282,718
Other	4,180
Total	286,898

With possible scale (if 50-cent top is possible)

Admissions	Number	Amount
10 cents	92,005	$9,200
15 cents	201,662	30,249
30 cents	532,239	159,673
50 cents	272,788	136,394
Miscellaneous	2,135	1,094
Total	1,100,829	336,610

Income:	
Admissions	$336,610
Other	4,180
Total	340,790

Expenses	Present admissions price scale	With possible 50-cent-top scale
Feature film rental [1]	$79,291	$94,199
Short film rental	6,644	6,644
Other attractions	7,963	7,963
Advertising and publicity	27,859	27,859
Operating staff	47,768	47,768
Management staff	1,040	1,040
Electricity	5,775	5,775
Supplies, fuel, telephone, etc	9,776	9,776
Maintenance and repairs	3,349	3,349
Fixed charges (rent, insurance, taxes, interest, and depreciation)	63,444	73,024
Total	252,909	277,397
Net earnings before Federal taxes [2]	33,989	63,393

See footnotes on p. 390.

Another theater operation in a Minnesota city of 101,000 population was examined in a similar fashion which revealed the following comparative figures:

Present admission price scale

Admission	Number	Amount
10 cents	33,223	$3,322
25 cents	243,704	60,986
40 cents	277,726	107,091
Miscellaneous	975	961
Total	545,628	172,300

Income:	
Admissions	$172,300
Other	329
Total	172,629

With possible scale (if 50-cent top is possible)

Admission	Number	Amount
10 cents	32,223	$3,322
30 cents	243,704	73,112
50 cents	267,726	133,863
Miscellaneous	975	961
	545,628	211,258

Income:	
Admissions	$211,258
Other	329
Total	211,587

Expenses	Present admission price scale	With possible 50-cent-top scale
Feature film rental [1]	$52,315	$64,137
Short film rental	6,357	6,357
Other attractions	5,305	5,305
Advertising and publicity	14,058	14,058
Operating staff	28,782	28,782
Management staff	15,425	15,425
Electricity	8,637	3,637
Supplies, fuel, telephone, etc	4,[illegible]	4,643
Maintenance and repairs		
Fixed charges: Rent, insurance, taxes, interest, and depreciation	26,190	26,190
Total	157,661	169,482
Net earnings before Federal taxes [2]	14,968	42,105

[1] In estimating results, if "possible scale of admissions" reached 50 cents, feature film rental costs are assumed to rise in proportion to income from admissions as such film is usually sold for a percentage of the gross. It is assumed that all other expenses remained fixed whereas in actual practice this might not be entirely true.

[2] These earnings are all subject to Federal taxes as follows:

1. Capital-stock tax.
2. Corporation income tax.
3. Excess-profits tax or increased capital-stock tax due to increased valuation.
4. Undistributed-profits tax.
5. Taxes to individuals for corporate dividends estimated to be 15 percent of any increase in corporate income.

The slight loss in admissions tax will unquestionably be offset by the increase in income taxes which will be paid to the Government by thousands of theaters throughout the country. The suggested modification would result in the added income opening the way toward increased expenditures for advertising, general operation, building, remodeling, and the construction of new theaters.

Reference to the Internal Revenue Department records will disclose that approximately $19,000,000 was secured from admissions taxes during the year ending June 30, 1937, of which approximately 40 percent came out of the State of New York where a large percentage of the tax was paid by establishments in the high admission bracket. The suggested increase in the exemption would have very little effect upon this situation.

Further, it is estimated that at least 70 percent of the admissions tax is obtained from admissions of 60 cents and upward and the adoption of our recommendation would in nowise affect the revenue now being obtained by the Government from establishments in this classification.

Therefore, on behalf of the great mass of small theater owners, I respectfully request that your committee recommend that section 500-A be amended to the extent of raising the exemption from "less than 41 cents" to "less than 51 cents."

Senator KING. How many of those theaters are there in the United States?

Mr. WOOD. Such modification of the law would affect, I should say, eight or ten thousand theaters, because most of them charge 40 cents or less today.

Senator BULKLEY. And did that many or would that many take advantage of it?

Mr. WOOD. They could take advantage of it, Senator.

Senator BULKLEY. How many charge 50 cents or 55 cents?

Mr. WOOD. I would say around 100 throughout the country.

Senator BULKLEY. What is the gross business of those?

Mr. WOOD. I have no figures on that, Senator.

Senator BULKLEY. Have you any idea?

Mr. WOOD. No; I have no figures. But I might make this statement: It would be with those theaters only that the Treasury or Government loses in admission taxes.

Senator BULKLEY. We would lose some revenue from those theaters?

Mr. WOOD. From those theaters in that classification.

Senator BULKLEY. And as to the others we are not getting it any way?

Mr. WOOD. As to the others we are not getting it any way in the theaters which charge 40 cents.

As I said, 70 percent of the tax comes from theaters charging 60 cents and upward.

Senator CONNALLY. Where does the tax start now; at 40 cents?

Mr. WOOD. The act reads those theaters charging less than 41 cents shall be exempt.

Senator CONNALLY. Is that the present law?

Mr. WOOD. That is the present law.

Senator CONNALLY. So the result is the bulk of the theaters charge 41 cents to avoid the tax?

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Mr. WOOD. To avoid the tax; yes, sir.

Of course, you understand, that applies to what is known as first-run houses, which establishes rates in our business. And the second run, third, and fourth have to be guided by first-run prices.

Senator CONNALLY. If we make this proviso and raise to 51 cents, it will of course operate to increase the prices to the consumer without getting any taxes.

Mr. WOOD. No.

Senator CONNALLY. And all of these prices will go up from 40 to 50.

Mr. WOOD. They will be in the position where the Government will get additional income tax.

Senator CONNALLY. No; but I am talking about the fellow who pays 40 cents, and under this he will pay 50 cents if we eliminate this.

Mr. WOOD. That is very true; but this 40-cent exemption has been a barrier which prohibited the theaters from recovering some of their additional operating expenses in the form of various forms of taxes, such as social-security taxes, and so forth, during the last few years. They have been stymied.

Senator CONNALLY. But they have not decreased these Hollywood actors' salaries?

Mr. WOOD. We want those reduced, Senator.

The CHAIRMAN. Mr. Wood, you are familiar with the fact that unless Congress extends the law this tax is removed after July 31, 1939?

Mr. WOOD. Yes. It was extended last spring, I believe.

The CHAIRMAN. That is right, to July 31, 1939.

Mr. WOOD. But we do need this relief now, Mr. Chairman, and I hope you will look upon it with favor.

Senator KING. You say 40 percent of our income from this tax comes from New York?

Mr. WOOD. Forty percent of the tax comes out of the State of New York. The Treasury Department's statements will reveal that; that is, of $19,000,000 the State of New York contributes around, I think, seven and a quarter million, if I am not mistaken.

Senator KING. Are there many theaters outside of the State of New York paying 40 percent of all these taxes that charge admission rates above 41 cents?

Mr. WOOD. I am satisfied as to the State of Ohio, and there are only two theaters in the State of Ohio charging over 40 cents, regularly first-run houses.

The CHAIRMAN. Mr. Gillespie.

STATEMENT OF KINGSLEY GILLESPIE, STAMFORD, CONN., SECRETARY, THE STAMFORD RUBBER SUPPLY CO.

Mr. GILLESPIE. Mr. Chairman and Senators, I desire to speak upon the subject of the excise tax on rape oil in the Revenue Act of 1936 and what effect this tax has had on the rubber-substitute industry since August 1936.

We have no quarrel with any taxes which have been applied to rape oil to prevent its competing with domestic edible oils.

Denatured inedible rape oil finds three general uses in this country: (1) By far the most important use is in compounding lubricating

oils for reciprocating marine engines. Three-quarters of this tax is recovered by drawback or through purchasing the oil in foreign ports, although our own coastwise steamers cannot obtain this advantage. (2) Denatured rape oil was used to make sulfonated oils for the textile industry. It can no longer compete with castor oil because of the low duty of one-fourth cent per pound on castor beans. (3) The third use for denatured rape oil—and the one to which I would like to direct your attention—is in the manufacture of vulcanized oils called rubber substitutes.

We are the oldest and largest manufacturers of rubber substitutes in this country, but in spite of our experience in vulcanizing vegetable oils and our desire to use domestic oils in place of imported oils, we have been wholly unsuccessful since August 1936 in using any domestic oil or combination of domestic oils to replace rape oil.

The principal effect that the Revenue Act of 1936 has had upon the rubber-substitute industry is to add 4½ cents per pound to the price of rubber substitute made from rape oil, thus increasing the price of this rubber substitute until it exceeds that of natural rubber. We have not been able to persuade our customers to use rubber substitute made from domestic oils in place of that made with rape oil because the products made from domestic oils do not give the required performance in rubber.

If we are forced to continue to try to sell rubber substitute at a price equal to or greater than the price of rubber, we know it is only a matter of time until the use of rubber substitute is further greatly reduced. Since August 1936 this tax has been passed along by us to the rubber manufacturer, who, in turn, has been forced to add it to the price of the hospital sheeting, hot-water bottles, druggists' sundries, erasers, and rubberized fabrics, which the public buys.

An examination of these samples of white-rubber substitute will show the superior color and fineness of the rape oil product. But the real, vital difference between these products lies in their performance in rubber. Every one of the samples made with domestic oils contains three times as much unvulcanized oil as the rape-oil product.

Only the rape-oil product can be used without making the rubber too soft and tacky, to say nothing of the discoloration. Brown-rubber substitute made from rape oil is the only one which can be vulcanized to a degree that will permit fine grinding and the only one which will keep rubber pigments in suspension in such rubber cements as are used in spreading on fabrics.

This tax prevents us exporting rubber substitutes, and our Canadian business has dwindled to emergency odd lots because the Canadian rubber manufacturers can buy English rubber substitute for less than the cost of our raw materials.

Because we cannot make a rubber substitute from domestic oils to replace rubber substitute made from rape oil; because the present tax of 4½ cents per pound makes the cost of rape-oil rubber substitute equal to or greater than that of natural rubber; because the removal of the excise tax on denatured rape oil would in no way injure the producers of edible or inedible domestic oils; and because the total net moneys received from this tax are insignificant com-

pared to the injury to the rubber-substitute industry, we respectfully petition your honorable body to enact the following amendment:

In title IV of the Revenue Act of 1938, section 702B, line 17, after the words "rapeseed oil", add the following: "except as included in paragraph 1732 of the free list of the Tariff Act of 1930."

And thereby restore denatured rapeseed oil to the duty-free status which it occupied prior to August 21, 1936.

(Brief referred to by Mr. Gillespie is as follows:)

By W. F. Gillespie, general manager, the Stamford Rubber Supply Co.: In support of the following amendment to the Revenue Act of 1938, in title IV, section 702B, line 17, after the words "rapeseed oil," add the following: "except as included in paragraph 1732 of the free list of the Tariff Act of 1930."

March 19, 1938.

Dear Sirs: Since 1900 our company has been engaged in the manufacture of vulcanized vegetable oil known as rubber substitute. It is used in the manufacture of waterproof hospital bed sheeting, hot-water bottles, druggists' sundries, as well as rubber tubing, rubber erasers, rubberized fabrics, and all rubber goods which are either dipped or extruded.

Since the passage of the Revenue Act of 1936 and the inclusion of section 701 thereof of an excise tax of 4½ cents per pound on rapeseed oil of all descriptions, we have tried diligently but have failed to find a domestic oil to replace satisfactorily rapeseed oil. Rapeseed is not grown in this country. The domestic oils, castor, soybean, linseed, corn, peanut, cottonseed, sesame, and several other oils, have failed to produce rubber substitutes which compare either in physical properties or chemical analysis with the vulcanizates of rapeseed oil.

Rapeseed oil vulcanizes more completely than any other vegetable oil. All the other oils, both domestic and imported, vulcanize only partially. Thorough vulcanization is indispensable in producing a rubber substitute which is of a light color; which will resist the attack of mineral oil and solvents; which will not deteriorate with age, and which is capable of fine grinding.

In the United States there are about 300 potential users of rubber substitute as made by ourselves and other manufacturers located in New York and New Jersey. The excise tax of 4½ cents per pound has increased the price of rubber substitute made from rapeseed oil until it is more expensive than crude rubber itself. Under these conditions history has proven that there is but one outcome—a drastic reduction of rubber substitute as a rubber compounding ingredient.

Up until the passage of the Tariff Act of 1930, rapeseed oil bore a duty of 6 cents per gallon. When the Tariff Act of 1930 was framed, this duty was eliminated on denatured rapeseed oil because Congress was convinced that its nonedible usage was completely noncompetitive with domestic oils or fats. We are convinced that had we been heard when the so-called Bailey amendment was passed, we could have again secured the exemption of nonedible rapeseed oil as defined in paragraph 1732 of the free list of 1930.

It is noteworthy, however, that the Senate did actually vote to restore denatured rapeseed oil to its import tax-free status. See Congressional Record of June 2, 1936, page 8857, when on motion of the Senator from Michigan, Mr. Couzens, at the time of the passage of the Bailey amendment containing the tax on various oils, the Senate voted to exempt denatured rapeseed oil from the 4½ cents per pound tax carried in the Bailey amendment. Unfortunately, the amendment was left out in conference. Undoubtedly, this would not have been done had the testimony of any witness been had upon the Bailey amendment. It should be recalled that the Bailey amendment was adopted without any hearings whatsoever. Neither the writer nor any other witness had an opportunity to appear and present testimony against the amendment.

We therefore now respectfully petition your honorable committee on behalf of ourselves and other industrial users of rapeseed oil to read carefully the testimony introduced into the record of the hearings before the Ways and Means Committee on January 21, 1938, concerning the uses of nonedible rapeseed oil.

Our industry is not the largest user of rapeseed oil. The largest users are the manufacturers of lubricating oil for reciprocating marine engines. About three-quarters of such lubricating oil is sold to ships which move in international commerce, and 99 percent of the duty paid is recovered in the form of draw-back by the petroleum companies. The other 25 percent of the lubri-

cating oil is sold to coastwise steamship companies which are forced to pay the full 4½ cents per pound tax, as they do not move in international commerce.

With respect to the larger users of rapeseed oil, the repeal of the tax will not cost the Treasury any important sum of money because of draw-back, and will remove the discrimination against coastwise shipping companies and the manufacturers of rubber substitute made from rapeseed oil, and also the sulphontors of textile oils who employ rapeseed oil extensively.

If we could utilize any domestic oil or fat to produce a product which would be acceptable to the trade, we assure your honorable committee that we would be only too glad to do so. After repeated trials of other oils, the Stamford Rubber Supply Co. and its customers are convinced that there is no substitute for rapeseed oil which will produce a product that is as satisfactory to the consuming trade. We respectfully petition the members of the Senate Finance Committee, therefore, to enact the following amendment:

In title IV of the Revenue Act of 1938, section 702B, line 17, after the words "rapeseed oil", add the following: "except as included in paragraph 1732 of the free list of the Tariff Act of 1930", and thereby restore denatured rapeseed oil to the duty-free status which it occupied prior to August 21, 1936.

Respectfully submitted.

THE STAMFORD RUBBER SUPPLY CO.,
W. F. GILLESPIE, *General Manager.*

N. B.—If you wish, we will be only too glad to supply samples of our ground-rubber substitute as supplied to manufacturers of hospital sheeting, druggists' sundries, etc., so that you may see the distinct superiority of rubber substitute manufactured from rapeseed oil.

The CHAIRMAN. Senator Lonergan, did you say Mr. Klein wanted to leave?

Senator LONERGAN. Mr. Klein; yes.

The CHAIRMAN. Is Mr. Klein here?

Mr. KLEIN. Yes, sir.

The CHAIRMAN. Mr. Klein, you have a brief which you wish to file in the record?

STATEMENT OF DR. JOSEPH J. KLEIN, CHAIRMAN OF THE COMMITTEE ON FEDERAL TAXATION, NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

Dr. KLEIN. Yes, sir; I have.

The CHAIRMAN. You have 10 minutes.

Dr. KLEIN. I shall try to complete my statement within that time. Mr. Chairman, my name is Joseph J. Klein, chairman of the committee on Federal taxation of the New York Society of Certified Public Accountants.

Senator KING. You are connected with certified accountants?

Dr. KLEIN. Yes, sir; I am also a lawyer.

The CHAIRMAN. All right; proceed, Dr. Klein.

Dr. KLEIN. In the brief which you permitted me to file, of which there were sufficient copies to be distributed, the tax committee of the New York State Society of Certified Public Accountants deals first with the three major provisions in the proposed revision that is contained in the House bill. In addition, the committee deals with half a dozen other matters which we believe should be brought to your attention.

I shall speak very briefly with respect to the three or four matters in the House bill, and perhaps one other. Of course, in what I say I am expressing my personal views and not necessarily those of my committee or of the society.

Regarding the remnant, or, as you, Mr. Chairman, have called it, the ghost or skeleton of the undistributed-profits tax, may I direct your attention to the fact that while it may appear that the bill attempts to secure an additional 4 percent from corporations failing to distribute profits, that is, from the group of corporations having incomes above $25,000, as a matter of fact, on the basis of the statistical data furnished to the Ways and Means Committee by the Treasury, this is not so. Instead of a maximum rate of 20 percent, the effective rate may very well be less than 18 percent because of the dividend practices of American corporations. The figures furnished by the Treasury, which I believe cover a period of 10 years, show that most United States corporations distributed on an average over 60 percent of their earnings during the period covered by the official statistics for this 10-year period. It would follow, therefore, that if that dividend history were to be continued, the 4 percent-drawback would probably not leave more than 1⅝ or 1¾ percent instead of 4 percent.

Senator KING. Gross earnings, you mean?

Dr. KLEIN. No; net earnings.

Senator KING. Net earnings?

Dr. KLEIN. Of the net taxable earnings of which 60 percent was distributed as dividends.

It would follow, therefore, as I have said, that if that same dividend history were continued, the average history, the yield could not possibly be more than 1¾ or 1⅝ percent instead of 4 percent.

When, in addition, you take into consideration that the House bill provides set-offs against the 4-percent drawback because of the dividends paid credit and the dividend carry-over, the theoretical 4-percent yield may become negligible.

Senator BROWN. Do you mean by that that you would prefer to have the so-called 16–20 plan rather than a flat 18-percent tax?

Dr. KLEIN. No, sir.

Senator BROWN. That is the conclusion I have drawn from what you said.

Dr. KLEIN. It is my fault and not yours that you have drawn that erroneous conclusion.

Senator CONNALLY. What do you mean by 4 percent on the 40 percent would only be 60 percent, which you say is distributed? And you would not get a tax on that?

Dr. KLEIN. I blame myself for that misunderstanding.

Senator CONNALLY. Four percent on the 40; is that the way you figure?

Dr. KLEIN. No; not quite that, Senator.

The proposed tax in the bill is a maximum of 20 percent and a minimum of 16 percent; actually, in most instances, a minimum of about 16⅝ percent.

My statement was that the bill, as drawn, would not net the full 20-percent maximum tax, but rather, if the dividend history of American corporations were to continue unchanged, the yield from the proposed tax could not possibly exceed 18 percent.

Senator CONNALLY. It would be 16, plus 18, and plus 40.

Senator BROWN. I do not see why your answer to my question is not "yes," that there would be less taxable income under the 16–20 plan than if we establish a straight 18-percent tax.

Dr. KLEIN. Probably. But the point I am making, and I will come back to yours in a moment, Senator, is if you decide to perform the appendectomy that was in the Senator's mind, you are not cutting out 4 percent, but you are cutting out less than 2 percent. And I want to emphasize that, because you are confronted with providing the necessary revenue, and you should feel differently toward the proposition, if you realize that you are not being asked to give up 4 percent, but you are being asked to give up at most less than 2 percent.

Senator VANDENBERG. You are challenging the President's estimate of the prospective loss if we cut this thing out.

Dr. KLEIN. No, sir. I absolutely agree, but I am drawing a conclusion.

Senator VANDENBERG. You are challenging the President's Treasury figures and saying they are wrong conclusions.

Dr. KLEIN. Or, rather, the House bill's conclusion.

I do not know what the real effect of the undistributed profits tax has been on industry. I fear that this tax has played its part, a very effective part, in the existing depression. Surely, and this I base not on my professional knowledge but on contact, direct and through other members of my committee, with those who pay this tax, there is deep-seated resentment, and there is fear of the effect of this undistributed-profits tax. And if you gentlemen can become convinced, as I know some of you are, that there is something wrong about this tax, something irrational, and on top of that, if you are also convinced, as I believe you will be, that its effectiveness as a revenue producer has been greatly exaggerated, I do not believe much can be said in its favor.

I might add, and this is merely hunch and feeling, that if the undistributed profits tax remnant were completely eliminated the psychological effect on business might be what you wish it to be, and that the taxable income that would flow consequent upon such elimination would more than make up for the slight loss in revenue.

To sum up, in this remnant of the undistributed profits tax, there is neither revenue production nor dividend distribution compulsion; it is merely an irritant which produces, in the minds of taxpayers nothing but revulsion.

Now, as to a tax on all corporations——

Senator KING (interposing). You mean the normal tax?

Dr. KLEIN. The present bill provides, aside from special corporate taxes, three separate levies depending on the net income of corporations: one on corporations with net incomes of not over $25,000; another on corporations with net incomes slightly over $25,000; and a third on corporations with net incomes above this last figure.

First of all, if you are going to retain the "notch" provision, it cannot be simplified, but most continue to remain a tax abomination. You cannot avoid that. The purpose is commendable. There should not be too great an increase in tax with respect to a corporation with an income, let us say, of $25,001 as compared with a corporation having a net income of only $25,000. Second, there was no logical excuse, in my opinion, for the introduction, I think in the 1935 act, of the graded corporate taxes. That gradation with respect to income

has absolutely no place in a logical tax on corporations. It has no relationship whatever to ability to pay, as I am willing to demonstrate, if you call for such demonstration.

It seems to me that the same bracket of income of all corporations should be subject to the same measure of tax, and that is the principle which applies today and has applied consistently ever since 1913 with respect to the income of individuals. The first $5,000 of taxable income of every individual, regardless of his total income, is subject to the same measure of tax. That, too, should be the rule with respect to corporations.

Thus, I feel that a flat tax on all corporations, regardless of net income, in the fairest corporate levy. But if you are to differentiate between classes of corporations merely because of net income and not because of size, it seems to me that the first $25,000 of net income, let us say, should be subject to the same tax, and that those corporations enjoying larger incomes should be subject, if necessary, to a higher tax rate, but only on net incomes above $25,000.

Senator KING. Then the equality of taxation relates to those having a smaller income rather than to those having a huge income, so that the equality is not preserved, if I understand you?

Dr. KLEIN. Not if you have two brackets, you are correct.

Senator KING. Yes.

Dr. KLEIN. But I am speaking practically, as you always do, because you are confronted with the real problem of raising revenue, and if you are to differentiate between corporations because of income and preserve some measure of the existing differentiation, reluctantly I concede no other way of achieving your purpose except to divide the corporations into two classes.

Senator CONNALLY. You say large incomes. Do you mean a large percentage or just merely a large amount?

Dr. KLEIN. You put your finger on a weak spot, Senator. When people speak of large corporations they sometimes forget that if there are a large number of stockholders the individual share may be less than the average ownership in small corporations.

Senator CONNALLY. You say we would probably have to divide into two classes and tax one at the higher rate. Where would the line break? Would it mean simply that a big corporation that had a big income and would it mean that they had a high rate on their stock, or high dividends? How would you do that?

Dr. KLEIN. Logic and equity should determine that the levy should be based upon the return on the investment. Expediency and administration rebel at such a tax levy.

Senator CONNALLY. That is the excess-profits tax idea.

Dr. KLEIN. So I say as to the question of expediency—Mr. Parker is here, and he will agree with me, I believe, that the Treasury, if you will pardon the characterization, would have tantrums if you reintroduced the excess-profits tax of the 1918 vintage.

One word about capital-gains taxes. The brief which I filed contains a rather complete presentation of the subject.

May I, speaking for myself, say here that it seems to me advisable to adopt merely one of the British revenue provisions, and that is the classification of income by types.

I would—this is not in the brief—put in a separate category or compartment capital gains and losses; I would treat them separately and apart from ordinary income of all types. If you do that you can then subject the net capital gain to a tax rate, which ought to be a flat rate, in my opinion, not less than 10 percent. I feel that the rate would be repressive and unproductive if over 15 percent. But whatever the rate fixed tentatively you would soon find out whether you were wise or not quite so wise, because the returns would come back quickly enough to indicate whether you had been sufficiently prophetic to hit the right rate to produce the maximum amount of revenue, and to undo that log jamming in the capital market which Mr. Wertheim discussed a few minutes ago.

The CHAIRMAN. In other words, it would be a pretty good experiment, in your opinion?

Dr. KLEIN. I think a very wise and a very justified experiment, Senator.

About 2 years ago, or 3 years ago, when consideration of revision of taxation with increased rates was before Congress, the question arose as to whether those increased rates would or would not be made retroactive. I suggested to the Ways and Means Committee that it would be beneficial to the country to make as early announcement as possible as to whether it would recommend retroactive application. The decision was against retroactivity and the announcement was made sometime before the entire bill was ready. The announcement was hailed by all.

May I, in line with my former recommendation to the Ways and Means Committee, suggest to you, Senators, that if, in your deliberations, which may take longer than you now plan, you should reach early determinations of the kind which business pleads for with respect to the undistributed-profits tax, with respect to the capital-gains tax, with respect to the corporate rate—if you could see your way clear to make public those separate determinations on the part of your committee, you would do much, in my opinion, to calm existing fears and uncertainty. In other words, instead of waiting until you have decided upon the content of the entire bill, if with respect to these three major items about which the business world, I assure you, is anxiously awaiting a decision, you would make known what your recommendations will be, I think that would be a wise and statesmanlike procedure.

Senator CONNALLY. You would put all capital gains, regardless of character, into one provision, and then allow all sorts of capital, whether the same as capital gains, to be deducted?

Dr. KLEIN. Only in this separate department of income.

Senator CONNALLY. I am talking about a man who sells a farm and makes $500 and loses $500 on some other capital investment, and maybe it is not a farm and maybe not on real estate. In other words, is it your idea to put all capital gains in one compartment aside from ordinary income from his business, and then allow him to deduct all sorts of capital losses as against capital gains and then levy on the net?

Dr. KLEIN. You will appreciate, Senator, that I have been very conscious of the running of time, and that is why I did not elaborate my views as fully as I otherwise would.

First of all, I was dealing with the major item in capital gains and losses, to wit, those that result from security trading.

Senator CONNALLY. A man not doing security trading is entitled to the same consideration as the man gets on the exchange who loses his hat.

Dr. KLEIN. There is no question about it. And my sympathy is fully as great for that loses as for the person who goes to Wall Street and loses.

Senator CONNALLY. It seems to me you could answer that question "yes" or "no."

Dr. KLEIN. I think I would prefer to have real-estate gains offset by real-estate losses, but I do not think I would have real-estate losses offset against capital gain from the stock market, and vice versa.

Senator CONNALLY. That is what I was trying to get at.

The CHAIRMAN. You have discussed that fully in your brief?

Dr. KLEIN. Except the matter of separate compartments, sir. That is not referred to in my committee's brief.

Now, one word about a matter for which you are not responsible, but which was continued in the House bill, and which was introduced for the first time in the 1937 act.

I refer now to section 802 of the House bill, the one which provides for disclosure by lawyers and accountants of advice given with respect to foreign corporations.

The CHAIRMAN. That has been discussed pretty fully.

Dr. KLEIN. Has it? I won't continue the subject, then.

The CHAIRMAN. What is your position, just briefly stated?

Dr. KLEIN. Very briefly stated, we oppose it, and we hope you will as well.

The CHAIRMAN. I understand. I have not seen a lawyer yet that is for it.

Dr. KLEIN. It is unnecessary, Senator.

A provision for sufficient disclosure on the part of the American shareholders, officers, and directors appears in the bill. The provision is rightly regarded as obnoxious and vicious, and it is resented by every reputable accountant and attorney. Those of us who practice resent the imposition on us of the obligation, which, if it is in the law, we shall, of course, respect and observe. I submit we should not be asked to reveal matters which ought to be confidential as between client and adviser.

And one final work is about the liquidation of personal holding companies. Has that been discussed?

The CHAIRMAN. It has been discussed a great deal, but nobody seems to agree on it, and the experts do not agree on it.

Dr. KLEIN. You have made it practically impossible, and I am not objecting for section 351 corporations to continue on the old stand and in the old way. The result has been that you have dammed up business operations, trading by these corporations, for they simply cannot indulge in trading under the oppressive rates which exist.

My suggestion is that, just as you have done in two other comparable instances, you make it relatively noncostly tax-wise for these entities to dissolve if they do so at once. I would give them until the end of the year, for example.

The CHAIRMAN. They have given them 5 years in the House bill.

Dr. KLEIN. I am dealing only with tax rates, which I think ought to be no higher than whatever the rates finally determined are with respect to capital gains.

The CHAIRMAN. Let me ask you, because that to me is one of the important things in this bill——

Dr. KLEIN (interposing). Certainly.

The CHAIRMAN. I have no conclusion on it, because the experts all differ, and the Treasury differs from various people.

Suppose here is a holding company built up, and it is subjected to high rates, of course, in 102, and a great deal of those securities are unmarketable and not listed on the exchange, and they want to liquidate, and some of these securities are unmarketable. They want to liquidate. They have some cash on hand, and they want to liquidate. What is your suggestion on the thing?

Dr. KLEIN. You say the experts have differed. There were 12 or 14 members of my committee which met to prepare the brief filed with you.

The CHAIRMAN. I am talking about our experts here.

Dr. KLEIN. And the experts on our committee differed, too. So we presented alternate propositions. One of them, I think, meets the thought that was embraced in your question, that permission should be granted in some cases—perhaps in all cases—to bring down the earnings theretofore retained by the corporation at dividend rates or at capital-gain rates, but to permit the other property, representing in some cases unrealized and unrealizable profits, to take the same basis as the investment in the liquidating corporation, so that thereafter any transaction would be undeniably subject to tax. There then would be no longer any inducement not to try——

The CHAIRMAN (interposing). I think the assignment of this committee is to deal with them like they deal with anybody else, provided they liquidate; but they do not feel like showing them some favored treatment in the matter of liquidation as to capital gains. You discuss that fully in your brief, don't you?

Dr. KLEIN. This is an important matter. Will you give me just one moment?

The CHAIRMAN. Yes.

Dr. KLEIN. The so-called utility death bill was introduced——

The CHAIRMAN (interposing). We are trying to work that out.

Dr. KLEIN. I am not talking about that except by way of analogy. On the Senate floor—I believe in the 1935 act—a very logical and equitable amendment was introduced, which is part of the bill, that during a specified period of time the breaking up of these pyramided corporate structures should result in no immediate realization of gain and no advantage to the top company, because the assets are taken over on the same basis as carried by the liquidating subsidiaries. That was wise.

I am not urging a provision which would permit section 351 corporations to dissolve as subsidiaries are permitted to dissolve in section 112 (b) (6) of the House bill and of the 1936 act—that is, without the immediate recognition of gain or loss. I believe that Mr. Parker, if called upon—I am not trying to read his mind—would testify that there is no prospect of realizing much revenue from the continued operation of section 351 corporations or from a heavy tax on their dissolution. If the tax resulting from dissolution is too

burdensome, the corporations will continue in existence, but will be inactive and dormant. These corporations, as you know, cannot afford to operate under the proposed bill which subjects their undistributed profits to a tax of 75 percent—except for the first $2,000 which is subject to a 65-percent tax. I favor the encouragement of the dissolution of section 351 corporations through the medium of an enticing tax—a tax rate which would not prohibit dissolutions, but would rather encourage liquidation. I am convinced that the Treasury and all concerned would be better off if section 351 corporations disappeared from the scene.

The CHAIRMAN. I hope Mr. Parker, Dr. Klein, will look at that last part of your brief dealing with these holding-company suggestions.

All right; thank you, Dr. Klein.

(The brief of Dr. Klein is as follows:)

THE NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS,
NEW YORK, *March 18, 1938.*

To the Senate Finance Committee:

Herewith is a memorandum prepared by the Committee on Federal Taxation of the New York State Society of Certified Public Accountants relative to H. R. 9682.

The members of the committee are: Maurice Austin; Nathaniel B. Bergman; Francis P. Byerly; Walter A. Cooper; Franklin C. Ellis; Herbert W. Ellis; Joseph Getz; Henry A. Horne; J. Arthur Marvin; Leo Mattersdorf; Max Rolnik; Nathan F. Ross; Arthur E. Surdam; Nicholas Salvatore, vice chairman; Joseph J. Klein, chairman.

Respectfully submitted.

MORRIS C. TROPER, *President.*

MARCH 19, 1938.

MEMORANDUM RELATIVE TO THE REVENUE BILL OF 1938

To the Senate Finance Committee:

Receipt is acknowledged of your telegram requesting submission of a brief embodying the views and suggestions of the New York State Society of Certified Public Accountants relative to the pending revenue revision. This memorandum, in response to your request, has been prepared by the society's committee on Federal taxation.

The society's membership consists of over 2,700 certified public accountants to whom certificates have been issued by the State of New York. Many of the members have received certificates from other States as well.

During many years, technical and special committees of the society have cooperated with Federal and State agencies relative to matters with respect to which the training and experience of the certified public accountant have fitted him to speak with assurance and authority. If, in connection with your deliberations, you believe that the society can be of any help, you are urged to make your wishes known, and the response will be as cordial and as prompt as it has been when the request for assistance has come from other governmental sources.

I. THE REVENUE BILL (H. R. 9682, IN GENERAL)

The subcommittee of the Ways and Means Committee and then the Ways and Means Committee itself labored earnestly and long and succeeded in producing a proposal which, in principle, constitutes a distinct improvement over existing law and which, in the form voted by the House, relieves many corporate taxpayers of burdens which should never have been imposed. Manifestly and concededly, the House bill does not embody a revision of the entire structure of the Revenue Act, but is limited, in the main, to revision of the taxes on corporations and on capital gains. In view of the commendable action of the House

in eliminating title 1B from the bill introduced by the Ways and Means Committee, no extended comment is in order with respect to the dscriminatory and unsupportable so-called "third basket" proposal. It is sincerely hoped that no further attempt will be made to impose a punitive tax on a small and selected group of operating corporations. Further, because of the relatively limited scope of the pending revision, this memorandum will not deal with many administrative and substantive matters to which attention would be directed if general revision of the taxing statute were under consideration.

It is manifest that the House in addressing itself to a very limited revision of the taxing statute was greatly and naturally concerned about the effect of taxation on business conditions, including unemployment. The House proposals relative to the undistributed-profits tax and the tax on capital gains were motivated by a commendable desire to improve business conditions. The so-called law of diminishing returns undoubtedly applies to tax yields as well as to other economic phenomena.

It is suggested that the Senate Finance Committee might well extend the boundaries of revision fixed in the House bill so as to include an examination of surtax rates applicable to individuals. A reduction of these surtax rates so as to lessen the burden on the relatively few taxpayers whose fortunes are sufficiently large to affect, in the aggregate, general business conditions, might well result in such a measure of improvement as to provide increased aggregate revenue. Admittedly, the effect of reduced rates on revenue yield is still in the realm of more or less enlightened guesswork; nevertheless, the Senate Finance Committee would be well advised if it were to recommend a downward revision of surtaxes.

II. NEED OF STABLE INCOME-TAX BASE

The outstanding weakness and fault of the bill, as of existing law, is the wide disparity between taxable "net income" and accounting or business concept of net income. The great need is for a revenue measure which will predicate the income tax on net income as closely approximating the businessman's concept of net income as is feasible in view of constitutional limitations and the need of safeguarding the revenue. If this result could be achieved, a stable income-tax basis would be established and changes in fiscal needs could easily and simply be met by changes in normal and graduated rates. This is no novel suggestion; it has been frequently advocated throughout the years; it bears repetition, however, and now when fiscal stability is most needed, is the time to emphasize the virtues of the suggestion.

Since 1913 we have had 13 revenue acts, most of them major revisions, an average of one revision per period of less than 2 years. What such instability does to business planning is altogether too manifest. In Great Britain, William Pitt, in 1799, when advocating for England the then new income tax, argued as its chief virtues simplicity and the fact that the only change which time would make necessary would be change in rates. The years have not borne out his prophecy.

In this respect the situation is no better in England, although uninformed persons have frequently referred to the incomparably greater stability and simplicity of the British income-tax structure. That the British income tax is neither simple nor stable is known to all who are familiar with the British taxpayers' criticism of their own tax system, a matter which is more interestingly presented in volume 1 of the Report of the Income Tax Codification Committee, which was presented to Parliament in April 1936. Somewhat earlier, Messrs. Magill, Parker, and King reported on the British tax system in a pamphlet entitled "A Summary of the British tax System." Their conclusions with respect to the complexity of the British system are in accord with the views expressed in the official British publication.

By 1918 there had been 52 British revenue acts. Since the Income Tax Act of 1918, which brought together and rearranged the material contained in 52 previous acts, 18 finance acts have been passed, of which 17 contain extensive and elaborate revisions. "Indeed," as stated in the report of the codification committee, "the 17 years between 1918 and 1935 have wrought more changes, both in principle and detail, in income-tax law than were effected in the long period between 1853 and 1910, when supertax was first introduced."

Many observers despair of ever having a simple Federal income-tax statute. Hope for improvement may be found, if at all, in a law which will expressly recognize that the only fair basis for the imposition of an income tax is net income determined under recognized principles of accounting consistently

applied. Such a law would be not only fair but simple, and it would approach the commendable goal of imposing an income tax in accordance with ability to pay.

III. NEED OF ENTRUSTING RECOMMENDATIONS FOR REVISION OF OUR TAX LAWS TO A COMMISSION OF EXPERTS

No informed person is satisfied with our tax structure. To convert the existing scheme of taxation into a permanently sound income-tax system is not the work of a few weeks or even months. It is hardly a task, in the first instance, for overworked congressional committees. The duty of preparing recommendations for fundamental changes should be entrusted to a carefully selected group of experts, including certified public accountants, responsible to Congress alone, with or without congressional representation. England has benefited from the activities of royal commissions in many fields; one such commission and seven parliamentary committees have investigated and reported on taxation during the past 87 years. The committee of lawyers expert in tax matters which was appointed in 1927 by the Honorable Winston Churchill, Chancellor of the Exchequer, to consolidate and simplify the income-tax law, submitted its report and the draft of an income-tax bill to Parliament in April 1936.

IV. SPECIFIC RECOMMENDATIONS WITH RESPECT TO THE HOUSE BILL

As realists we must deal with the immediate problem before this Senate committee, for which reason we offer a number of specific recommendations for the betterment of, and greater equity in, the bill under consideration.

These specific recommendations relate to:

(a) The undistributed-profits tax.
(b) Taxation of corporations.
(c) Capital gains and losses.
(d) Consent dividends credit.
(e) Capital stock and related excess-profits tax.
(f) Deduction for charitable contributions by corporations.
(g) Reporting of compensation of $75,000.
(h) Disclosure by lawyers and accountants.
(i) Carry-over of business losses.
(j) Consolidated returns.
(k) Time for filing income-tax returns.
(l) Expenses incurred in connection with management of income-producing property.
(m) Liquidation of personal holding companies.

(A) UNDISTRIBUTED-PROFITS TAX

With respect to corporations with net incomes in excess of $25,000, the House bill, in lieu of existing levies which consist of a normal tax ranging from 8 percent to 15 percent and a surtax of from 7 percent to 27 percent, provides a 20-percent tax with a maximum drawback of 4 percent. This drawback, although otherwise expressed, is in reality a 4-percent undistributed-profits tax. The offsets in the House bill are simpler than those provided in the present law, but there appears to be no sound reason for retaining any remnant of the undistributed-profits tax, for section 102 may be so strengthened as to accomplish all that the undistributed-profits tax sought to achieve. Surely, effective revenue yield cannot be urged in its behalf. Surely, effective dividend distribution compulsion cannot be claimed for it. Whether the view is justified or not, we can testify, on the basis of our professional contact with taxpayers, that the business community appears to associate with the undistributed-profits tax such feelings of unmistakeble resentment that we feel free to urge on your committee, in the interest of a more wholesale attitude of the taxpayer toward his Government, the complete abandonment of this tax irritant. We do not advocate a subsituted source of revenue for the 4-percent undistributed-profits tax element for two reasons:

(a) Encouraged business may yield a larger measure of taxable income than was estimated by the House Ways and Means Committee, and

(b) The proposed 4-percent undistributed-profits tax would net much less than 4 percent.

We have questioned the yield of the proposed 4-percent undistributed-profits tax. This is so because we have taken into consideration the average dividend

distribution history of domestic corporations. Because of the set-off or drawback allowed as a dividends paid credit, the maximum corporate rate of 20 percent would be reduced greatly, probably to less than 18 percent. Further reduction would also result because of the dividends received set-off and the dividend carry-over provision.

Our specific recommendation is a flat tax on all ordinary corporations at a rate to yield from this source a proportionately fair amount of necessary revenue. In the determination of this rate, we believe that Congress can rely confidently on a large measure of taxable net income which should inevitably result from improved business consequent upon the encouragement to trade and industry which would follow removal of the undistributed-profits tax.

If the Senate Finance Committee, early in its deliberations, should decide to recommend the elimination of the undistributed-profits tax, it is suggested that prompt release of such a decision would be welcome and most encouraging news. By the same token, it would be well to advise the country, as promptly as possible, of other constructive recommendations decided by your committee, instead of withholding such information until all of your recommendations for revision of the House bill have been completed.

(B) TAXATION OF CORPORATIONS

In the preceding division of our specific recommendations we have urged the elimination of the undistributed-profits tax and the imposition of a flat rate on net incomes applicable to all ordinary corporations.

If such a flat rate were adopted, it would make unnecessary the unavoidably complicated calculation with reference to corporations having net incomes slightly more than $25,000. If Congress insists, however, on dividing corporations into two general categories, one with incomes not over $25,000 and the other with incomes in excess of $25,000, the same rate should be made applicable to the first $25,000 of net income and the increased rate should apply only to the net income above that amount.

In the case of individuals, graduated surtaxes are levied on the principle that the tax burden should be commensurate with ability to pay. Nevertheless, and properly, all taxpayers, regardless of differences in net income, are subject to the same measure of tax within the same brackets. There is no sound reason for graduated corporate taxes, but, if the rates are to be graduated, every corporation should, in fairness, be subject to the same rates within the same brackets exactly as in the case of individuals. It might be well to recall that during a number of years all corporations were treated alike with respect to exemptions or credits and rates. It was not until the 1921 act that credits were allowed only to corporations with net incomes not over $25,000, and it was not until 1935 that graduated taxes, unjustifiably with respect to corporations, were introduced.

If the suggestion for a flat rate on all ordinary corporations is adopted, the allowance with respect to interest on Government securities and with respect to dividends received obviously can be expressed much more simply than in the House bill with respect to corporations with net incomes not more than $25,000 and with net incomes slightly more than $25,000.

(C) CAPITAL GAINS AND LOSSES

The House bill recognizes that the existing taxation of capital gains and treatment of capital losses has had undesirable economic and fiscal results. The improvement sought by the House is commendable; the solution manifestly adds to the complication of the tax structure and its administration. We do not undertake to express statistical judgment as to the extent to which the present taxation of capital gains has interfered with the free flow of capital funds. We know that the interference has been great and real, and to the detriment of the national economy and to the Federal revenues.

To express professional judgment in the premises, there would have to be available the results of more thorough-going study than has as yet been made of the relationship between capital-gains taxes and Federal revenues, and of the relationship between such taxes and the security markets.

It is possible that the importance of the tax on capital gains has been exaggerated. This appears to be indicated by the fact that during the year 1935, the estimated tax revenues ($85,000,000) on capital gains (less losses) of individuals was only about 13 percent of the total income taxes collected from individuals for that year. (For the year 1934, the relative importance of the tax

collected on capital gains was substantially less.) This fact is significant in its indication of the relatively small risk of loss of revenue involved in any revision of the capital gain and loss provisions which may be made in an attempt to increase the yield from this tax through the stimulation of capital transactions and to increase the tax yield by removing an existing obstacle to the free flow or change of ownership of capital assets.

In dealing with the tax treatment of capital gains and losses, and particularly those realized on securities transactions, at least four major points present themselves:

(1) The maximum tax rate to be applied to capital as distinguished from ordinary gains.

(2) The distinction, if any, to be made between (*a*) so-called long-term gains, and (*b*) so-called short-term, or speculative and trading gains.

(3) The application of graduated percentages of gain based upon period of ownership.

(4) The treatment of capital losses.

As to (1):

It is felt, and the House committee expressed the same view, that it is desirable to tax capital gains (other than trading and speculative gains) at a substantially lower rate than ordinary income. The House bill establishes the capital-gains tax rate at maximum figures ranging from 40 to 16 percent, depending upon a period of ownership. We have not available sufficient statistical data upon which to predicate a definite recommendation as to the proper tax rate. We feel, however, that the rate should be lower than that provided for in the House bill, and we suggest that a flat rate no lower than 10 percent and no higher than 15 percent be provided, and that, as in the House bill, the taxpayer have the option of subjecting his capital gains to this flat rate, or of including such gains in ordinary income subject to normal tax and surtax rates.

As to (2):

We feel that the line of demarcation made in the House bill between short- and long-term gains, based on ownership of 1 year (and of longer than a year), is arbitrary and places too great a premium upon continued holding of securities until the "more than 1 year" period has been reached, thus tending to accentuate the holding, as opposed to the selling, of securities on a rising market.

We suggest that a sounder basis of distinction is whether or not the taxpayer is engaged in the business of trading in securities (or other capital assets). Many persons are engaged in securities trading to such an extent as to raise it to the level of a trade or business and yet, under the present and the proposed law, the gains from such activities are taxed as capital gains. A distinction based upon whether the taxpayer is or is not engaged in the business of trading in the assets the sale of which result in gain, would be more logical and less arbitrary than the proposed 1-year dividing line. If such a distinction were adopted the gains of those engaged in the business of trading in securities, etc., would be taxed as ordinary income, regardless of period of ownership, that is, whether more or less than a year. In order to cover the activities of speculators, other than those engaged in the business of trading in securities, a short-term capital-gain period of 6 months, instead of a year, might be established. While this would concededly still be arbitrary, it would more nearly approach the realities of speculation, than a 1-year period, and would tend to minimize tax-induced holding for the purpose of establishing the more favorable longer period of ownership.

It is recognized that the impelling purpose underlying the adoption by the House committee of the long schedule of graduated percentages of recognition of gain based upon period of ownership was the elimination of the very great tax premium for continuing to hold securities and other capital assets, until the next period of ownership was reached, and thus to remove the existing tax encouragement for holding, instead of selling, securities on a rising market.

It is felt, however, that despite the beneficial objective sought to be accomplished, the adoption of the House provision would needlessly complicate the statute and add to the taxpayer's troubles, and to the difficulties of tax administration. Practical difficulties which at present exist in determining period of ownership would be multiplied manifold, and the number of Bureau of Internal Revenue adjustments which would be required in the net-income computations made by taxpayers would increase considerably. The time and expense of preparing returns and of their subsequent verification would be multiplied. We feel that the recommendations hereinabove made would be

fully sufficient to meet the problem of tax-motivating continued holding, as opposed to selling of, securities on a rising market; and that, accordingly, a flat rate on capital gains would serve the purpose and have the very obvious advantage of simplicity and ease of administration.

As to (4):

As a matter of accounting, of logic, and consistency, it is felt that the losses of one engaged in the business of trading in securities, or other property now defined as capital assets, should be fully deductible against ordinary income just as in the case of other business losses. Subject to this observation, however, we are generally in accord with the treatment of capital losses in the House bill, except that it is our opinion, in view of the fact that the price cycles of capital assets are more than 1 year in duration on each side of the cycle, that the carry-over of long-term capital losses should be permitted for more than 1 year; we suggest at least 3 years.

(D) CONSENT DIVIDENDS CREDIT

Assuming, but not granting, that there should, in general, be tax punishment for failure to distribute earnings, the consent dividends credit provided in section 28 of the House bill is a commendable effort to lighten the burden of corporations which cannot afford to make actual distribution of cash or other assets. With the elimination of the so-called third basket (title 1B of the House bill), there is no need for the necessarily complicated consent dividends credit provision except with respect to personal holding companies (title 1A) of the House bill. If the suggestion made with respect to the encouragement of the dissolution of personal holding companies (see item (m), below) is adopted, the occasion for the application of the consent dividends credit may become so rare as to justify considerable simplification of the proposed provision.

In its present form, section 28 is one of the most complicated sections of the bill.

(4) In fairness to taxpayers, they should be given an opportunity to consent to the inclusion of additional income determined by the Commissioner of Internal Revenue upon the subsequent audit of a corporation return, and the finding that the net income as originally reported has been increased. The shareholders should have the right to include the additional income in their returns for the year ending within the corporation's fiscal year.

(e) CAPITAL STOCK AND RELATED EXCESS-PROFITS TAX

If the capital stock and the related excess-profits tax is to be retained, we approve of the redeclaration of values for capital-stock purposes every 3 years, as provided in section 601 (f) (1) of the House bill. We do not favor, however, the retention either of the capital-stock tax or of the excess-profits tax. The declared value, for capital-stock purposes, is purely arbitrary and has no relationship to true worth. Congress, in the House bill, continues its indifference to that fact and relies on the excess-profits tax to discourage unduly low valuations. Taxes should not be based on guesswork.

(f) DEDUCTION FOR CHARITABLE CONTRIBUTIONS BY CORPORATIONS

(Section 23 (2) (2) and 23 (q))

There is increasing need for corporate contributions to charitable causes. We do not know of any abuses under the 1936 and earlier acts which permitted corporations to deduct charitable contributions, limited to 5 percent of their net income, but which permitted such expenditures, when really in the nature of operating or business expenses, to be deducted in full. The limitation sought in the House bill is, in our opinion, unfortunate and undesirable. The provision in the 1936 act should be permitted to remain unchanged.

(g) REPORTING OF COMPENSATION OF $75,000

The House bill, in section 148 (f), provides for the publicizing of salaries and other compensation in excess of $75,000 per annum paid by corporations to individuals. In the bill as introduced in the House the provision for reporting compensation had been eliminated.

While the number of persons directly affected by the provision is undoubtedly negligible, we submit that there is no revenue excuse for the provision. The arguments against publication of salary lists are well known to the members of the Senate Finance Committee. They need not be repeated here; to us it appears unconscionable to select the names of relatively few citizens and to subject them to the type of suggested publicity.

(h) DISCLOSURES BY LAWYERS AND ACCOUNTANTS

(Section 802)

The House bill, in section 802, continues the unwarranted and vicious provision introduced in the 1937 act providing for the disclosure by attorneys and accountants of professional advice given with respect to foreign corporations. Aside from the fact that foreign corporations and those interested in them will be encouraged to seek advice from others than American attorneys and accountants, the principle involved appears to us to be peculiarly vicious. The relationship between the attorney and his client is naturally one of confidence, and communications between them should be privileged. To the extent that the accountant participates in technical reorganization advice, usually in cooperation with the attorney, the accountant's relationship with the client should be regarded exactly in the same light as the relationship between the attorney and the client.

Naturally, the reputable attorney as the reputable accountant will be bound by, and he will rigorously observe, all the requirements of the law. We advocate that the provision should be eliminated as un-American, unfair, and unnecessary. Are not the needs of the tax administrator sufficiently met by the statutory requirement that foreign corporations, through their directors, officers, and American shareholders supply periodic information?

(I) CARRY-OVER OF BUSINESS LOSSES

The provisions of former revenue laws permitting net business losses to be carried forward should be restored and such losses should be allowed to be carried over for at least 3 years.

(J) CONSOLIDATED RETURNS OF CORPORATIONS

The House bill continues the provisions in the existing law with respect to consolidated returns of affiliated railroad corporations. However, neither the House bill nor the existing law contain any similar provisions for other corporations such as were contained in some of the former laws. We recommend that the consolidated return provisions be made to apply to all corporations. This recognizes the realities of corporate practice and avoids the taxation of fictitious income of a group of affiliated corporations considered as a unit. Corporations for various reasons find it necessary to have subsidiaries. Often it is to comply with State laws. In such cases, the effect is exactly the same as if one corporation had different departments or branches. No one has ever suggested that each department of a corporation pay an income tax, without regard to the losses of another department of the same corporation. It is just as illogical to tax one subsidiary of a group of affiliated corporations without regard to the losses of the other corporations in the group.

It is submitted that administration of the revenue act would be simplified by adoption of this recommendation.

(K) TIME FOR FILING FEDERAL INCOME-TAX RETURNS

Under section 53 of the proposed bill income-tax returns are required to be filed, as heretofore, within 2½ months following the close of the taxable year. The Commissioner is empowered, by the same section, to grant reasonable extensions of time.

Experience has shown that many taxpayers, especially corporations, cannot gather the necessary data for the preparation of returns within the time specified by law. The technical complexities of our present income-tax structure make it imperative for many taxpayers to secure professional aid, despite which fact it is frequently impossible for returns to be prepared by due date.

As a result, a large number of taxpayers are forced each year to obtain extensions of either 1 or 2 months within which to file their returns. This is a

source of expense, inconvenience, and uncertainty to both taxpayers and the Treasury Department.

This difficulty may be removed by amending section 53 (a) (1) of the proposed bill to read as follows:

"(1) General rule: Returns made on the basis of the calendar year shall be made on or before the 1st day of May following the close of the calendar year. Returns made on the basis of a fiscal year shall be made on or before the first day of the fifth month following the close of the fiscal year."

In respect to installment payments, section 56 could at the same time be amended to provide for the payment of one-half of the total tax on or before the first day of the fifth month following the close of the taxable year and one-fourth on the fifteenth day of the ninth and twelfth months. This would not lessen the Government's revenue in any fiscal year and at the same time it would not be inequitable to taxpayers.

CONNECTION WITH (1) EXPENSES INCURRED IN THE MANAGEMENT OF INCOME-PRODUCING PROPERTY

Section 23 (a) of the proposed bill and the corresponding section of the present and prior laws provide for the deduction of all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. This provision should cover the deduction of expenses paid or incurred in the management of income-producing property, even though such income does not arise from the taxpayer's trade or business. In some instances, the Bureau has disallowed expenses such as investment counsel fees, custodian fees, safe-deposit fees, rental and professional fees, and has thus unduly narrowing interpretation of this section of the law.

The failure to allow such deductions is contrary to sound accounting concepts and the reasonable intent of the law, and results, in many cases, in the taxation of gross, instead of net income. Accordingly, it is recommended that section 23 (a) be amplified to expressly permit the deduction of all ordinary and necessary expenses paid or incurred during the taxable year in the management of income-producing property.

(M) LIQUIDATION OF PERSONAL HOLDING COMPANIES

In the Revenue Act of 1937 (sec. 205) provision was made for the complete liquidation of foreign personal holding companies. One of the purposes of the provision was to encourage the dissolution of such entities, undoubtedly in the knowledge that the assets distributed to American stockholders would tend to result in future taxable income.

A somewhat similar provision is found in section 115 (c) of the Revenue Act of 1936 which relates to the complete liquidation of all corporations. That provision has not been changed by the 1937 act except insofar as foreign personal holding companies are concerned. The provisions of the 1936 and 1937 acts are continued in section 115 (c) of the House bill.

It is well known that many domestic personal holding companies were organized before income taxation became an important element in business planning. At any rate, there was nothing censurable in the formation of these corporations, nor in their continued existence. Because some of these corporations were undoubtedly employed as tax-avoidance media, Congress has sought to cope with the problem. Under existing law, personal holding companies can continue in existence, but for practical purposes their normal functioning is prevented. To some extent, probably slight, the inactivity of personal holding companies does affect the security markets. In view of the attitude of Congress toward these enterprises, it seems desirable to encourage their early dissolution. Two alternative suggestions are offered:

(A) That these companies, surely the domestic ones, and possibly also the foreign ones, be permitted to dissolve without immediate tax to their stockholders, and with substitution of the stockholders' investment basis of the stock of the distributing company for the property received upon dissolution; or

(B) For a very limited period of time, option of either of two treatments of property distributed in liquidation:

(a) That to the extent that the market value of the distribution at the time of its distribution exceeds the recipient stockholders' basis, such excess, limited to the recipient's pro-rata share of the distributing corporation's earnings, shall be taxable to the recipient as an ordinary dividend. This suggested treatment is similar to the prescribed treatment of certain reorganization distributions (illustration):

Stockholders' basis	$10,000
Market value of distribution	18,000
Pro-rata share of distributing corporation's earnings	5,000
Taxable as an ordinary dividend	5,000

The balance of $3,000 should be treated as under (A), above. The stockholder's basis, then, under the comparable rule, would be increased by the amount of gain recognized, namely, $5,000. The basis for the property received in distribution in the instant case would then become $15,000.

(b) That the excess of the market value of the distribution over the stockholder's tax basis should be treated as a capital gain and subject to a flat capital-gains tax as hereinbefore recommended.

Respectfully submitted.

JOSEPH J. KLEIN,
Chairman, Committee on Taxation,
New York State Society of Certified Public Accountants.

The CHAIRMAN. Is Mr. Bowen in the room?

STATEMENT OF E. R. BOWEN, GENERAL SECRETARY OF THE COOPERATIVE LEAGUE, NEW YORK

The CHAIRMAN. I understand you want to discuss an amendment to section 101, excepting therefrom cooperative groups.

Mr. BOWEN. Yes, sir.

The CHAIRMAN. All right, Mr. Bowen, you have your brief there?

Mr. BOWEN. I have a very short statement for the committee.

The CHAIRMAN. Very well, Mr. Bowen.

Mr. BOWEN. What I have to say has to do with clause 12, of section 101 on page 81, if you care to turn to it in connection with the statement which I wish to make.

The CHAIRMAN. It is page 94 in the print before the members of the committee.

Mr. BOWEN. I see. I have the House bill on it.

The CHAIRMAN. All right.

Mr. BOWEN. The statement I wish to make is a very brief one. For many years revenue acts have rightly incorporated the principle of exempting cooperative purchasing associations from income taxation, since they are nonprofit organizations.

However, when earlier revenue acts were drawn the cooperative movement was largely confined to farmers. Accordingly, in describing the cooperative groups to which exemptions were granted the phraseology was worded to include only "farmers, fruit growers, or like associations organized and operated on a cooperative basis."

Now, urban residents, as well as farmers, are rapidly organizing cooperative purchasing organizations. They are logically and fairly entitled to the same exemptions as are granted to farm cooperative purchasing associations.

Such cooperative purchasing associations are generally described as "consumers' cooperative associations." We therefore offer for your consideration and approval an additional clause to be added to

section 101 covering consumers' cooperative associations. Your approval of this clause will apply the same principles of justice to urban cooperative purchasing associations as are now applied to farm cooperative purchasing associations.

The omission of urban cooperative purchasing associations when clause 12 of section 101 was drawn was presumably due to the small number of such associations which were then in existence. In the last few years, however, large numbers of urban cooperative purchasing associations have been organized which are fairly entitled to equal consideration with farm cooperative purchasing associations.

Your approval is requested by the directors of the Cooperative League, which includes in its membership farm and urban wholesale and retail cooperative purchasing associations in the United States.

TO BE ADDED TO SECTION 101 OF H. R. 9682

SEC. 101 (19). Consumers' cooperative associations organized and operated by ultimate consumers, including central cooperative purchasing associations owned and operated by such consumers' cooperative associations, for the purpose of purchasing food, goods, or services for members or others and turning over such food, goods, or services to them at actual cost, plus necessary expenses. Exemption shall not be denied any such association because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the savings of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by consumers or by consumers cooperative associations who purchase their food, goods, or services through the association; nor shall exemption be denied any such association because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose. Such an association may purchase food, goods, or services for nonmembers in an amount the value of which does not exceed the value of the food, goods, or services purchased for members. Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under this paragraph:

Only cooperative associations organized in good faith, with no intent to evade the tax imposed under this title, and incorporated under the cooperative laws of the State of their domicile may be granted exemption, provided that this requirement shall not be applied to true cooperative associations located in States having no cooperative laws under which such cooperative associations could be properly incorporated and operated.

Senator CONNALLY. What do they principally deal in? You say cooperative purchasers. What do they do—buy groceries?

Mr. BOWEN. Groceries and gasoline mostly, insurance to a certain degree. But largely household supplies and a certain amount of development in petroleum products. These cooperative associations are generally described by the phrase "consumer cooperative associations."

Senator CAPPER. Has this proposal ever been made before to Congress?

Mr. BOWEN. Not so far as I know, Senator Capper. I have been connected with the movement as secretary of the Cooperative League for 4 years, and if it has been it was prior to that time.

The CHAIRMAN. Was it made to the House committee?

Mr. BOWEN. It was not made to the House committee, Senator.

I think probably that the omission of the urban groups at the time this clause was drawn was largely due to the fact that there were few such groups in existence at that time.

Now, in the past few years, as I have said, these urban cooperative groups are organizing, and while we do not have an accurate census as yet, I think it is perfectly right to say in every State in the Union; in other words, there is no State now where urban groups are not organizing purchasing cooperative associations. I represent, may I say, the Cooperative League, national association of the purchasing cooperative movement.

We have in our league now a large number of wholesale and retail groups, both farm and urban, with a membership from 800,000 to 1,000,000, which is presumably about half the number in the United States, estimated at about 2,000,000. Of course, that means heads of families. So that, affected altogether, the whole number represents millions.

The clause we are speaking about is numbered 19, and we will supply copies to the Senate Finance Committee. It is drawn similar to clause 12. We have simply phrased a clause to give the same exemptions to urban groups as given to farm cooperative groups, with no intention of making any new proposal.

Senator BROWN. Your theory being that no profit was made by the cooperative association, it does not affect the membership in taxes?

Mr. BOWEN. Absolutely. In other words a cooperative was rightfully classified in the previous revenue acts as a nonprofit organization, but unfortunately our urban groups are being taxed because they are not specifically exempted.

Senator CAPPER. Is not there this difference: That these farmer cooperatives are also producers of farm products and that a large part of their business has to do with production——

Mr. BOWEN. The facts are, Senator, and you are very familiar with cooperatives, because there are a large number in your State, that the cooperative purchasing done by the farmers is growing now very rapidly, and bids fair to eventually equal the marketing or perhaps exceed it, so that there is no difference whatsoever in the application of this to urban groups as compared to farm groups.

The CHAIRMAN. Senator Capper, you understand this, do you, thoroughly? You understand this thought he has urged?

Senator CAPPER. Yes; I think so.

The CHAIRMAN. You have a pretty good representative on the Finance Committee.

Mr. BOWEN. Yes; not only one, but every Senator on the committee, I think, will be likewise.

The CHAIRMAN. He will be the most persistent. Thank you, very much. Do you want to elaborate any further your views?

Mr. BOWEN. No, sir. I will do what the other witnesses have not done and stick close to the time allotted.

The CHAIRMAN. All right. Thank you, sir.

Senator Pope, did you have something that you wanted to present to the committee?

STATEMENT OF HON. JAMES P. POPE, UNITED STATES SENATOR FROM THE STATE OF IDAHO

Senator POPE. Mr. Chairman, on yesterday I had printed in the Record, which will be found in today's Congressional Record, some proposed amendments, which levy what we call tariff equalization fees on the first manufacturing of certain farm commodities.

I had printed also a statement by those who drafted these amendments, representatives of the Department of Agriculture and the Department of Internal Revenue. Instead of placing a processing tax upon cotton, corn, wheat, tobacco, and rice, we have placed on the processed material certain graduated taxes. So that on the lower grades of cotton yarn, for instance, the tax will be very low, but as it would go up into the finer grades it will be higher. However, these taxes, as compared with the old processing taxes, are small. They would amount to about half of what the original taxes were.

I have discussed the matter with a number of farm leaders, the Farm Bureau Federation, Farmers' Union representatives, and a number of textile men, and very generally they much prefer this type of a tax to the processing tax.

Now, I desire to have the committee consider the amendment——

The CHAIRMAN (interposing). Has the Committee on Agriculture given any consideration to it?

Senator POPE. The Committee on Agriculture is now discussing the matter. I just left that committee. It is in session. They have made no recommendations. This matter has not been presented to them for recommendation. But they are talking about the matter. I know some of the members are not only interested but they are in favor of it. But the committee as a whole has not acted on the matter. I did desire to have this committee give it consideration and to have on it hearings or explanations as to whatever the committee may desire.

Senator CAPPER. Have these so-called processing taxes ever been in a general tax bill heretofore? They have always been in a special bill; is not that right?

Senator POPE. Yes; the processing taxes heretofore were, of course, in the Agricultural Adjustment Act itself.

Senator CAPPER. Yes.

Senator POPE. But not in a general revenue bill.

The CHAIRMAN. I do not know, Senator Pope, how the committee feels. It is a matter which the committee has to take up and consider. We were very anxious to expedite the consideration of this bill. This week we have put in more than the 8 hours permitted under the law, and, of course, we had some witnesses here yesterday that wanted to discuss this proposition.

If it is opened up at this time in the Senate for the first time, we have got to let those people be heard and discuss their views. I think it is fair that every side be heard on the proposition. I was personally very much hopeful that this legislation would start in the House and would come over after consideration by the Ways and Means Committee and the Agriculture Committee, because I think this is a matter which ought to be worked out by both committees, and then when it came to the Senate I was in hopes that the Agricultural Committee

would first consider it and then give it to us, because it has a tax feature involved, and naturally we would have to handle that feature, but the Committee on Finance would like to get the opinions of the experts on farming on the Agriculture Committee, and we were anxious to close hearings this week if we could. I find we cannot. We hope to close them Monday. But if the committee should decide to take up this phase of the proposition—and I had heard you offered the amendment yesterday—the committee will have to go into executive session and fix a time to hear everybody, and determine whether they are going to take it up in the Senate or not.

Senator POPE. Mr. Chairman, the committee might adopt—I would be very glad to abide by any procedure. I thought if the committee desired a carefully prepared statement explaining the amendment, its purposes, the amount of money it would raise, and what effect it would have on the consumers, and all those questions, I would be very glad to file a statement giving the information for the committee right now.

The CHAIRMAN. So far we have got this tentative understanding—that after we have finished this hearing we have witnesses from everywhere, and we have got the calendar all arranged, then our committee will have an executive hearing and consider your request, and the amendment, and let them pass on the proposition as to whether they want to open it up to go into this phase of your matter or whether it is their judgment to start over in the House in a separate bill.

Senator POPE. Very well, Mr. Chairman.

The CHAIRMAN. Do you not think that is the best way? Then we will notify you if it is their judgment that we are going to hear witnesses. May I state to the gentlemen and the ladies to consider those things in the bill in the committee at this time.

Senator POPE. Very well.

The CHAIRMAN. Mr. McKinney. I am going to hear just two more who are present and that will be about all we can do this morning. We will hear Mr. Oliver after this witness. I understand these are brief.

All right, Mr. McKinney.

STATEMENT OF H. S. McKINNEY, REPRESENTING THE REINSURANCE CORPORATION OF NEW YORK

Mr. McKINNEY. Mr. Chairman, I represent the Reinsurance Corporation of New York. The matter to which I wish to refer relates to section 402 (b), page 265, of House bill 9682, as applied to fire-insurance companies, especially fire-reinsurance companies.

All we ask is that fire-insurance companies be granted the same statutory rights and consideration as that granted to life-insurance companies and casualty insurance companies. Section 402 (b) of the House bill provides that—

> (b) Exceptions: The term "personal holding company" does not include a corporation exempt from taxation under section 101, a bank as denied in section 104, a life-insurance company, a surety company, * * *.

The amendment which we ask is to insert after the words "a surety company", on line 7, page 265, of the House bill, the words "a fire-insurance company."

This amendment will not only afford an equitable and fair statutory treatment of surety and fire insurance companies alike, but it will result, as far as fire reinsurance is concerned, in substantial increase in taxable revenues for the United States Government. This is due to the fact that at present a great volume of reinsurance premiums, estimated to be considerably in excess of $50,000,000 annually, now goes from this country to England and other foreign countries. None of these reinsurance premiums going abroad pay any income tax to the United States Government. The company which I represent has over 3,000 stockholders and is 100 percent American owned. It is seeking to build up in this country a home market for this excess fire reinsurance business and thus retain at home the premiums and profits which are now being paid to foreign reinsurancers. If this business can be built up here, then the income taxes on its profits will be paid to the United States Treasury, whereas, now no tax is paid here on these reinsurance premiums.

The predecessor to the Reinsurance Corporation was organized in 1929 with about 7,000 stockholders, principally druggists. During the depression about 3,900 of these small-business men took advantage of the privilege to withdraw and cash in their stock holdings at the net asset value per share and this left a few large-stock holders with a big percentage of the remaining stock. The result was that prior to the organization of the Reinsurance Corporation the predecessor company fell into the classification of a personal holding company, not because a few men incorporated to avoid taxes, but because a few men with substantial holdings allowed the small-stock holder who needed the money to "cash in" for the full value of his shares.

The Reinsurance Corporation of New York is not and never has been an "incorporated pocketbook" or a set-up for avoiding income taxes. If that had been the purpose or desire let us clearly point out that under the existing law this could have been very easily accomplished, and could even now be done, by simply going into the surety insurance, life insurance, or banking business.

The Reinsurance Corporation of New York is an active insurance company engaged in building up in this country a real American market for reinsurance. We have taken the necessary steps to qualify in all the States of the Union where such qualification is necessary.

The development of a broad American market for reinsurance of the types now being placed abroad requires the maintenance of adequate reserves against the risks assumed. The business is catastrophic in nature. It is, therefore, imperative, if the excess reinsurance business is to be built up in this country, that fire-insurance companies like the Reinsurance Corporation of New York be exempted from the personal holding company provision in the same manner as surety or casualty companies. The statutory reason for granting to surety-insurance companies and life-insurance companies the right to accumulate surpluses, as required by sound business practice, is to protect those purchasing insurance. It applies with equal force to fire-insurance companies, and especially excess reinsurance companies which insure risks as of a catastrophic nature.

The excess fire-reinsurance business should, we believe, be particularly interesting to Congress, conscious of the importance of in-

creasing the national revenue. We are leading the way in developing an American market that has in the past resulted in vast sums going to foreign markets and thus escaping all American taxes. Such premiums going abroad are, as stated above estimated to exceed $50,000,000 annually.

That is all, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. McKinney.

Mr. Oliver; Mr. J. W. Oliver, representing the New York Merchants' Association. All right, Mr. Oliver.

STATEMENT OF J. W. OLIVER, REPRESENTING THE NEW YORK MERCHANTS' ASSOCIATION, NEW YORK

Mr. OLIVER. Senator, I was listed yesterday as representing The Linen Thread Co., Inc., and today as representing the merchants' association, and that is due to a little confusion which arose wherein I requested to be heard in the name of The Linen Thread Co., Inc., and then the merchants' association decided that you were so crowded for time that they would ask me to speak in their behalf.

The CHAIRMAN. Very well, sir.

Mr. OLIVER. I won't take but a limited time to discuss what I might call the high spots and touch upon a few things that I believe most witnesses have overlooked.

First is the effective date of this new bill. It is similar to the last two or three revenue acts, and I agree that when you pass a revenue act it is far more simple to allow for the first fiscal after to continue over the old act before they start to be taxed under the new act. However, in 1926 you granted relief and made that effective from the entire prior calendar year. Other than that, all other acts until 1934 have required for the first year, on a fiscal-year basis to file under different laws, i. e., each fraction of the year being taxed under the appropriate tax law.

The CHAIRMAN. What is your request on that?

Mr. OLIVER. My request, sir, is to make the relief available immediately to the fiscal-year corporation as well as the calendar-year corporation.

The reason I say that is that it is primarily relief that this bill purports to give. I think I have quoted the Senators correctly in reference to the fact that you admit that this is for relief. I believe I understood correctly you to say that you did not want to bring in anything other than corrective provisions.

The CHAIRMAN. If you ask for it to apply to the fiscal-year corporations and make it retroactive from January 1, 1938, how much loss of revenue do you estimate?

Mr. OLIVER. I have no means of getting at that. I asked for it and they did not have it available.

The CHAIRMAN. That would be very material.

Mr. OLIVER. No. But I would be very glad to supply such information as a supplement if the Senator thinks it is desirable.

I can understand and I can anticipate a question to the effect as to our corporation, which is 9 months later, that we, at the inception of this act, were not taxed under the 1936 act until the year beginning after September 30, 1936. Let me state that since this is to cure

inequities, rather than to change the entire taxing system, that it would be like two men who were convicted of a crime, which is mentioned in my brief.

(The brief referred to is as follows:)

I am chairman of the tax committee of the American Management Association, a member of the tax committee of the New York Merchants' Association, an active member of the National Tax Association, and secretary of the Linen Thread Co., Inc. In my appearance before your committee I shall present my personal views—my reference to the various tax committees being only for the purpose of establishing that I feel competent to express some views that may be helpful to the Senate Finance Committee. In expressing those views, I am taking full responsibility for my statement as the organizations with which I am associated, except the New York Merchants' Association, have not specifically authorized me to speak on their behalf. The Merchants' Association has designated me as their spokesman to appear and officially represent them in advocating complete repeal of the undistributed-earnings tax and the repeal or further modification of the capital-gains tax.

It is my purpose to deal primarily with only a few phases of the problem before you. I shall endeavor to present suggestions for the consideration of the Senate Finance Committee and to make observations relating to some arguments that have been made in favor of the bill. I shall try to avoid a repetition of sound arguments that have already been presented.

The headings that I shall discuss are as follows:

1. Effective date of the 1938 Revenue Act;
2. Lack of understanding of ordinary accounting terminology on the part of the legislator, businessman, and the layman;
3. Distinction between a book surplus and a surplus available for distribution;
4. The term "business" as such implies no ability to pay taxes;
5. "Financial anemia" resulting from the capital-gains tax;
6. The necessity for the new tax law to provide tax-free dissolution of personal holding companies.

ITEM NO. 1. EFFECTIVE DATE OF THE 1938 REVENUE ACT

With the exception of certain excise taxes and the withholding of income taxes at source, both of which must be dealt with currently, the remainder of the proposed changes in the new revenue bill are applicable only to taxable years beginning after December 31, 1937. From the report of the subcommittee of the Committee on Ways and Means, and the full report of that committee as well as the published reports of most of the members of the Finance Committee who have made statements to the press, it is evident that the prime purpose for any change whatsoever in the Revenue Act is to afford relief or correct inequities that crept into prior laws.

The bill does not purport to be one seeking additional revenue or for the adoption of an entirely different medium of taxation. As a consequence, I am led to believe that had Congress considered the existing revenue measure as being entirely fair to taxpayers, irrespective of the amount of revenue it would produce, no changes whatsoever would have been recommended. The point I wish to emphasize here is that whenever Congress realizes that an unjust or uneconomic tax measure has been passed, it is the duty of Congress to amend it at the earliest possible date.

The 1926 act, granting a reduction in rates (relief) was retroactively effective from January 1, 1925. Prior to 1934 all other acts were effective from the first day of the calendar year in which they were passed. The 1934 and subsequent acts have been effective only for taxable years beginning on or after the first day of the calendar year of enactment. Until 1934, corporations on a fiscal-year basis, for the first year after a tax law was passed, were faced with the problem of preparing the tax return under the provisions of two different tax laws. Of course, this has been somewhat cumbersome on the part of the taxpayer as well as a troublesome administrative feature. Until the proposed 1938 act, I have found no fault with a simplified procedure that avoided the filing of a tax return under two different laws. With the present one, however, since it is predicated almost entirely, if not entirely, upon giving relief and eliminating inequities, I submit that it is only fair to call your attention to the fact that for a vast number of corporations, you are failing to provide at this

time the amount of relief that should be granted or the amount that the public is led to believe is being granted.

I think it would be a waste of your time for me to emphasize how the average businessman feels about certain provisions such as the undistributed-earnings tax and the capital-gains tax as now exist, but it is only fair that I express to you my feeling about the attitude of the average businessman when he suddenly finds, by reading the first sentence of the proposed revenue act (the last sentence that the average tax student does read) that the relief afforded does not apply to corporations or individuals reporting on a fiscal year basis until after the end of the first taxable year after the calendar year or enactment.

I have made some attempts to learn what proportion of the large industrial companies report on a basis of fiscal, rather than calendar, taxable year. The latest report I have available shows that in the year 1933 over 53,000 corporations report on fiscal year basis, and the net income of 17,000 of these amounted to $479,000,000, and the tax paid thereon amounted to over $67,000,000. Since that time, due to activities of the American Institute of Accountants and others in advocating the adoption of the normal business year, significant changes have been made from calendar to fiscal years. Even since the passage of the 1936 Revenue Act, something like 10,000 large corporations have adopted what is generally known as the natural business year.

In view of this I recommend strongly that, irrespective of additional work required on the part of the taxpayer and the Government, all corporations be allowed to enjoy the benefits provided in the new act from January 1, 1938. My own company is on a fiscal year ending September 30. In view of this, unless the effective date of the new law is changed, we will be compelled to pay a penalty tax on undistributed income—if we have any to distribute—at the end of our current year, even though conditions may be such as to require our directors, in the interest of the business, the continuity of wages, salaries, and so forth, to declare no dividends. I respectfully submit that this places us distinctly at a disadvantage with a competitor who happens to be reporting on a calendar year basis.

At this point I anticipate the question as to whether or not our company enjoyed a freedom from this penalty tax for 9 months after the 1936 Revenue Act was passed, and my answer is in the affirmative. However, we did pay out approximately what we had earned in the fiscal year 1936, because conditions were such as seemed to justify that action—the prospects were bright. At the close of 1937 we were faced with an entirely different situation. Almost the entire year had been an unusually good one, and we had had satisfactory earnings in spite of the market situation which caused a significant write-down in inventories, when we were faced with the problem of paying out all of our earnings or otherwise pay a penalty tax. The conditions at the close of the year—September 30—were already such as normally to warn us that future prospects were not bright, but the facing of a penalty tax if we did what subsequent months have proved we should have done, caused us to pay out practically all that which we earned. We did pay a small undistributed-earnings tax of $2,700. Incidentally this small amount was also a penalty for our stupidity in failing to guess the exact amount of our taxable earnings before we closed our books.

Now, as to why we should obtain relief immediately when we enjoyed a little freedom at the inception of the act, I respectfully submit that we are entitled to such relief as is afforded other corporations on the grounds that Congress now acknowledges that the provisions of the 1936 Revenue Act were unjust. To say that we, in order to make up for the 9 months' "freedom" that we experienced at the inception of the act, should now be penalized is like saying that a person unjustly imprisoned should be kept in prison as long as another prisoner likewise unjustly imprisoned at an earlier date for the same offense, while subsequent evidence has proved both to be innocent. As an example, let us say that two men are jointly charged with having committed a crime. The seeming guilt of one is proved and his sentence imposed several months before the other. Both, however, are supposedly guilty of the same crime. Two years later new evidence is uncovered showing that both were innocent. Is it fair to say that the man who was last sentenced must serve a time equal to that already served by the other before being released from prison, or, in the name of justice, must not both prisoners be released at the earliest possible date? Gentlemen, I think that is a fair analogy to make.

I have with me some material representing notable examples of American companies keeping their accounts on a natural fiscal-year basis, which I will gladly file if you desire.

Another feature about the effective date of this law relates specifically to section 27 (b) (2), providing for a net operating loss of the preceding year as a deduction in determining the undistributed-earnings tax as finally amended by the House bill. Under the strict wording of this section, the first deductible loss of the preceding taxable year is a loss that has been realized in a year subsequent to the effective date of this act—consequently a company having a loss in the calendar year 1937 but a taxable profit in the calendar year 1938 could not deduct the loss of the preceding year. Furthermore, as explained above, if the company happens to be on a fiscal-year basis, it could enjoy no benefit of this net loss carry-over before its fiscal year 1940. I am hopeful that the Senate will abolish altogether the undistributed-earnings tax and thus make the application of section 27 (a) (2) unnecessary unless it is willing to allow a net loss carry-over as in some of the former tax laws, to apply as a deduction from normal taxable income. However, if a net loss carry-over is to be given under either of these conditions, it is to be hoped that the Senate will consider it their duty to make such relief provisions effective immediately.

Gentlemen, I do not believe that the average businessman or, for that matter, most students of taxation who have read the various reports emanating from the Ways and Means Committee realize that a very significant portion of the benefit granted is not in fact immediately available to each and all business corporations. I cannot at this point resist the temptation to call your attention to the fact that too many honest businessmen of this country are now imbued with the feeling that Congress as well as the taxing authorities take undue advantage of them. For that reason, it is highly desirable that this Congress avoid the possibility of any features of the new revenue act being misconstrued as "political" or "congressional" trickery. At this point, I respectfully call your attention to an editorial in the New York Times of March 15 which I would quote had I the authority to do so, which calls attention to the necessity of the removal of obvious inequities. It refers to the "heads-I-win, tails-you-lose" policy of the Government in its taxing procedure and especially to the absolute necessity of the Government depending upon its taxpayers to be scrupulously fair, and looks to the Government itself to set an example of "scrupulous fairness." Certainly, if taxpayers are allowed reason to believe that the lawmakers have treated them unfairly, we cannot hope for their cooperation in reporting true tax liability and assisting the Government to the extent that is necessary if administration is to be fair, economical, and efficient.

ITEM NO. 2. LACK OF UNDERSTANDING OF ORDINARY ACCOUNTING TERMINOLOGY ON THE PART OF THE LEGISLATOR, BUSINESSMAN, AND THE LAYMAN

In discussing the Revenue Act of 1936, as amended by the proposals in the House bill, we must keep in mind that the public was misled in 1936 and continues to be misled by a misunderstanding of the words "depreciation reserve." In 1936 the proponents of the tax bill in explaining why corporations, even though subjected to the proposed rate of the undistributed-earnings tax, were being generously dealt with, emphasized the act that most all corporations accumulate large depreciation reserves and these are plowed back into the business, free of tax. There can be no more absurd argument in favor of a tax than this. Depreciation is just as much an element of cost in determining profits as the raw material consumed in manufacturing a product. It stands on the books as a reserve purely from the standpoint of accounting convenience. Should a cotton processor credit the account of cotton consumed in each month's operation to a reserve, he would have on his books an accumulated reserve as an offset against the cost of raw material. The net value of raw material in his inventory could only be determined by subtracting from the raw material cost account the reserve on the credit side of the ledger. No one could say that such a reserve is a generous allowance on the part of the Government having been plowed back into the business, tax free, unless they are advocating a tax on gross income rather than on operating net income.

The Treasury Department officials appearing before the Ways and Means Committee and the Senate Finance Committee in 1936 frequently pointed to the

fact that large corporations had been plowing back depreciation reserves and that the proposed law would not interfere with such accumulations. On page 8 of the subcommittee's report to the Ways and Means Committee advocating the present changes, most of which have been incorporated in the bill passed by the House, some misleading statements about depreciation allowances are again set forth. It points specifically to the fact that depreciation deductions for the prior year amounted to more than 20 percent of the net income before such deductions and that the depreciation allowed was 1½ billion dollars in the case of 145,000 corporations. It goes on to state that "in the average case, a substantial portion of these depreciation reserves are, as a practical matter, available for plant expansion and improvements." Nothing could be more misleading. The accumulated depreciation reserves are only available for replacement of the original depreciable assets on the assumption that they can be replaced at no greater cost than the original cost; even then only to the extent not dissipated by losses after deduction of depreciation. Certainly, therefore, they cannot be considered available for expansion or improvements.

Under Treasury Decision 4422 (and the companion mimeograph 4170), the deduction for depreciation is, by that specific regulation, limited to that which can be proved as a fact. Not only must one prove that the rate is correct, but one must prove that the original cost to which this rate applies is likewise correct.

Our company has, throughout its entire history, provided what it considered to be a conservative estimate for depreciation except in years when the Department has ruled that rates have been too high in which case we would deduct the full allowance granted us by the Department. During this period of time we have had to abandon several individual plants due to rearrangement of our manufacturing facilities and after removing all items of movable machinery and equipment that could be used to advantage elsewhere, we disposed of the remaining net depreciated assets. During the last 10 years we have been forced to take very substantial losses on the disposal of residual values which indicates clearly that the depreciation allowed as a deduction does not take sufficient cognizance of obsolescence. In most instances we have failed to realize as much as one-fourth of the residual value. In only one instance have we disposed of an abandoned plant at a profit, and this was due largely to an increment in the land value rather than a realizable gain on the depreciable assets. Over a period of years, we, as we believe to be the case with most other manufacturers, have found it necessary to install more modern equipment; and even if the replaced item were 100 percent depreciated, the reserve provided is never equal to the required amount for the replacement.

It is my belief that the continual modernization of plant facilities in this country which has tended to decrease costs has had more to do with the high standard of living in this country than any other factor. A tax law designed to discourage the accumulation of amounts required to keep up such modernization is bound to react against the consuming public and make our country static rather than dynamic.

ITEM NO. 3. DISTINCTION BETWEEN A BOOK SURPLUS AND A SURLUS AVAILABLE FOR DISTRIBUTION

Another feature that has to a great extent been misunderstood both by businessman and legislator is the distinction between a book surplus and a real surplus available for dividend distribution. Under the 1918 Revenue Act, which placed a wartime excess-profits tax on all earnings over and above a definite percentage of the invested capital, this "invested capital" was defined as being either an original investment or earnings that had been reinvested in the business. So far as invested capital is concerned, there is no difference in company A that started 20 years ago with a million dollars' capital and has built its business up to $2,000,000, and company B that starts today with $2,000,000 paid-in capital. Assuming that both these companies have all their money, except the limited amount required for current expenses, invested in plant, inventories, and so forth, neither of them would then have any money from which to pay dividends.

From a standpoint of giving employment and creating industrial activity, from which must flow all profits from which taxes are paid, both these companies are identical. Unfortunately, however, the legislator, unless he understands accounting, in looking at the balance sheet of company A would see that

it has a million-dollar surplus and would think it proper to pay a substantial amount of dividends. The company with the $2,000,000 paid-in capital, with no surplus from a legal standpoint, would not be able to pay a dividend. The company with $1,000,000 paid-in capital and $1,000,000 accumulated earnings reinvested in the business would, from a legal standpoint, be in a position to pay in dividend, but to do so it would have to borrow the money. Practically speaking, neither company would have any available surplus to pay dividends, and no legislation should be so designed as to influence company A to borrow money to pay a dividend. The present proposed law assumes to give credit to the corporation which finds itself legally unable to pay a dividend when it should give like credit to both these companies. However, even if you attempt to give credit to both these companies, you must abandon all ideas of a penalty tax on undistributed earnings, because of the impossibility of determining proper exceptions—nothing should interfere with the directors exercising business judgment in the determination of a dividend policy.

I contend that any corporation which willfully retains "practical surplus" as distinguished from a "legal surplus" beyond its needs should be punished, and I have no objection to the present provision in the act which is designed to punish those who willfully withhold surplus for the purpose of avoiding taxes on stockholders, being so broadened as to take care of any corporation that withholds more than is necessary, irrespectively of the motive for so doing.

In my opening remarks I stressed the desirability of having the provisions of this act become immediately applicable so as to grant relief and offer an inducement to business. Since business activity provides the principal market for the farmers' produce and employment for the Nation, I respectfully submit that in the interest of the people as a whole, business is entitled to as much as, if not more, inducement than is given to agriculture—thus I respectfully urge you to disregard, if necessary, the effect on total revenue or the possibility of balancing the Budget, and refund to every corporation the full amount of undistributed-earnings taxes that have been paid. Nothing would inspire business of this country more than to have Congress take such a bold action. In my opinion, that would stimulate business activity to such an extent that we might very shortly again see signs of a real recovery which eventually will provide the necessary revenues from various sources to meet the cost of government. I realize that it has been repeatedly said that this revenue act must produce approximately the revenue originally estimated on the basis of the House proposals. I think, however, that small differences, even running into the hundreds of millions of dollars, resulting from an arithmetical application to the business uncertainties ahead of us, are of no significance at a time when Congress has perhaps its last opportunity to prevent a complete collapse.

ITEM NO. 4. THE TERM "BUSINESS" AS SUCH IMPLIES NO ABILITY TO PAY TAXES

Coming to the most important part of my argument, I respectfully submit that business as such has no ability whatsoever to pay taxes—any cost of government first charged to business must be shifted either to the consumer, the wage earner, or the stockholder. A great deal of emphasis is laid upon the ability to pay, in determining Federal tax laws. I realize that ability to pay is a factor—whether or not it is the most important factor is a debatable point. But to the extent that it is an important factor, than any tax assessed against business as such must necessarily defeat the principle of ability to pay. It is seldom that two stockholders in a corporation have equal ability to pay, but any tax that is taken out before the dividends are received is equally borne by these two stockholders. If the tax is shifted to the wage earner—by causing the corporation to pay less wages than it otherwise would—then perhaps it is fairly uniform, but here it must be admitted that the tax is, in its final effect, assessed against those least able to bear it. If the tax is shifted in the price to the consumer, there again you have the widest possible variation in ability to pay. I believe that the less tax that is directed against business in the first instance, the higher living standards will be in this country and the greater the industrial activity, and in the long run, the Treasury Department will be able to collect its required revenue with greater ease than if it continues to tax business which can be done perhaps with the greatest political expediency.

ITEM NO. 5. FINANCIAL ANEMIA RESULTING FROM THE CAPITAL-GAINS TAX

The term "financial anemia" is not original with me, but I think it is a most accurate description of the economic malady existing today definitely resulting from the high tax on capital gains and the failure to allow as deductions, capital losses. I feel that the arguments so far presented, especially the booklet entitled "The No. 1 Job Killer"—a copy of which has been given to each member of the committee—are sound arguments and are overwhelmingly on the side of complete repeal. However, I would have no quarrel with Congress should it feel, at this moment, that complete repeal is out of the question, but could see its way clear to establishing a capital gains taxing procedure approximately the same as existed under the 1921 Revenue Act.

Those who favor a tax law primarily for the purpose of redistributing wealth rather than raising revenue may honestly think that the present capital-gains tax is desirable. I believe, however, that many of those who are profoundly of the opinion that wealth should be redistributed are blind to the effect of this method on industry and the people as a whole.

However, there are some so pessimistic as to believe we are heading for disastrous monetary inflation. I also believe there are some who favor retention of the capital-gains tax so that when money becomes practically worthless, the taxing authorities will, as a result of the present law, which would collect a tax on artificial gains, have a real means of confiscating wealth. Perhaps they believe there is no way out except through a wild orgy of spending, with the resultant inflation, and that to remove the capital-gains tax at this time would be playing into the hands of those who hold equities.

It is my opinion that the surest way to avoid this disastrous occurrence is to take steps at this moment to inspire investors with the incentive to put their money to work employing people and producing the required income which would enable us to reduce the depression indebtedness.

ITEM NO. 6. THE NECESSITY FOR THE NEW TAX LAW TO PROVIDE TAX-FREE DISSOLUTION OF PERSONAL HOLDING COMPANIES

I take no exception to those in Congress who are anxious to prevent tax avoidance through the device of the personal holding company. I do realize, however, that there are many personal holding companies now in existence which had their inception long before heavy surtaxes were a matter of prime consideration. I realize also that many of these companies, whether formed for the purpose of tax avoidance or otherwise, which are now paying out all they receive each year in order to avoid any penalty tax, should be wound up and would be wound up except for the additional tax involved in dissolution. I, therefore, recommend that the 1938 Revenue Act allow tax-free dissolution of personal holding companies within a limited period of time after the act is passed. Here again I fell impelled to urge you to demonstrate to all classes of taxpayers your willingness to free them of all unnecessary hardships.

CONCLUSIONS

In conclusion, I respectfully submit that the effective date of the new law be made uniform on all taxpayers in order to remove inequities promptly.

I contend that the arguments hitherto advanced in favor of the undistributed-earnings tax have been based upon accounting fallacies and that the undistributed-earnings tax should be repealed in its entirety. Furthermore, I suggest that this committee demonstrate its willingness to show a spirit of fairness to the taxpayers of the country by recognizlwng that the undistributed-earnings tax was unjustly imposed and that every dollar of this tax which has been collected by the Federal Government be refunded.

I urge Congress to take recognition of the fact that any tax levied on business defeats the principal of ability to pay. I advocate the complete repeal or the modification of the capital-gains tax in order to cure the country of the financial anemia from which it is currently suffering.

Finally, I recommend that the new law provide for the tax-free dissolution of personal holding companies for a limited period after the passage of this act.

The CHAIRMAN. Thank you very much, Mr. Oliver.

Mr. Marsh, as I understand it, wishes to file a brief, and wanted to leave. Is that right, Mr. Marsh?

STATEMENT OF BENJAMIN C. MARSH, REPRESENTING THE PEOPLE'S LOBBY, WASHINGTON, D. C.

Mr. MARSH. I have to go up to New York for 2 or 3 days and I wish to file two or three statements with you.

The CHAIRMAN. Very well.

Mr. MARSH. My name is Benjamin Marsh, secretary of the People's Lobby, with offices here.

A basic reason for the present depression is that we tried to borrow our way out of the last one, instead of debloating the wreckers of America and paying our way in the war against poverty, which has been lost so far on every front.

Prof. Harold M. Groves, of Wisconsin University, has correctly stated—

> If the British schedule of income and inheritance taxes were applied to our American situation, it would produce from two to three times as much income as we now collect through our Federal and State income and inheritance taxes combined.

We could and should raise at least $3,000,000,000 a year more from these sources, and at least $1,000,000,000 more by taxing land values, and repeal that amount of consumption taxes.

Unless Congress does this, it is guilty of criminal betrayal of the American people, and all the talk about taking the profits out of war is bombastic hypocrisy.

Southern Senators seem much more interested in unloading their or their friends' farm lands and marble deposits on the Government and getting a subsidy out of the Federal Treasury for their farm products.

Congress should retain the undistributed-profits tax, with leeway for small concerns, repeal all Federal consumption taxes, and increase the normal tax rate and surtax rate, as suggested by Senator La Follette.

It can compel States and cities to end their pickpocket tax system and tax land speculators instead of their victims—through Federal subventions and Federal aid.

Dividend and interest payments in 1937 were $9,293,000,000, compared with $7,016,000,000 in 1933, an increase of $2,277,000,000.

Entrepeneurial withdrawals and net rents and royalties were $13,187,000,000 in 1937, as compared with $8,590,000,000 in 1933, an increase of $4,597,000,000.

The property income increased $6,874,000,000 in these 4 years—but the increase in unemployment since September last year is almost half of the number reemployed during the 4½ years of reformless recovery.

In 1935 about 1⅓ percent of the families got one-quarter of the property income and one-eighth of the total national income.

In 1934 cash of reporting corporations was $19,960,857,000, and tax-exempt bonds held amounted to $19,083,771,000. Both are probably much larger now.

I am going to give you some striking figures on the per capita income of Mississippi. Mississippi has the lowest per capita income in the United States, Senator Harrison.

The CHAIRMAN. I realize that.

Mr. MARSH. And I wish to file these statements.

(The matter referred to is as follows:)

Per capita income

[A study of per capita income in 1937 and 1936, recently published by the National Industrial Conference Board, emphasizes the misleading nature of "averages"]

	1937	1936	Change		1937	1936	Change
			Percent				*Percent*
United States	522	498	+5	South Atlantic	388	375	+3
New England	617	592	+4	East South Central	261	260	+0.4
Middle Atlantic	694	663	+5	West South Central	353	332	+6
East North Central	590	545	+8	Mountain	547	496	+10
West North Central	431	423	+2	Pacific	658	646	+2

Ranges within the groups which include nine States in the South Atlantic and three in the Pacific category were marked in 1937 from maximum to minimum.

New England: Connecticut, $760; Vermont, $433.

Middle Atlantic: New York, $806; Pennsylvania, $581.

East North Central: Illinois, $626; Indiana, $524.

West North Central: Minnesota, $513; North Dakota, $305.

South Atlantic: District of Columbia, $1,406; Delaware, $816; South Carolina, $268.

East South Central: Kentucky, $284; Mississippi. $204.

West South Central: Texas, $406; Arkansas, $214.

Mountain: Nevada, $812; New Mexico, $455.

Pacific: California, $718; Oregon, $483.

These are of course averages for all classes, city and farm, in each State, including millionaires.

All of the eight States averaging in 1937 a per capita income of $299 and under were southern—North Carolina, South Carolina, Georgia, Alabama, Mississippi, Arkansas, Tennessee, and Kentucky.

(Mr. Marsh also submitted the following table:)

The national income, a marketing guide—State-by-State breakdown shows where the income went on a State and per capita basis in 1937 and 1938

[From Business Week]

States by regional groups	Income (000,000 omitted)					Per capita income				
	1937	1938	Percent change	Rank		1937	1938	Percent change	Rank	
				1937	1936				1937	1936
New England	$5,304	$5,076	+4	......	......	$617	$592	+4	......	......
Maine	400	390	+3	37	37	467	457	+2	27	25
New Hampshire	251	239	+5	40	39	492	470	+5	23	23
Vermont	166	159	+4	47	47	433	418	+4	30	30
Massachusetts	2,710	2,646	+2	8	6	612	598	+2	12	9
Rhode Island	453	428	+6	34	36	665	628	+6	8	8
Connecticut	1,324	1,215	+9	14	14	760	701	+8	5	6
Middle Atlantic	19,064	18,157	+5	......	......	694	663	+5	......	......
New York	10,440	10,112	+3	1	1	806	782	+3	4	2
New Jersey	2,712	2,498	+9	7	8	624	577	+8	11	10
Pennsylvania	5,912	5,548	+7	2	2	581	547	+6	17	14
East North Central	15,255	14,011	+9	......	......	590	545	+8	......	......
Ohio	3,890	3,641	+7	5	5	578	542	+7	18	16
Indiana	1,820	1,675	+9	10	10	524	484	+8	20	22
Illinois	4,935	4,466	+11	3	3	626	569	+10	10	11
Michigan	2,841	2,605	+9	6	7	588	545	+8	16	15
Wisconsin	1,769	1,623	+9	11	12	605	558	+8	13	13
West North Central	5,960	5,825	+2	......	......	431	423	+2	......	......
Minnesota	1,360	1,305	+4	13	13	513	495	+4	22	21
Iowa	1,086	1,058	+3	15	15	426	416	+2	32	32
Missouri	1,705	1,669	+2	12	11	427	422	+1	31	28
North Dakota	215	211	+2	43½	42	305	300	+2	41	41
South Dakota	215	220	−2	43½	40	311	318	−2	40	39
Nebraska	551	558	−1	31	30	404	409	−1	35	34
Kansas	827	804	+3	22	22	444	426	+4	29	27
South Atlantic	6,702	6,407	+5	......	......	388	375	+3	......	......
Delaware	213	193	+10	45	45	816	745	+10	2	3
Maryland	999	901	+11	17	18½	595	538	+11	15	17
District of Columbia	656	666	−2	29	29	1,046	1,076	−3	1	1
Virginia	956	922	+4	18	17	333	345	+2	38	38
West Virginia	729	693	+5	26	26	391	379	+3	36	35
North Carolina	1,033	968	+7	16	16	296	280	+6	43	44
South Carolina	503	486	+3	32	32	268	261	+3	46	46
Georgia	915	901	+2	19	18½	297	294	+1	42	42
Florida	698	677	+3	28	28	418	412	+1	33	33
East South Central	2,801	2,766	+1	......	......	261	260	+.4	......	......
Kentucky	854	829	+3	21	21	284	288	−1	44	43
Tennessee	816	791	+3	23	23	273	276	−1	45	45
Alabama	719	681	+6	27	27	248	238	+4	47	47
Mississippi	413	466	−11	36	34	204	232	−12	49	48
West South Central	4,558	4,249	+7	......	......	353	332	+6	......	......
Arkansas	439	462	−5	35	35	214	228	−6	48	49
Louisiana	802	770	+4	25	24	376	363	+4	37	37
Oklahoma	810	769	+5	24	25	318	304	+5	39	40
Texas	2,506	2,247	+12	9	9	406	367	+11	34	36
Mountain	2,075	1,863	+11	......	......	547	496	+10	......	......
Montana	324	208	+9	38	38	601	561	+7	14	12
Idaho	234	203	+15	42	44	475	419	+13	26	29
Wyoming	151	150	+1	48	48	643	644	−.2	9	7
Colorado	559	533	+5	30	31	522	500	+4	21	20
New Mexico	192	183	+5	46	46	455	434	+5	28	26
Arizona	287	208	+38	39	43	697	512	+36	7	19
Utah	247	215	+15	41	41	476	417	+14	25	31
Nevada	82	73	+12	49	49	812	730	+11	3	4

The national income, a marketing guide—State-by-State breakdown shows where the income went on a State and per capita basis in 1937 and 1938—Con.

States by regional groups	Income (000,000 omitted)					Per-capita income				
	1937	1938	Percent change	Rank		1937	1938	Percent change	Rank	
				1937	1936				1937	1936
Pacific	$5,816	$5,620	+3			$658	$646	+2		
Washington	904	859	+5	20	20	545	523	+4	19	18
Oregon	496	477	+4	33	33	483	469	+3	24	24
California	4,416	4,292	+3	4	4	718	708	+1	6	5
United States	67,534	63,984	+6			522	498	+5		

Data: National Industrial Conference Board; U. S. Bureau of the Census.

Mr. MARSH. I wish to also file a map, but I do not believe you can reproduce that map [indicating].

The CHAIRMAN. No; we cannot do that.

Mr. MARSH. Then I will keep it, because it is very significant, although it is only on one page.

The CHAIRMAN. All right.

Mr. MARSH. I thank you for your courtesy; may God have mercy on you if you do not follow as to our recommendations.

The CHAIRMAN. I hope God will have mercy on us anyhow.

Mr. MARSH. I am not sure you are entitled to it.

The CHAIRMAN. Mr. Burnett, State commissioner of the Department of Alcoholic Beverage Control of the State of New Jersey. I understand you cannot be here Monday?

STATEMENT OF D. FREDERICK BURNETT, NEWARK, N. J., COMMISSIONER OF THE DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL OF THE STATE OF NEW JERSEY

Mr. BURNETT. No, sir.

The CHAIRMAN. We are going to take up this liquor question then. Can you just give us now your ideas briefly?

Mr. BURNETT. Yes.

The CHAIRMAN. And then give us a brief on your ideas of the thing?

Mr. BURNETT. Senator, I am looking at this thing through your eyes. I represent no interests at all except the State. My duty, like yours, is to raise revenue, and to keep the liquor industry under control.

I want to mention briefly a few figures only for the sake of driving home a point.

Senator BROWN. Tell me, are you in substantially the same position as we are in Michigan?

Mr. BURNETT. No. You are under a different system.

Senator BROWN. We are under a different system?

Mr. BURNETT. We are under the licensing system.

Senator BROWN. You do not handle retail?

Mr. BURNETT. Most of the States are following the licensing system.

Senator BROWN. I see.

Mr. Burnett. I am only speaking now from the standpoint of raising revenue.

I think by an increase of the tax you will defeat your own purpose and I want to show you why.

The cost of alcohol to produce, according to the Fleishman Co. of New York is 18⅘ cents per gallon; that is 20 cents per gallon. The Federal tax on that is $2 a gallon. The State of New Jersey adds a tax of $1 a gallon. The result is you have a $3 tax on a 20-cent article. That is 1,500-percent tax on the cost of production. If you add an additional 25-cent tax you are really adding an additional 125-percent tax on the cost of production, which will make it 1,625 percent. In those figures are the reason we have bootlegging, because when you add to $3.20, which is your cost of production plus your present tax, $1.27 for the manufacturers, let us say, the distillers', wholesalers', and retailers' profit, you get us to $4.47 of cost as the minimum cost of legitimate alcohol, whereas the bootlegger will sell you all you want at a figure which will vary from $1.40 to $2.50 a gallon.

The Chairman. Do you have much bootlegging in New Jersey?

Mr. Burnett. A tremendous amount, sir, despite our efforts.

To talk about bootlegging being out of the picture is not true. Of course, substantial progress has been made. I am afraid this bill is not only going to lose revenue but create a social disturbance, and this is the reason, because of the inordinate profit which is to be made by bootlegging. If all that we had to do was to deal with the criminal class it would not be difficult, but it is as to people that sell and the places where they sell. Time and again they go to a State licensee to whom they can sell and refill bottles over and over again with the same label. That retailer can sell so much cheaper with the refills with illicit liquor than he can on the legitimate that, of course, he will do it on the illicit liquor, which escapes taxation entirely.

Now, through strict enforcement we have driven up the revenue in New Jersey from $4,000,000 the first year until by successive steps the State revenue alone on that $1 a gallon is $9,000,000 in the calendar year just closed. That meant $18,000,000 for the Federal. You are dealing with a tax. You are putting a tax on from the Federal angle, and most every one of the States also taxes the same commodity. If the Federal Government increases its tax, then by the same token the States may increase their tax, and the result of it is you have got more and more of a dangling prize for the bootlegger to manufacture and more and more of a temptation for the retailer.

Perhaps you may think the retailer will shoulder the added impost. The point of it is the tax is not such that it is permissible on a 25-cent drink to bring it down into the charge for a drink, and it is so small that 1 cent a drink would absorb the whole cost; but you could not put out a cocktail or a drink of State liquor for 26 cents as against 25, nor could you put out a 42-cent drink of bonded liquor as against 40 cents. It usually goes up in nickels.

Now, we have a national conference of State liquor administrators, and in that conference there are some 15 or 18 States. I knew nothing about this until the House passed the bill, and thereupon we polled the members of the different States, and I find that Rhode Island is in favor of the increase in tax. Vermont is uninterested.

But the following States are all opposed to it—and I am speaking for those States as well as the State of New Jersey, to wit: California, Alabama, Mississippi, Minnesota, New Jersey, Texas, and West Virginia. The reason why Rhode Island is against it is because they say by raising the tax it will be a temperance measure. That is simply fooling themselves, because when the legitimate licensee cannot sell, the result is you are going to have the speak-easy. That brings all the evils of prohibition back. You say, "What is the difference between the speak-easy and the licensed saloon?" All the difference in the world.

If I want to go into a licensed establishment today, and I see a closet, I say, "Open it up." And they have to. That is the law. That is the condition under which they get their privilege. But into a speak-easy I cannot go today, and I have to get down on my hands and knees before some justice of the peace and petition him for a writ or a search warrant to accomplish my purpose; I have to get down on my hands and knees until I get housemaid's knee until such time as he can telephone and tip them off as to the speak-easy. That is the trouble prohibition was up against.

Now, your Federal law today, even under our Constitution, there is no way the Federal people can supervise those retail outlets. They have no authority to go and take a speak-easy as long as they pay the tax. The whole jurisdiction of the Federal law is based upon interstate commerce and taxation, and consequently the Federal people cannot touch that. The result of it is that you simply drive out of the legitimate business the licensees into the speak-easy, which is simply going to have the whole trouble of prohibition over again, and the result is you will have less revenue.

Consequently, I advise to strike that and that you do not increase it. Some day I would like to see you decrease that tax. I am not sure that the time has yet arrived to decrease it.

The State of New Jersey memorialized Congress 2 years ago to reduce and promised Congress if they reduced the tax that the State of New Jersey would follow suit and reduce at least that revenue.

Senator BULKLEY. Can we interpret this statement in favor of an argument to reduce the tax?

Mr. BURNETT. Yes, sir. I believe strongly in reducing the tax.

Senator BULKLEY. Can we get more revenue by reducing the tax?

Mr. BURNETT. I believe you can get increased revenue.

Senator BULKLEY. What would be your suggestion?

Mr. BURNETT. Take away the temptation to bootleg liquor.

Senator BULKLEY. I understand. But I want to know how far would you go.

Mr. BURNETT. It would take a statistician to answer that, but I am in favor of it.

Senator BULKLEY. You do think that the tax ought to be reduced?

Mr. BURNETT. Yes, sir. I believe you would get more revenue, sir.

The CHAIRMAN. Thank you very much.

There are two gentlemen here who say that they want to leave. One is Mr. Glass and one is Mr. Hall, who say they cannot be here Monday, and I understand they only want 5 minutes each. Is that right, gentlemen? And you wish to put your brief in the record?

All right, Mr. Glass. And when we get through with these two gentlemen the committee will adjourn until 9:30 Monday morning, and those witnesses who are on the calendar today will be heard Monday morning.

STATEMENT OF I. R. GLASS, TANNERS' COUNCIL OF AMERICA

Mr. GLASS. My name is I. R. Glass, and I represent the Tanners' Council of America. I shall only take a few minutes of your time, gentlemen.

Senator CONNALLY. Go ahead.

Mr. GLASS. As the economist for the Tanners' Council of America, the national trade association of the leather industry, I am concerned here with primarily one aspect of the present and proposed revenue laws. That is, the inequity of the present required regulations for the determination of taxable income.

If tanners were required to pay income tax upon earned and realized income, I should have nothing to say upon this score. The fact is, however, that tanners may be, and frequently are, required to pay tax upon income which is not realized, upon income which in the vernacular of the trade is called "paper profits." That situation arises from two factors. In the first place, there are certain characteristics of the tanning industry, and several others similarly situated, which distinguish them from the majority of manufacturing industries.

In the tanning industry, the processing period is extremely long. It takes many months to produce leather; in some cases the finished leather cannot be removed from the final stage of the process before 8 or 9 months. In the second place, tanning is an industry which requires a constant inventory of raw and in process material. The industry cannot exist without such an inventory which is its stock in trade just as much as vats, drums, and other physical equipment. In short, inventories may be likened to fixed assets comparable to plant, buildings, or other assets. The importance of inventories in the tanning of leather may be gathered from the fact that the inventory maintained ranges up to 60 or 70 percent of total assets at all times.

The other factor which produces the inequitable condition I refer to is the present regulations of the Bureau of Internal Revenue for the determination of taxable income. These regulations may apply and may be proper for many manufacturing industries. They are not proper and not correct for the tanning industry and for other industries in which inventories play such an important role and where turnover may be extremely slow. Present regulations for determining taxable income actually distort and present an incorrect picture in the tanning industry.

May I offer a simple illustration? Let us assume a tanner begins his fiscal year with an inventory consisting of one hide valued at $1. He cannot do without the hide as the minimum inventory essential to his business. He cannot dispose of that quantity, for if he does dispose of it, without immediately replacing it by an equivalent quantity, he must go out of business. It would mean an interruption of the processing period, and sooner or later the tanner would have no leather to sell. Consequently, he is bound to maintain that mini-

mum inventory, just as any other manufacturer must maintain machinery and other fixed assets. To carry the illustration further, let us assume the price of hides advanced during the year. At the end of the fiscal year the tanner may have a hide worth $2 instead of $1 as at the beginning of the year. According to the regulations of the Bureau of Internal Revenue, the tanner must include in his taxable income a fictitious paper profit of $1, a profit which the tanner can never realize because he must maintain the same physical inventory with which he began the year. In this analogy the paper profit would be the appreciation in value of the single hide with which he started the fiscal year. At the end of the year the tanner finds, and this was the case in 1935 and 1936, that a very great proportion of his income represents book profits that he can neither distribute nor pay taxes with. Such profits must disappear when the market declines, and the banks would be very loathe indeed to loan money on profits which might be dissipated as soon as prices turn downward. That happened in 1937. The paper profits of the preceding year were offset by the inventory losses which occurred then.

This whole matter has been, I think, presented to your committee very thoroughly by other witnesses, and I merely want to stress one phase of the question.

In the tanning industry the only criterion of true income is, we maintain, determined by applying latest or replacement costs to current sales. Tanners always do business on today's market. They sell leather and buy hides on a day-by-day market. If a piece of leather sells at 20 cents, they must buy hides to cover sales at an adequate price. They are in business to obtain a converting profit, which can only be obtained by what the trade terms "replacement prices." Such prices represent the tanners' latest or replacement costs, and these are the only adequate measure of realized or realizable income.

Senator CONNALLY. Could not this be rectified by a modification of the regulation, or do you think it would take an act?

Mr. GLASS. It could, sir.

May I state, to amplify, that in 1936 it was brought to the attention of your committee.

Senator CONNALLY. I recall we had it up in the last tax.

Mr. GLASS. It was brought before your committee, and your committee recognized the logic of the situation. The committee recommended that the matter be taken up with the Commissioner for possible modification of the regulations. We have interviewed various officials in the Bureau and in the Department, and it is my opinion that they have not been able to offer any cogent objections to the remedy which we wish to propose. And the matter, I believe, has also been discussed with Mr. Parker, and I think he recognizes the seriousness of the problem as well as the cogency of the solution that is proposed.

Senator CONNALLY. Have you got a brief to file?

Mr. GLASS. I should like to file one.

Senator CONNALLY. All right. You may do so.

We will now hear Mr. Hall.

STATEMENT OF JOHN S. HALL

Mr. HALL. My name is John S. Hall. I am the general counsel and represent the Flavoring Extract Manufacturers' Association of the United States, the National Association of Manufacturers of Fruit and Flavoring Syrups, and the National Manufacturers of Soda Water Flavors.

The Flavoring Extract Manufacturers' Association of the United States is composed of practically all of the large manufacturers of flavoring extracts and/or flavors producing insoluble extracts and/or flavors as distinguished from the soluble extracts; these products are used mostly for culinary purposes, for flavoring cakes, custards, and ordinary flavoring purposes in the home.

The National Association of Manufacturers of Fruit and Flavoring Syrups is an association whose members supply soda fountains as distinguished from the bottling trade, with soluble soda-fountain extracts and/or flavors, finished or fountain sirups, and crushed fruits. Said products are used for further manufacturing purposes by the dairy, ice-cream, confectionery, soda-fountain, and still-beverage industries.

The National Manufacturers of Soda Water Flavors is an association whose members likewise produce soluble extracts and/or flavors for the bottling industry. These products are used for further manufacturing by the carbonated beverage industry.

The combined activities of the membership of said associations cover practically the whole field of flavoring extracts outside of medicinal extracts and are used for culinary and further manufacturing purposes.

The flavoring products industry uses approximately 5,000,000 gallons of alcohol in the manufacture of vanilla, lemon, almond, orange, and some 20 to 30 other flavors, all of which are used entirely to flavor food products such as bakery goods, confectionery, ice cream, and nonalcoholic beverages.

The Food and Drugs Administration in the enforcement of the Federal Food and Drug Act of 1906 has promulgated regulations recognizing two separate and distinct classifications of flavoring products: (1) Extracts (which implies an alcoholic product), and (2) nonalcoholic flavoring products (which implies that the vehicle for holding the flavor in suspension is not alcoholic but such products must contain the same percentage of flavoring ingredients as are required for extracts).

The average vanilla extract contains approximately 35 percent alcohol. The citrus group—that is, orange and lemon—contains approximately 90 percent alcohol. Therefore, it will be readily appreciated that alcohol is the biggest item of cost in raw materials used in the manufacture of extracts. The increase in tax from $2 to $2.25 represents an increase in costs of 47½ cents a wine-gallon. The approximate market value of alcohol in bond is 40 cents a wine-gallon. The tax on a wine-gallon of alcohol under the increased tax is approximately 4.27½ cents, which represents a tax of 10½ times the value of this most important raw ingredient entering into the manufacture of these common household necessities.

Pure vanilla extract for culinary purposes is sold, in grocery

stores, generally in 2-ounce bottles and 1-ounce bottles, at 10 cents an ounce bottle, 2 ounces for 19 cents, and so forth. There is no way that the manufacturer can pass this added tax on to the consumer. Likewise, the same principle exists in reference to lemon and orange extracts.

In reference to members of our industry selling their products for further manufacturing purposes—that is, bulk flavoring extracts—there is the possibility that the additional costs can be passed along unless written contracts have been entered into in which case the manufacturer will be forced to absorb the tax. The increase in cost of any commodity results in curtailment of its use.

Now then, I desire to call your attention to the severest competition that pure-extract manufacturers are confronted with; that is, competition coming from nonalcoholic flavoring manufacturers who produce inferior flavors which are sold on price and price alone. Nonalcoholic flavors are usually prepared by small manufacturers who have no machinery or equipment, no invested capital. They are sometimes produced in unsanitary surroundings and usually sold locally and generally by house-to-house canvassers. Little, if any, alcohol is used in making them, as they are usually synthetics dissolved in water and glycerin. Every gallon of these products sold displaces the sale of pure products containing alcohol, with corresponding loss in income to the Government. As this competition is based solely on price, it has had a startling increase during the past few years.

Since the repeal of the National Prohibition Act practically all of the States have passed drastic liquor-control laws. Some States require payment of a gallonage tax on distilled spirits intended for beverage and nonbeverage purposes. Others require payment of an annual license fee. I do not believe in the event a differential is made in the tax on the use of distilled spirits for beverage and nonbeverage purposes, any diversion would take place. The penalties as are now provided for under the revenue act estop such possibilities.

I do not believe that Congress, in the consideration of revenue measures or regulatory control over the manufacture and sale of distilled spirits, ever intended to burden interested industries with discriminatory taxes which in substance prohibit the use of certain raw materials in finished products universally used and consumed by the housewife or intended for further manufacturing purposes. It is my opinion that policies such as are invoked by other countries to encourage the use of raw materials grown and developed within said country likewise ought to be adopted here, particularly by our legislative bodies.

In conclusion, in behalf of the associations I represent, it is recommended that H. R. 9682 (the Revenue Act of 1938), section 712, "Tax on distilled spirits," subparagraph (e), page 308, lines 1 to 4, inclusive, be amended to read as follows:

(e) The amendments made by this section shall not apply to brandy "or to ethyl alcohol used in flavoring extracts," and the rates of tax applicable to such brandy "or to ethyl alcohol used in flavoring extracts" shall be the rates applicable without regard to such amendments.

Senator CONNALLY. As to your flavoring extracts, you had a large business during prohibition?

Mr. HALL. No. We were all legitimate, Senator.

Senator CONNALLY. I know; but you sold them, and if a fellow bought them afterward you could not regulate what he did, and did not they drink up a lot of flavoring extracts during prohibition?

Mr. HALL. I have been down here at hearings where that was claimed that that was done, Senator, but I have never seen it done and don't believe it.

Senator CONNALLY. Has your business fallen off or increased since prohibition?

Mr. HALL. No. It is still about the same. We are still using about 5,000,000 or 6,000,000 gallons of ethyl alcohol in the flavoring-products industry.

Senator CONNALLY. All right, sir. Have you a statement you want to file in addition?

Mr. HALL. Yes; I will prepare such a statement and file it.

Senator CONNALLY. All right, sir. We will be very glad to have it. I desire to place in the record a brief submitted by Dr. Cloyd Heck Marvin, president of George Washington University, on behalf of the special committee of the American Council on Education.

STATEMENT SUBMITTED TO THE SENATE COMMITTEE ON FINANCE AND THE HOUSE COMMITTEE ON WAYS AND MEANS BY THE SPECIAL COMMITTEE OF THE AMERICAN COUNCIL ON EDUCATION

This memorandum is submitted on behalf of a large group of educational and charitable institutions, comprising most of the privately administered colleges, universities, hospitals, and libraries of this country. A list of the institutions on whose behalf this statement is made is filed with it (appendix A). These institutions, dedicated to the service of mankind and not engaged directly or indirectly in carrying on their activities for profit, understand the necessity of the administration's program for the development of public revenue. The purpose of this memorandum is not in any respect to place these institutions in opposition to the objects of the revenue bill, but to point out as earnestly as possible to the committee that the exception for which the privately administered public institutions are asking has the support not only of the historic conception of public policy but will help maintain the system of public education which has been serving this Nation, and thus relieve the Federal Government from carrying an additional burden.

We need not mention to your body that privately administered and publicly administered institutions of higher learning have been considered a part of our public-school system. This is attested to by the fact that for many centuries it has been believed that public policy was best served by exempting from general levies institutions which were engaged exclusively in religious, educational, and charitable activities, in order that they might be better enabled to pursue their humanitarian purposes. From a broad point of view, they have always been regarded as arms of government. In the last analysis the problem has always been one, and always must be one, of evaluating social methods for insofar as Government activity diminishes the resources of educational and charitable organizations, it diminishes their capacity for service to their several communities and increases the burdens which must fall upon the Government. This was never more true than at the present time. With the readjustment of the Government's financial program, there have been many items which have affected directly and indirectly the support of such institutions.

As a part of the provision in section 23, subdivision (q) of H. R. 9682 which is the subject of this statement, the report of the subcommittee on taxation to the Ways and Means Committee of the House of Representatives says: "If a charitable contribution is made in property rather than in money, the donor is permitted to deduct the present value of the property from his gross income, and is not limited to the cost of the property to him. It is, therefore, to the donor's advantage to make contributions in securities or other kinds of property, which have appreciated in value, since in this way he avoids the tax upon the unrealized capital gains. There is no gain to the charity in this procedure.

It is, therefore, recommended (recommendation No. 37) that in the case of contributions in kind, allowance of the deduction should be limited to the basis of the property in the hands of the donor or the fair market value of the property at the time of the contribution or gift, whichever is the lower."

The statement, "There is no gain to the charity in this procedure", that is to say in permitting the deduction of the present value of the property from the donor's gross income, is certainly misleading. If the donor's deduction is limited to the adjusted basis of the property in his hands as the fair market value, "Whichever is the lower", then obviously there is withdrawn a major incentive to make the contemplated gift or contribution.

As has been said above, gifts are needed by the institutions presenting this petition to meet public demands. The following table shows the progressive decrease in gifts to privately administered public educational institutions of higher learning since 1925, and, we repeat, at a time when in the last few years their income from other sources has been substantially reduced and their need of gifts correspondingly increased:

1925-26	$70, 119, 672
1927-28	46, 812, 052
1929-30	59, 235, 086
1931-32	42, 430, 662
1933-34	22, 058, 099
1935-36	33, 538, 827
1936-37	(1)

[1] Not yet available, but a partial check-up indicates that the figure will be substantially lower than for 1935-36.

It need not be presented to your honorable body that there never was a time when the need for educational institutions, for hospitals, for medical research, or for the care of the destitute was greater than today. To meet these needs privately administered public institutions must look to investments which have shrunk and to contributors whose contracted incomes make them less able than ever before to respond to the appeals which are made to them. Hence, to have the lines more closely drawn at this time, it seems to us, will work a great hardship upon the institutions, and hence be detrimental to them by discouraging gifts which they might have a reasonable right to expect to continue.

As has been mentioned above, there is a great need for the development of educational facilities, in order to prepare the youth of our land for leadership in citizenship and government, for leadership in the professional services, for leadership in the arts, for leadership in engineering and mechanics, as well as the applied arts, but, above all, for the leavening of life itself.

The United States Government has frankly recognized this need and supported land-grant colleges, vocational education, professional training of those of its members in service, Howard University, and adult education. The most recent figures available (Office of Education 1935-36) show it to have contributed $43,233,704 to such education. This is the equivalent of a return on an endowment of more than a billion dollars. It seems to our membership that even if Congress should continue to encourage contributions in property to privately administered public institutions by retaining the present rule with regard to their valuation for purposes of deduction from gross income, it would not result in a gain to such institutions that would be at all commensurate with the above-mentioned figure that is now being spent by the Government and which would have to be augmented considerably if the privately administered institutions were not able to function in an effective manner because of lack of resources.

We would have you know that, as institutions, we are trying to readjust our programs as rapidly as possible to meet the financial conditions that confront us. We are asking at this time for consideration to the end that we may have the opportunity of making the adjustment without harming or destroying an important arm of our great system of public education.

It is respectfully submitted, therefore, that the last sentence of section 23 (o), immediately preceding the parenthetical reference to section 120 of the House bill, be eliminated, and that the last paragraph of Section 23 (q) of the House bill should likewise be eliminated, and the provisions of the present act, as contained in section 23 (o) and section 23 (q) of the Revenue Act of 1936, should be carried forward in the proposed revenue bill of 1938.

It is believed that the continuation of the present law as set forth in the Revenue Act of 1936 would require no change in section 113, relative to the

adjusted basis of property. However, a change may be necessary in section 102 (c) (B) of the proposed bill, and similar changes may be necessary in section 836 (a) (2) of the supplement P. Also, slight change may be necessary in title 1B.

Respectfully submitted.

CLOYD H. MARVIN,
Chairman of the Committee.

APPENDIX A

MEMBERS OF THE COUNCIL—CONSTITUENT MEMBERS AND THEIR DELEGATES, 1937–38

American Association of Colleges of Pharmacy: W. Paul Briggs, George Washington University, Washington, D. C.; Rufus A. Lyman, University of Nebraska, Lincoln, Nebr.; Wortley F. Rudd, Medical College of Virginia, Richmond, Va.

American Association of Collegiate Schools of Business: S. J. Coon, University of Washington, Seattle, Wash.; R. C. McCrea, Columbia University, New York City; Frank T. Stockton, University of Kansas, Lawrence, Kans.

American Association of Dental Schools: H. M. Semans, Ohio State University, Columbus, Ohio; Gerald D. Timmons, Indiana University School of Dentistry, Indianapolis, Ind.; Charles R. Turner, University of Pennsylvania, Philadelphia, Pa.

American Association of Junior Colleges: Doak S. Campbell, George Peabody College for Teachers, Nashville, Tenn.; Katharine M. Denworth, Bradford Junior College, Bradford, Mass.; Nicholas Ricciardi, San Bernardino Valley Junior College, San Bernardino, Calif.

American Association of School Administrators: Frank W. Ballou, superintendent of schools, Washington, D. C.; S. D. Shankhead, 1201 Sixteenth Street NW., Washington, D. C.; D. E. Weglein, superintendent of schools, Baltimore, Md.

American Association of Teachers Colleges: E. C. Higbie, Wilson Teachers College, Washington, D. C.; W. P. Morgan, Western Illinois State Teachers College, Macomb, Ill.; M. E. Townsend, president, State Normal School, Newark, N. J.

American Association of University Professors: W. W. Cook, Northwestern University Law School, Chicago, Ill; R. E. Himstead, 744 Jackson Place NW., Washington, D. C.

American Association of University Women: Mrs. R. E. Heineman, 311 State Building, Los Angeles, Calif.; Kathryn McHale, 1634 I Street NW., Washington, D. C.; Margaret Morriss, Pembroke College, Providence, R. I.

American Jesuit Educational Association: William J. McGucken, S. J., St. Louis University, St. Louis, Mo.; Daniel M. O'Connell, S. J., Loyola University, Chicago, Ill.; Edward B. Rooney, S. J., 55 East Eighty-fourth Street, New York City.

American Library Association: George F. Bowerman, Public Library, Washington, D. C.; Joseph L. Wheeler, Enoch Pratt Free Library, Baltimore, Md.; Louis R. Wilson, Graduate Library School, University of Chicago, Chicago, Ill.

Association of American Colleges: Samuel P. Capen, University of Buffalo, Buffalo, N. Y.; F. P. Graham, University of North Carolina, Chapel Hill, N. C.; Gilbert W. Mead, Washington College, Chestertown, Md.

Association of American Medical Colleges: Samuel P. Capen, University of Buffalo, Buffalo, N. Y.; Ross V. Patterson, 2126 Spruce Street, Philadelphia, Pa.; Fred C. Zapffe, 5 South Wabash Avenue, Chicago, Ill.

Association of Collegiate Schools of Nursing: Sister M. Olivia Gowan, Catholic University of America, Washington, D. C.; Marion G. Howell, Western Reserve University School of Nursing, Cleveland, Ohio; Isabel M. Stewart, Teachers College, Columbia University, New York City.

Association of Land-Grant Colleges and Universities: O. M. Leland, University of Minnesota, Minneapolis, Minn.; J. M. Smith, Louisiana State University, Baton Rouge, La.; A. C. Willard, University of Illinois, Urbana, Ill.

Association of Urban Universities: Charles J. Deane, S. J., Fordham University, New York City; Roscoe M. Ihrig, Carnegie Institute of Technology, Pittsburgh, Pa.; Guy E. Snavely, 19 West Forty-fourth Street, New York City.

Council on Medical Education and Hospitals of the American Medical Association: W. D. Cutter, 535 North Dearborn Street, Chicago, Ill.; Reginald Fitz, 721 Huntington Avenue, Boston, Mass.; Merritte W. Ireland, 1870 Wyoming Avenue, Washington, D. C.

Council of Section of Legal Education and Admissions to the Bar of the American Bar Association: Alexander B. Andrews, 239 Fayetteville Street, Raleigh, N. C.; James Grafton Rogers, Yale University, New Haven, Conn.; Will Shafroth, 1140 North Dearborn Street, Chicago, Ill.

Dental Educational Council of America: Henry L. Banzhaf, 1217 West Wisconsin Avenue, Milwaukee Wis.; William H. G. Logan, 55 East Washington, Street, Chicago, Ill.; Albert L. Midgley, 1108 Union Trust Building, Providence, R. I.

Department of Secondary School Principals, National Education Association: H. V. Church, 5835 Kimbark Avenue, Chicago, Ill.; Harrison C. Lyseth, State supervisor of secondary education, Augusta, Maine; Willard N. Van Slyck, principal, high school, Topeka, Kans.

Institute of International Education: Stephen P. Duggan, 2 West Forty-fifth Street, New York City; Edgar J. Fisher, 2 West Forty-fifth Street, New York City; William F. Russell, Teachers College, Columbia University, New York City.

National Association of Colleges and Departments of Education: (Delegates not yet appointed.) Dean G. N. Kefauver, Stanford University, secretary.

Middle States Association of Colleges and Secondary Schools: H. G. Doyle, George Washington University, Washington, D. C.; D. A. Robertson, Goucher College, Baltimore, Md.; J. H. Tyson, Upper Darby High School, Upper Darby, Pa.

National Association of State Universities: W. B. Bizzell, University of Oklahoma, Norman, Okla.; F. P. Graham, University of North Carolina, Chapel Hill, N. C.; Herman G. James, Ohio University, Athens, Ohio.

National Catholic Educational Association: George Johnson, 1312 Massachusetts Avenue NW., Washington, D. C.; P. J. McCormick, Catholic University of America, Washington, D. C.; Francis L. Meade, C. M., Niagara University, Niagara, N. Y.

National Education Association: Sidney B. Hall, state superintendent of public instruction, Richmond, Va.; Joseph H. Saunders, superintendent of schools, Newport News, Va.; George D. Strayer, Teachers College, Columbia University, New York City.

National University Extension Association: F. O. Holt, University of Wisconsin, Madison, Wis.; D. Walter Morton, Syracuse University, Syracuse, N. Y.

F. W. Shockley, University of Pittsburgh, Pittsburgh, Pa.

North Central Association of Colleges and Secondary Schools: G. H. Reavis, State department of education, Columbus, Ohio; A. M. Schnitalla, S. J., St. Louis University, St. Louis, Mo.; G. A. Works, University of Chicago, Chicago, Ill.

Phi Delta Kappa: Paul M. Cook, 1180 East Sixty-third Street, Chicago, Ill.; N. L. Engelhardt, Teachers College, Columbia University, New York City; W. W. Patty, Indiana University, Bloomington, Ind.

Progressive Education Association: W. Carson Ryan, Jr., Carnegie Foundation for the Advancement of Teachinrg, 522 Fifth Avenue, New York City; Eugene R. Smith, Beaver County Day School, Chestnut Hill, Mass.; Laura Zirbes, Ohio State University, Columbus, Ohio.

Society for the Promotion of Engineering Education: F. L. Bishop, University of Pittsburgh, Pittsburgh, Pa.; Henry S. Jacoby, 3000 Tilden Street, Washington, D. C.; W. E. Wickenden, Case School of Applied Science, Cleveland, Ohio.

Southern Association of Colleges and Secondary Schools: K. J. Hoke, College of William and Mary, Williamsburg, Va.; Shelton Phelps, Winthrop College, Rock Hill, S. C.; Guy E. Snavely, 19 West Forty-fourth Street, New York City.

(27) ASSOCIATE MEMBERS

American Alumni Council.
American Association for the Advancement of Science.
American Association of Collegiate Registrars.
American Camping Association.
American Council of Learned Societies.
American Historical Association.
American Physical Education Association.
Commission on Relief of Belgium Educational Foundation.

Delphian Society.
Modern Language Association of America.
National Advisory Council on Radio in Education.
National Association of Deans and Advisers of Men.
National Association of Deans of Women.
National Congress of Parents and Teachers.
National Council of Business Education.
National Council on Parent Education.
National Council of Teachers of English.
National League of Nursing Education.
National Research Council.
National Society of College Teachers of Education.
National Vocational Guidance Association.
Pennsylvania Board of Presidents.
Presbyterian Board of Christian Education.
United Chapters of Phi Beta Kappa.
Western Personnel Service.

NEW ASSOCIATE MEMBERS

American College Personnel Association Girl Scouts, Inc.
Change of name: National Council of Y. M. C. A.

(301) INSTITUTIONAL MEMBERS, UNIVERSITIES AND COLLEGES

Alabama: Alabama College, Montevallo; University of Alabama, University; Birmingham-Southern College, Birmingham; Huntingdon College, Montgomery; Tuskegee Normal and Industrial Institute, Tuskegee.
Arizona: University of Arizona, Tucson.
Arkansas: Arkansas State College, Jonesboro; Hendrix College, Conway.
California: Claremont Colleges, Claremont; University of California, Berkeley; College of the Pacific, Stockton; Dominican College, San Rafael; Fresno State College, Fresno; Immaculate Heart College, Hollywood; Loyola University, Los Angeles; Mills College, Oakland; University of Redlands, Redlands; San Francisco College for Women, San Francisco; University of San Francisco, San Francisco; University of Southern California, Los Angeles; Stanford University, Stanford University.
Colorado: Colorado College, Colorado Springs; Colorado State College of Education, Greeley; University of Denver, Denver.
Connecticut: Albertus Magnus College, New Haven; Connecticut College for Women, New London; Junior College of Connecticut, Bridgeport; Connecticut State College, Storrs; Wesleyan University, Middletown; Yale University, New Haven.
Delaware: Tower Hill School, Wilmington; University of Delaware, Newark.
District of Columbia: American University, Washington; Catholic University of America, Washington; George Washington University, Washington; Georgetown University, Washington; Howard University, Washington; Miner Teachers College, Washington; Southern Education Foundation, Inc., Washington; Trinity College, Washington; Wilson Teachers College, Washington.
Florida: Florida Agricultural and Mechanical College, Tallahassee; Florida State College for Women, Talahassee; University of Florida; Gainesville; John B. Stetson University, De Land; Rollins College, Winter Park.
Georgia: Agnes Scott College, Decatur; Emory University, Emory University; Georgia School of Technology, Atlanta; Georgia State College for Women, Milledgeville; University of Georgia, Athens; Mercer University, Macon; Shorter College, Rome.
Hawaii: University of Hawaii, Honolulu.
Illinois: Armour Institute of Technology, Chicago; Augustana College and Theological Seminary, Rock Island; Carthage College, Carthage; Central Y. M. C. A. College, Chicago; University of Chicago, Chicago; Chicago Musical College, Chicago; Monticello College, Godfrey; DePaul University, Chicago; Elmhurst College, Elmhurst; Francis W. Parker School, Chicago; University of Illinois, Urbana; Knox College, Galesburg; Lake Forest College, Lake Forest; Lewis Institute, Chicago; Loyola University, Chicago; Northwestern University, Evanston; The Principia, Elsah; Rockford College, Rockford; Rosary College, River Forest; St. Francis Xavier College for Women, Chicago; Wheaton College, Wheaton.

Indiana: Ball State Teachers College, Muncie; DePauw University, Greencastle; Franklin College of Indiana, Franklin; Indiana State Teachers College, Terre Haute; Indiana University, Bloomington; University of Notre Dame, Notre Dame; Purdue University, Lafayette; Rose Polytechnic Institute, Terre Haute; St. Mary's College, Notre Dame; St. Mary-of-the-Woods College, St. Mary-of-the-Woods.

Iowa: Coe College, Cedar Rapids; Drake University, Des Moines; Grinnell College, Grinnell; Iowa State College of Agriculture and Mechanical Arts, Ames; Iowa State Teachers College, Cedar Falls; State University of Iowa, Iowa City; Luther College, Decorah; Ottumwa Heights College, Ottumwa.

Kansas: Kansas State Teachers College, Pittsburg; St. Mary College, Leavenworth; Southwestern College, Winfield.

Kentucky: Kentucky State Teachers College, Western Bowling Green; University of Kentucky, Lexington; University of Louisville, Louisville.

Louisiana: Louisiana State University, Baton Rouge; Southwestern Louisiana Institute, Lafayette; Tulane University, New Orleans.

Maine: Bowdoin College, Brunswick; Colby College, Waterville; Maine, University of, Orono.

Maryland: Georgetown Preparatory School, Garrett Park; Goucher College, Baltimore; Hood College, Frederick; Johns Hopkins University, Baltimore; Maryland State Teachers College, Towson; University of Maryland, College Park; Mount St. Mary's College, Emmitsburg; College of Notre Dame of Maryland, Baltimore; St. Joseph's College, Emmitsburg; Washington College, Chestertown; Western Maryland College, Westminster.

Massachusetts: Beaver Country Day School, Chestnut Hill; Boston College, Chestnut Hill; Boston University, Boston; Bradford Junior College, Bradford; Clark University, Worcester; Emmanuel College, Boston; Harvard University, Cambridge; College of the Holy Cross, Worcester; International Y. M. C. A. College, Springfield; Massachusetts Institute of Technology, Cambridge; Massachusetts State College, Amherst; Mount Holyoke College, South Hadley; Phillips Academy, Andover; Radcliffe College, Cambridge; Regis College, Weston; Simmons College, Boston; Smith College, Northampton; Wellesley College, Wellesley; Worcester Polytechnic Institute, Worcester.

Michigan: Albion College, Albion; Alma College, Alma; Detroit, University of, Detroit; Marygrove College, Detroit; Merrill-Palmer School, Detroit; Michigan State College, East Lansing; Michigan State Teachers College, Western, Kalamazoo; Michigan, University of, Ann Arbor; Wayne University, Detroit.

Minnesota; Carleton College, Northfield; Macalester College, St. Paul; University of Minnesota, Minneapolis; College of St. Catherine, St Paul; College of St. Scholastica, Duluth; College of St. Teresa, Winona; College of St. Thomas, St. Paul; Virginia Junior College, Virginia.

Mississippi: Millsaps College, Jackson; Mississippi College, Clinton; Mississippi State College, State College; Mississippi State College for Women, Columbus.

Missouri: Central College, Fayette; Lincoln University, Jefferson City; Lindenwood College for Women, St. Charles; Missouri State Teachers College, Northeast, Kirksville; Missouri State Teachers College, Northwest, Marysville; Missouri State Teachers College, Southwest, Springfield; Missouri, University of, Columbia; Park College, Parkville; St. Louis University, St. Louis; Stephens College, Columbia; Washington University, St. Louis; Webster College, Webster Groves; Westminster College, Fulton; William Jewell College, Liberty.

Montana: Montana State University, Missoula.

Nebraska: Creighton University, Omaha; Nebraska, University of, Lincoln; Union College, Lincoln.

New Hampshire: Dartmouth College, Hanover; University of New Hampshire, Durham.

New Jersey: Georgian Court College, Lakewood; Newark College of Engineering, Newark; New Jersey State Normal School, Newark; Princeton University, Princeton; Rutgers University, New Brunswick; College of St. Elizabeth, Convent Station; Seton Hall College, South Orange.

New Mexico: New Mexico, University of Albuquerque.

New York: Adelphi College, Garden City; Alfred University, Alfred; Brooklyn College, Brooklyn; Buffalo, University of, Buffalo; Canisius College, Buffalo Colgate University, Hamilton; College of St. Rose, Albany; Columbia University, New York; Cornell University, Ithaca; D'Youville College, Buffalo; Elmira College, Elmira; Ethical Culture Schools, New York; Fordham University, New York; Good Counsel College, White Plains; Hamilton College, Clinton;

Houghton College, Houghton; Hunter College of the City of New York, New York; Keuka College, Keuka Park; Manhattan College, New York; Marymount College, Tarrytown-on-Hudson; College of Mount St. Vincent, New York; Nazareth College, Rochester; College of New Rochelle, New Rochelle; College of the City of New York, New York; New York State College for Teachers, Albany; New York State Normal School, Geneseo; New York University, New York; Niagara University, Niagara Falls; Polytechnic Institute of Brooklyn, Brooklyn; Rensselaer Polytechnic Institute, Troy; Rochester Athenaeum and Mechanics Institute, Rochester; University of Rochester, Rochester; Russell Sage College, Troy; College of the Sacred Heart, New York; St. John's University, Brooklyn; St. Joseph's College for Women, Brooklyn; St. Lawrence University, Canton; Sarah Lawrence College, Bronxville; Skidmore College, Saratoga Springs; Syracuse University, Syracuse; Vassar College, Poughkeepsie; Wells College, Aurora.

North Carolina: Asheville Normal and Teachers College, Asheville; Bennett College, Greensboro; Duke University, Durham; Johnson C. Smith University, Charlotte; Lenoir-Rhyne College, Hickory; Meredith College, Raleigh; North Carolina, Woman's College of the University of, Greensboro; North Carolina, University of, Chapel Hill.

North Dakota: University of North Dakota, Grand Forks.

Ohio: University of Akron, Akron; Antioch College, Yellow Springs; Capital University, Columbus; Case School of Applied Science, Cleveland; University of Cincinnati, Cincinnati; Denison University, Granville; Heidelberg College, Tiffin; John Carroll University, Cleveland; Marietta College, Marietta; Miami University, Oxford; College of Mount St. Joseph-on-the-Ohio, Mount St. Joseph; Mount Union College, Alliance; Muskingum College, New Concord; Oberlin College, Oberlin; Ohio State University, Columbus; Ohio University, Athens; Ohio Wesleyan University, Delaware; St. Mary of the Springs College, East Columbus; University of Toledo, Toledo; Western College, Oxford; Western Reserve University, Cleveland; College of Wooster, Wooster.

Oklahoma: Oklahoma Agricultural and Mechanical College, Stillwater; Oklahoma State Teachers College, East Central, Ada; Phillips University, Enid.

Oregon: Oregon State Agricultural College, Corvallis; University of Oregon, Eugene.

Pennsylvania: Allegheny College, Meadville; Bucknell University, Lewisburg; Carnegie Institute of Technology, Pittsburgh; Dickinson College, Carlisle; Drexel Institute, Philadelphia; Duquesne University, Pittsburgh; Gettysburg College, Gettysburg; Grove City College, Grove City; Immaculata College, Immaculata; Lebanon Valley College, Annville; Lehigh University, Bethlehem; Marywood College, Scranton; Mercyhurst College, Erie; Misericordia College, Dallas; Mount Mercy College, Pittsburgh; Mount St. Joseph College, Philadelphia; Muhlenberg College, Allentown; Pennsylvania College for Women, Pittsburgh; Pennsylvania State College, State College; Pennsylvania State Teachers College, Indiana; Pennsylvania State Teachers College, West Chester; University of Pennsylvania, Philadelphia; University of Pittsburgh, Pittsburgh; Rosemont College, Rosemont; St. Thomas College, Scranton; Seton Hill College, Greensburg; Susquehanna University, Selinsgrove; Swarthmore College, Swarthmore; Temple University, Philadelphia; Thiel College, Greenville; Wilson College, Chambersburg.

Rhode Island: Brown University, Providence; Rhode Island State College, Kingston.

South Carolina: College of Charleston, Charleston; Converse College, Spartanburg; University of South Carolina, Columbia; Winthrop College, Rock Hill.

South Dakota: Yankton College, Yankton.

Tennessee: University of Chattanooga, Chattanooga; Fisk University, Nashville; George Peabody College for Teachers, Nashville; Maryville College, Maryville; Southern Junior College, Collegedale; Southwestern, Memphis; Tusculum College, Greeneville; Vanderbilt University, Nashville.

Texas: Baylor University, Waco; Incarnate Word College, San Antonio; Our Lady of the Lake College, San Antonio; Rice Institute, Houston; Stephen F. Austin State Teachers College, Nacogdoches; Texas State College for Women, Denton; Texas State Normal and Industrial College, Prairie View; Texas State Teachers College, North, Denton; Texas State Teachers College, West, Canyon; Texas Technological College, Lubbock; University of Texas, Austin.

Utah: Brigham Young University, Provo.

Vermont: Bennington College, Bennington; Green Mountain Junior College, Poultney; Middlebury College, Middlebury; University of Vermont, Burlington.

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Virginia: Hollins College, Hollins; Lynchburg College, Lynchburg; Mary Baldwin College, Staunton; Sweet Briar College, Sweet Briar; Virginia Military Institute, Lexington; Virginia Polytechnic Institute, Blacksburg; Virginia State Teachers College, East Radford; University of Virginia, Charlottesville; Washington and Lee University, Lexington; College of William and Mary, Williamsburg.

Washington: College of Puget Sound, Tacoma.

West Virginia: Bethany College, Bethany; West Virginia State College, Institute; West Virginia State Teachers College, Fairmont; West Virginia University, Morgantown.

Wisconsin: Beloit College, Beloit; Carroll College, Waukesha; Lawrence College, Appleton; Marquette University, Milwaukee; Milwaukee-Downer College, Milwaukee; Stout Institute, Menomonie; University of Wisconsin, Madison.

Wyoming: University of Wyoming, Laramie.

PUBLIC-SCHOOL SYSTEMS

Indiana: Indianapolis public schools.

Iowa: Iowa State Department of Public Instruction.

Maryland: Baltimore Department of Education.

Massachusetts: Massachusetts State Department of Education.

Missouri: Missouri State Department of Education; St. Louis public schools.

New York: New York State Department of Education; Rochester public schools.

Ohio: Akron public schools.

Rhode Island: Providence public schools.

Tennessee: Tennessee State Department of Education.

Utah: Utah State Department of Education.

Virginia: Virginia State Board of Education.

SECRETARIES OF ASSOCIATION MEMBER ORGANIZATIONS

American Camping Association: Mr. P. B. Samson, secretary, Lane Hall, University of Michigan, Ann Arbor, Mich.

American Association of Collegiate Registrars: Mr. J. R. Robinson, secretary, George Peabody College for Teachers, Nashville, Tenn.

American Council of Learned Societies: Mr. Waldo G. Leland, secretary, 907 Fifteenth Street NW., Washington, D. C.

American Historical Association: Prof. Dexter Perkins, secretary, University of Rochester, Rochester, N. Y.

American Physical Education Association: Prof. E. D. Mitchess, secretary, box 362, University of Michigan, Ann Arbor, Mich.

Board of Christian Education of the Presbyterian Church in the United States of America: Dr. C. C. McCracken, 822 Witherspoon Building, Philadelphia, Pa.

Board of Presidents, State Teachers College of Commonwealth of Pennsylvania: Mr. Henry Klonower, secretary, Department of Public Instruction, Harrisburg, Pa.

C. R. B. Educational Foundation, Inc.: Mr. Perrin C. Galpin, secretary, 420 Lexington Avenue, New York, N. Y.

Delphian Society: Mr. F. A. Brown, secretary, 307 North Michigan Avenue, Chicago, Ill.

Girl Scouts, Inc.: Mrs. Paul Rittenhouse, 14 West Forty-ninth Street, New York, N. Y.

Modern Language Association of America: Dr. Percy W. Long, secretary, New York University, New York, N. Y.

National Advisory Council on Radio in Education: 60 East Forty-second Street, New York, N. Y. (new secretary to be appointed).

National Association of Deans and Advisers of Men: Dean D. H. Gardner, secretary-treasurer, University of Akron, Akron, Ohio.

National Association of Deans of Women: Miss Kathryn Heath, 1201 Sixteenth Street NW., Washington, D. C.

National Congress of Parents and Teachers: Mr. W. H. Bristow, secretary, 1201 Sixteenth Street NW., Washington, D. C.

National Council of Business Education: Miss Helen Reynolds, secretary, Ohio University, Athens, Ohio.

National Council of Parent Education: Mr. Ralph P. Bridgman, director, 60 East Forty-second Street, New York, N. Y.

National Council of Teachers of English: Mr. W. Wilbur Hatfield, secretary-treasurer, 211 West Sixty-eighth Street, Chicago, Ill.

National Council of the Y. M. C. A.: Mr. Owen E. Pence, 347 Madison Avenue, New York, N. Y.
National League of Nursing Education: Miss Claribel A. Wheeler, executive secretary, 50 West Fiftieth Street, New York, N. Y.
National Research Council: Mr. Paul Brockett, secretary, Twenty-first and Constitution Avenue, Washington, D. C.
National Society of College Teachers of Education: Mr. Fowler D. Brooks, secretary-treasurer, De-Pauw University, Greencastle, Ind.
National Vocational Guidance Association: Mr. Fred C. Smith, executive secretary, University of Tennessee, Knoxville, Tenn.
United Chapters of Phi Beta Kappa: Mr. William A. Shimer, secretary, 145 West Fifty-fifth Street, New York, N. Y.
American Association for the Advancement of Science: Dr. Forest R. Moulton, secretary, Smithsonian Institution, Washington, D. C.
American Alumni Council: Dr. Glen O. Stewart, secretary, Michigan State College, East Lansing, Mich.

SECRETARIES OF CONSTITUENT MEMBER ASSOCIATIONS

American Association of Colleges of Pharmacy: Prof. Zada M. Cooper, secretary-treasurer, State University of Iowa, Iowa City, Iowa.
American Association of Dental School: Dr. Gerald D. Timmons, secretary-treasurer, Indiana University, Indianapolis, Ind.
American Association of Junior Colleges: Dr. Doak S. Campbell, secretary, George Peabody College for Teachers, Nashville, Tenn.
American Association of Teachers Colleges: Dr. Charles W. Hunt, secretary-treasurer, State Normal School, Oneonta, N. Y.
American Association of University Women: Dr. Kathryn McHale, secretary, 1634 Eye Street NW., Washington, D. C.
American Association of University Professors: Dr. Ralph E. Himstead, 744 Jackson Place, Washington, D. C.
American Jesuit Educational Association: Rev. Daniel M. O'Connell, S. J., secretary, Loyola University, Chicago, Ill.
American Library Association: Mr. Carl H. Milam, secretary, 520 North Michigan Avenue, Chicago, Ill.
Association of American Colleges: Dr. Guy E. Snavely, secretary, 19 West Forty-fourth Street, New York City.
Association of American Medical Colleges: Dr. Fred C. Zapffe, secretary, 5 South Wabash Avenue, Chicago, Ill.
Association of Collegiate Schools of Nursing: Miss Agnes Gelinas, secretary, Stanford University, Stanford University, Calif.
Association of Land-Grant Colleges: Mr. Thomas Cooper, secretary, Experiment Station, University of Kentucky, Lexington, Ky.
Association of Urban Universities: Dr. Roscoe M. Ihrig, secretary, Carnegie Institute of Technology, Pittsburgh, Pa.
Council on Medical Education and Hospitals of the American Medical Association: Dr. William D. Cutter, 535 North Dearborn Street, Chicago, Ill.
Council of Section of Legal Education and Admissions to the Bar of the American Bar Association: Mr. Alexander B. Andrews, secretary, 239 Fayetteville Street, Raleigh, N. C.
Dental Educational Council of America: Dr. Albert L. Midgley, secretary, 1108 Union Trust Building, Providence, R. I.
Department of Secondary School Principals of the N. E. A.: Mr. H. V. Church, executive secretary, 5835 Kimbark Avenue, Chicago, Ill.
American Association of School Administrators (formerly department of superintendence, N. E. A.) : Mr. S. D. Shankland, executive secretary, 1201 Sixteenth Street NW., Washington, D. C.
Middle States Association of Colleges and Secondary Schools: Prof. George W. McClelland, secretary, University of Pennsylvania, Philadelphia, Pa.
National Association of Colleges and Departments of Education: Dean Grayson N. Kefauver, secretary, Stanford University, Stanford University, Calif.
National Association of State Universities: President Herman G. James, secretary, Ohio University, Athens, Ohio.
National Catholic Educational Association: Rev. George Johnson, secretary, general, 1312 Massachusetts Avenue NW., Washington, D. C.
National Education Association: Mr. Willard E. Givens, secretary, 1201 Sixteenth Street NW., Washington, D. C.

Progressive Education Association: Mr. Frederick L. Redefer, executive secretary, 310 West Ninetieth Street, New York, N. Y.
Society for the Promotion of Engineering Education: Dean F. L. Bishop, secretary, University of Pittsburgh, Pittsburgh, Pa.
Southern Association of Colleges and Secondary Schools: President Shelton Phelps, secretary, Winthrop College, Rock Hill, S. C.
Institute of International Education: Dr. S. P. Duggan, director, 2 West Forty-fifth Street, New York, N. Y.
Phi Delta Kappa: Dr. Paul M. Cook, executive secretary, 1180 East Sixty-third Street, Chicago, Ill.
National University Extension Association: Mr. W. S. Bittner, secretary, Indiana University, Bloomington, Ind.
North Central Association of Colleges and Secondary Schools: Dr. A. W. Clevenger, secretary, University of Illinois (209 Administration Building, East), Urbana, Ill.
American Association of Collegiate Schools of Business: Dr. Charles C. Fichtner, secretary, University of Arkansas, Fayetteville, Ark.

Now, the committee will stand recessed until 9:30 Monday morning.

(Whereupon, at 12:55 p. m., a recess was taken until Monday, March 21, 1938, at 9:30 a. m.)

REVENUE ACT OF 1938

MONDAY, MARCH 21, 1938

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

The committee met, pursuant to recess, at 9:30 a. m. in the Finance Committee room, Senate Office Building, Senator Pat Harrison (chairman) presiding.

The CHAIRMAN. The committee will be in order. Congressman O'Toole wanted to be heard briefly in order that he might attend a committee meeting. All right, Congressman.

STATEMENT OF HON. DONALD L. O'TOOLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. O'TOOLE. Mr. Chairman and gentlemen of the committee, I appear here in opposition to the so-called Thompson amendment. The Thompson amendment places an excise tax of 6 cents a pound on imported meats. I would like you to understand that I do not appear here in the interests of foreign pork exporters, but I stand here in the name of 325,000 people of the city of New York who make their living in the handling of foreign commerce. Likewise, there are other hundreds of thousands, perhaps millions, throughout the United States that are engaged in similar occupations. In my own city, not only is the shipping industry affected, but also the longshoremen, draymen, motor transfer companies, and their employees, storage warehouses, commission brokers, custom brokers, and thousands of clerical employees, or organizations of that type.

Foreign commerce is a necessary part of civilization. No nation is self-sustaining. It is incumbent that nations trade with each other, one providing what the other lacks, and, as a consequence, there must be a balance. One nation cannot do all the selling, there must be a medium of exchange in return other than money. During this depression the agriculturist, whether he was farmer or pork raiser, received financial assistance from the Government, but our city workers, particularly those who were engaged in the transportation and handling of imports and exports, had to work out their own salvation without assistance from any source. The curtailment of foreign trade would work hardships upon millions of our workers and would add hundreds of thousands to the already overburdened relief rolls of the Nation and respective States.

The imported meats are not in direct competition with the domestic meats for the reason that the added costs due to duty, shipping, handling, other transportation, and clerical work, create such a high price for the imported meat that it may well be put in the luxury class.

To cite the difference, the domestic boiled canned ham is being sold in Callahan's, in New York City, today for 42 cents a pound and the imported canned ham, selling at the same place, is priced at 54 cents a pound. This is a difference of 12 cents per pound, and there has been a greater variance at other times during the past year. The housewife purchasing meat, which is the principal article of a meal, will certainly not pay 12 cents a pound more for an article, which averages 12 pounds, thereby adding $1.44 to her daily budget, if she can obtain a domestic product which is that much cheaper. This pork is purely a luxury.

The past year has seen the American pork raiser receive the highest price for his product that he has obtained since the days of the World War in 1917-18.

In 1937 the United States exported to other countries 200,210,608 pounds of pork product, while it imported but 74,830,480 pounds of similar product. The total amount of domestic pork sold in the United States during 1937, according to the figures supplied by the Department of Agriculture, amounted to 6,650,000,000 pounds plus 1,400,000,000 pounds of lard, while the total amount of imported pork coming into the United States in 1937 was but 74,000,000 pounds, or a fraction of 1 percent of the total amount of pork consumption.

But we must not stop here. It was in 1930 that these pork products first started to come into this country in any degree of volume. At that time, according to the figures supplied by the Department of Commerce, Poland imported from the United States but $81,000 worth of cotton. From 1930 to date, as a result of her ability to send pork products to the United States, she has been able to increase her cotton purchases, until last year when she purchased $11,986,000 worth of that staple, an increase of 1,470 percent of a single article since 1930. All other exports to these pork-sending countries have shown large gains, and we have gradually built up a market in these countries for our cotton, farm machinery, automobiles, accessories, and many other articles of American manufacture. It will only be natural for these foreign countries to, in turn, place retaliatory taxes on the product that we are sending to their shores.

If this allowed to happen American shipping, manufacturing, and even agriculture, will be unable to dispose of hundreds of millions of dollars' worth of their products that would have no market in the United States, and would be a contributing cause to the knocking down of prices, due to the fact that they would create such a great surplus at home.

In conclusion, gentlemen, it is most important to bear in mind that the balance of trade between these nations and the United States has been unfavorable to the exporting European nations as a class.

I thank you for your courtesy and I hope that you will realize that the Thompson amendment will do much more harm to American industry and agriculture than it will do good, so that I ask that the committee give this matter full consideration.

The CHAIRMAN. Thank you. Mr. Dirksen.

STATEMENT OF HON. EVERETT M. DIRKSEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. DIRKSEN. My interest in the proposed increase of 25 cents a gallon in the Federal tax upon distilled spirits arises out of the fact that I have the honor to represent a district in which distilling is a predominant industry. The pending bill contains a provision for an increase of 25 cents per gallon in the tax on distilled liquors. I want to address myself to that very briefly, and to express myself in opposition, the opposition of our people and the opposition of our industry. So that there can be no misapprehension in the minds of the committee as to my interest in the matter may I say that I represent what is commonly called a whisky district where the manufacture of distilled spirits is a predominant industry.

Senator BROWN. Peoria is the largest town?

Mr. DIRKSEN. Peoria is the largest town in the district. We think, of course, of distilled spirits as something more than distilled spirits. First of all, it is a livelihood for thousands of people; secondly, it is an outlet for coal, grain, bottles, stamps, labels, and a great many other things. So we have that economic interest.

First of all, let me say, it appears to me that the tax on distilled spirits at the present time, under existing law, is amply high. Distilled spirits today pay the most tremendous taxes of any American product. The Federal Government alone imposes direct taxes which amount to as much as $7.14 per case. Six dollars of this amount consists of the $2 per gallon Internal Revenue tax. Ninety cents a case is made up of the Federal rectifying tax of 30 cents a gallon. Twenty-four cents a case, or 1 cent a bottle, is collected for strip stamps, and that is only the beginning. Federal occupational taxes should be considered.

Senator KING. It was $1 a gallon before the war?

Mr. DIRKSEN. $1.10. It was at one time 50 cents a gallon. That is a long time ago, beyond our generation. There are State taxes upon gallonage which range as high as $2.20. Many Commonwealths have occupational taxes and the municipalities impose license fees of all degrees. Before the various tax collectors have finished, from 76 cents to $1.05 in every quart represents direct taxation upon distilled spirits. In addition, all other regular business, property, and income taxes must also be paid by this industry.

Now then, here is an aspect that is possibly forgotten in connection with this tax. The tax represents a direct investment that has to be made in advance. Before liquor can go into a bonded warehouse the money has to be laid on the line, so to speak, so that the mere financing of the tax burden is one of the most pressing problems confronting every individual in the liquor industry. There is approximately $90,000,000 of capital constantly invested in direct taxes. That is a tremendous amount, if you please, and in that case the burden is on the distillers, with respect to the tax on distilled spirits. Taxation is the foundation and not the superstructure in determining the ultimate costs of distilled spirits. A tax increase is just as certain to be reflected in the ultimate product as the grain which entered into it. There is no business wizardry by means of which any distiller, rectifier, wholesaler, or retailer can make the tax disappear.

Now, then, this tax cannot be absorbed by the industry. I would like for some of those who say that the distiller can absorb a tax increase such as is proposed, to tell me where this might be done. In my judgment, it could not be absorbed without putting a great many of the distillers out of business.

Senator KING. May I interrupt?

Mr. DIRKSEN. Yes, Senator.

Senator KING. I have had a large number of letters from druggists and from proprietary medicine establishments protesting against the tax, contending that it would injure them in their business. Have you any comment to make on that?

Mr. DIRKSEN. I haven't examined into that particularly. That, so far as my interest is concerned, would be a collateral matter. I should be able, however, to adduce that information that comes to my attention and probably submit it for the purposes of the record.

I have stated that the present tax burden is from 76 cents to $1.05 a quart, and business statistics show that 70 percent of all distilled spirits sales are on merchandise priced at under $2 a quart. You can buy a good deal of it cheaper than that. The margin of profit that the distillers have on whisky of this kind at the present time, on the basis of present sales, is about 2 cents a quart, or about 1 cent a pint.

The CHAIRMAN. How old is it before you can sell it?

Mr. DIRKSEN. We have whisky in the warehouse long enough to qualify as being bottled in bond.

The CHAIRMAN. Do you think that the tax on liquor that has been in bond for 2 years should be higher than on whisky that is in bond longer than 2 years?

Mr. DIRKSEN. I have heard that argument advanced, to make it progressive or contingent upon the age of the liquor. I have not given a great deal of thought to it, as a matter of fact. I heard about it recently. I do not know that the difficulties of enforcement would be, for one thing. I do not know what the difficulties would be in having to differentiate between the different ages of whisky that may go on the market. I think it may offer a considerable administrative difficulty.

Senator KING. May I add to it, it seems to me that after carrying whisky for so many years in bond, or in storage, with the interest on investment, and so forth, that it would be a penalty if you made a higher tax upon that liquor than the cheaper liquor.

Mr. DIRKSEN. I would not be a bit surprised.

The CHAIRMAN. The object was not to make it as much on the old stuff as on the new stuff, in order that people might get better liquor at a cheaper price.

Mr. DIRKSEN. Those who seek a higher quality, on the theory that they can afford to pay for it, probably would not object to a higher tax. Frankly, I do not know what difficulties that proposal will offer. It may offer some, and it should be investigated, surely, before the committee undertakes to make a recommendation of that kind.

I want to dwell for a moment on this matter of the possibility of the industry absorbing this tax. The cost of raw materials, labor, transportation, capital investment, and necessary administrative expenses cannot come out of thin air. They, too, must be paid in dollars. The result is that today the distiller has a profit margin of about 2 cents a

quart in his product retailing below $2. In the case of many distillers the entire output falls in that price class. The effect of the 25-cent tax burden proposed in this bill, if absorbed, would be to place him in bankruptcy. You say 25 cents a gallon, 6¼ cents a quart or 3⅛ cents a pint, that it looks as if no consumer of spirits would kick particularly on that.

Senator HERRING. Do you know what it will yield?

Mr. DIRKSEN. You mean the present tax?

Senator HERRING. Yes.

Mr. DIRKSEN. There have been different estimates, I suppose, that run all the way from $19,000,000 to $35,000,000.

Senator HERRING. I had a statement that it would run about $39,000,000, and the profit to the distillers is less than $29,000,000; therefore it could not be absorbed.

Mr. DIRKSEN. The total profits of the distillers in 1937, probably the best year they ever had, just about equalled $35,000,000, but in view of the various collateral developments taking place in the country, and in view of the recent freight increase by the Interstate Commerce Commission, it would equal just about the whole profit in the industry in 1937. If the tax is going to equal that amount, manifestly that answers the argument as to whether or not it can be absorbed by the industry. Even on merchandise selling above $2 a quart, 75 cents a case, if absorbed, would usually mean the difference between profit and loss. I do not believe that any Member of Congress is today interested in bankrupting any business, large or small.

As evidenced by business to date, the present year will not be anything like as good as 1937 for the distilled spirits industry. Its members know, for instance, that they will have to pay up to 10-percent increase in freight rates on their raw materials and their finished product. They know already that regardless of the tax, the volume of sales has decreased.

There is another side of this financial picture which I believe you should examine. Virtually all whisky is held for varying lengths of time. During the period of storage it is a liability rather than an asset unless it has collateral value. I am informed that the distillers of the United States have between 75 and 85 million dollars in bank loans. The addition of 25 cents a gallon Federal tax will immediately depress the collateral value of every gallon upon which banks have advanced funds. With business conditions as they are now, where are the distillers to get the money which the banks may demand to protect their loans? The doors of capital markets are tightly closed.

If the gallonage tax is imposed, as it now stands, you may expect a period of disruption which will completely demoralize the distilled-spirits industry. The effective date in the bill, July 1, 1938, will be preceded by an avalanche of withdrawals from bonded warehouses. Every distiller will convert every dollar he possesses into stocks. The entire industry on through the rectifiers, wholesalers, and retailers will be glutted with an over-supply of every form of distilled spirits. There will be price demoralization and price wars. Many of the smaller units will be wiped out.

If the Congress choses to impose a floor tax in order to prevent conditions such as I have just mentioned, there will be a situation fully as grave. There is at all times about 4 months' supply of distilled spirits between the bonded warehouse and the ultimate consumer. Statis-

tics show that it is almost equally divided between stocks in the hands of distillers, rectifiers, wholesalers, and retailers. At the present rate of consumption, distillers have on hand at their plants, warehouse, and in transit an average of 10,000,000 gallons of distilled spirits at all times. Wholesalers and rectifiers are in the possession of approximately 9,500,000 gallons at all times, and retailers constantly have on their shelves another 9,500,000 gallons. A floor tax would mean that each of these component parts of the industry would immediately owe the Federal Government 25 cents for every gallon so held. Do the members of this committee know of any industry which could today lay on the line $7,000,000? Remember, please, that this necessity for the additional capital would not be confined to large companies or wealthy businessmen.

The small distiller and rectifier, the little jobber and the tiny retailer would all be up against an equally tough problem. Any such strain as this tax increase, if made applicable to floor stock, would force scores of small distillers and rectifiers entirely out of business. It would ruin hundreds of wholesalers and many thousands of retailers. Translate the problem into that of a package retailer with a stock of approximately $5,000—and this is the average for the United States—where would little merchants of that type turn to find, even collectively, $2,375,000? Yet; that is what they would owe the Government on 9,500,000 gallons of floor stock. I say it is going to cause no end of difficulty. It is just like jumping out of the frying pan into the fire.

I read with much interest the other day a statement by the chairman of this committee that he hoped to take the brakes off business and free capital through the means of this bill. The effect of the additional tax on distilled spirits would do directly the opposite. The capital requirements of the distilled-spirits industry would be increased. Capital would be confined and frozen prior to any profit. I consider the principle embodied in the proposal I am discussing to be in direct conflict with any move designed to give business more freedom and so bring about a turn in the depressed condition from which all business is now suffering. Can we make any progress if we depress with the one hand even while we attempt to lift up with the other?

Senator, may I say, in the discussion we had over on the other side a great deal was said about the high liquor taxes in Great Britain. It is true that they do have a much higher tax over there than we do have over here, but may I cite to you some of the figures that I managed to get together. From 1921 to 1936, the last year for which figures are available, revenue was reduced from approximately $355,000,000 to $177,500,000. Further, the conditions in the two countries are not comparable. England has never suffered under prohibition. There is no illicit-spirits problem there in the sense that we have known it. They did not have the bootlegger over there, and that is what we have got to contend with. Decreased legal consumption in Great Britain does not mean a diversion of the reduced consumption into illicit channels as it does in the United States. In this country illicit spirits always absorb the market which legal liquors cease to occupy. If, for instance, a tax deters consumption of legal whisky they are going to buy bootleg whisky.

I was rather interested this morning in running over the Washington dailies the notice that police had arrested two people and seized 207

quarts of liquor. The 207 quarts of liquor seized would bring a revenue of $123.17. If you add this 25 cents it would increase from $123.17 to $136.10. The thing you have got to determine is this, whether in seeking to collect the extra $12.94 by virtue of 25 cents a gallon tax on spirits you are going to take a chance on losing $123.17 that the Government would ordinarily make if this were tax-paid liquor rather than illicit liquor. We cannot overlook that fact.

I would like now, if I may, to examine the records of the United States Treasury in order to determine whether an increase in distilled spirits taxation will result in increased revenue as contended by proponents of the proposal we are discussing. The nearest comparable increase I can find is that of the years 1894 and 1895. In the former year the tax on distilled spirits was 90 cents. It was increased at that time to $1.10, or 20 cents a gallon. The immediate effect was an 11,886,000 gallon decrease in legitimate liquor consumption and a $5,074,000 decrease in revenue. In 1894, Internal Revenue collections from distilled spirits amounted to $79,913,000. The following year they dropped to $74,839,000. On the same basis, the estimated loss to the Federal Government through the pending increase would be $6,496,000 in a year.

Conversely, Treasury records tell us that when the Federal tax was reduced from $2 to 50 cents a gallon in 1869, the income of $14,000,000 from legal liquors under the high rate was boosted to $33,000,000 under the much lower rate.

The failure of higher taxation as a revenue producer is due, of course, to the fact that consumption of legal liquor is affected by the retail price increases which necessarily follow the upward curve of taxes. High taxes divert the demand from the legal to the illegal source of supply. On each gallon diverted the Government will lose $2 instead of gaining 25 cents. Those who manufacture and sell distilled spirits have not escaped the recession which has fallen on business generally during the past months. Many of them, particularly the smaller units, are in distress. Decreased consumer demand will knock them out of the commercial arena.

This means unemployment, loss of revenue through occupational taxes and license fees, empty stores and all of the other accompaniments of a prostrate business.

The effects of such a slump cannot be confined to the distilled spirits industry alone. Scores of other industries provide material or services to distillers and rectifiers. They, too, will suffer. The farmer, the glass industry, the coopers, the railroads and the newspapers will feel immediately and severely any curtailment in the production and sale of legal distilled spirits. Just how wide this wave may be, it is impossible to state, but I would like to call your attention to the fact that in the fiscal year 1937, according to Treasury figures, corn, rye, malt, and other grains with a market value of more than $61,000,000, were purchased by those engaged in the manufacture of distilled spirits. In the same period the value of the white oaks stumpage which the farmer sold to be made into barrels was valued at approximately $12,500,000. It is hardly necessary for me to point out to you that the grain purchases were of a far greater value than even the dollars involved indicate, for distillers grains are purchased on the market where they do much to maintain and stabilize prices.

I do not believe that Congress in taxing what it mistakingly believes to be an easy source realized that it was placing one more burden upon the farmer, nor with the realization of that fact will approve this proposed tax.

I trust that the members of this committee and of the Congress will give some thought also to the enforcement problem which any tax increase may create. Official Treasury figures show that there is still work to be done in eliminating the manufacture and sale of illicit whisky. Although more than 4,000 fewer stills were seized in the calendar year 1937, than in 1936, seizures were still being made at the rate of 235 a week last year. Hundreds of thousands of gallons of non-tax-paid distilled spirits were seized and millions of gallons of mash were destroyed.

I got myself a couple of investigators last year and went around Washington for about 8 or 9 hours. We went all over into every section of town. You would be surprised at the amount of bootleg whisky that is going through Washington today. You have got the illicit distiller to deal with today, and the higher this tax goes the greater the incentive to undertake the hazard of violating the tax law and we would again have our prohibition ills in this country. Figure it out for yourselves. On the basis of $9 a case to $12 a case for both Federal and State taxes the bootlegger says to himself, "Can we operate on the basis of that hazard?" The answer is, that it is a clear incentive for the bootlegging business. To arrive at a prophecy, if this tax goes in I am satisfied it is going to stimulate bootlegging. It is probable that the revenue lost will offset what you expect to get in the form of this tax. Let us not fool ourselves. The illicit still operator and bootlegger already has approximately $1 a quart in his favor as compared to the legal businessman. If we increase the margin within which he has to work, the Alcohol Tax Unit of the Treasury will either have to spend more on enforcement or deprive the Treasury of revenue. Why withhold from the left hand what the right hand is doing, for if we provide for a doubtful increase in revenue and at the same time add to administrative expense, we are doing just that.

I believe I have shown that no element I have discussed so far in this bad bargain can hope to gain by it. There remains one very important factor, the ultimate consumer. He is, after all, the one who will pay the bill. Some gentlemen on the floor of the House said glibly that a 25-cent a gallon increase meant 6¼ cents additional cost per quart. That is very poor economics. It must be remembered that the additional 25 cents becomes a part of the cost of the whisky the moment it is withdrawn from bond, and what was intended to be only two bits becomes at least twice that much as it goes along the normal channels of business. It grows a little by way of interest charges while the distiller holds the whisky. It adds a few pennies when it is calculated in the business mark-up of the wholesaler. It is increased again when the retailer adds his cost of doing business and profit to the product. It may expand still more through an ultimate sales tax. What started at 6¼ cents a quart is double that much by the time you or any other consumer mix yourself a highball.

I have given you what I believe to be an accurate and truthful version of what the proposed 25-cent tax will do. No other commodity is now so heavily taxed. You may call it a luxury if you wish, but if you follow the theory that this amendment sets forth,

you will make it a luxury which only the rich can buy legally, you will have throttled both an industry and a source of revenue entirely.

Mr. Chairman, I will file this statement with the committee. I just want to emphasize this one fact all over again, that I think this is going to be a deterrent tax.

Now then, let me wind up with these figures. You can buy whisky anywhere in this country for about 90 cents a pint. That is a popular price for blended whisky. I have taken the trouble to find out just exactly what the profit break-down on 1 pint of 90 proof whisky is. Here is what happens: The Federal Government gets 27¼ cents. When they talk about the burden of factory taxes, security taxes, and so forth, here is what they will pay, when we aggregate it. The average of the State taxes will be 12½ cents a pint. That is in the form of gallonage taxes. The distribution cost is 38¼ cents. That includes the mark-up of the wholesaler of 12½ percent, and a 30 percent mark-up for the retailer. Now then, the distiller's cost, freight cost, bottles, grain, manufacturing, advertising, and so forth, will be 10¾ cents, and the profit will be 1 cent per pint. Now, then, it seems to me that is about as eloquent as any figure that anybody can adduce to this committee, to show that on that rather slender margin the industry cannot absorb this proposed tax. It has got to be passed along. If you do pass it along it will probably grow twice as high before the liquor gets to the ultimate consumer. Therefore it is not going to curtail the consumption of bootleg liquor in this country but increase it.

Speaking for the people in this industry, the people in my district, for the people engaged in the liquor industry, who work there, who find employment there, who find an outlet for their product there, I say I am opposed to this tax, and I sincerely hope, in the wisdom of this committee, it will not let the tax prevail in the bill as it will be finally reported.

(The table referred to is as follows:)

Profit break-down on 1 pint of 90-proof whisky retailing at 90 cents

	Cents
Federal tax:	
One-eighth of $1.80 (per gallon)	22. 5
One-eighth of 30 cents (rectifying)	3. 75
Stamp tax	1
State tax: One-eighth of $1 (average State gallonage tax)	12. 5
Other taxes: Federal and State occupational and license	. 25
Total taxes	40
Distributors' costs:	
Wholesale mark-up (12½ percent)	11. 25
Retailers' mark-up (30 percent)	27
Total distributors' costs	38. 25
Cost of whisky and merchandising:	
One-eighth of 1937 cost per gallon (50–60 cents)	7
Capital investment	. 75
Advertising	1
Transportation	. 25
Selling cost	. 75
Administrative expense	1
Total cost of whisky and merchandising	10. 75

Profit break-down on 1 pint of 90-proof whisky retailing at 90 cents—Continued

	Cents
Profit to distiller	1
Total	90

	Cents
Federal	27.25
State	12.75
Distribution	38.25
Cost	10.75
Profit	1
Total	90

(Subsequently Mr. Dirksen submitted the following letter:)

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D. C., March 21, 1938.

Hon. PAT HARRISON,
United States Senate, Washington, D. C.

DEAR SENATOR: By way of amplification of my remarks before the Finance Committee this morning, let me submit the break-down which I alluded to this morning.

Where does it go—The 90 cents you pay for a pint of whisky

	Cents
Uncle Sam takes For internal revenue tax, rectifying tax and stamp tax.	27¼
The States take The average of gallonage and occupational taxes.	12¾
Those who distribute to the trade take This embraces a 12½ percent mark-up for the wholesaler and 30 percent for the retailer.	38¼
The cost of the whisky is This includes 7 cents for actual cost of production on a basis of 50 to 60 cents per gallon, ¾ cents for capital investment, 1 cent for advertising, ½ cent for transportation, ¾-cent sales cost, 1 cent for administrative cost.	10¾
Profit to the distiller	1
Consumer price	90

Very truly yours,

EVERETT M. DIRKSEN.

The CHAIRMAN. Mr. Osgood.

STATEMENT OF ROY C. OSGOOD, CHICAGO, ILL., REPRESENTING THE UNITED STATES CHAMBER OF COMMERCE

Mr. OSGOOD. Mr. Chairman and gentlemen of the committee, my name is Roy C. Osgood. I am vice-president of the First National Bank of Chicago and in charge of its trust department activities. I appear here, however, as a member of the committee on Federal finance, Chamber of Commerce of the United States. Because of my contacts with the problems of estate and gift taxes in the administration of wills and trusts, I shall confine my remarks to the provisions of the proposed revenue bill that relate to these taxes.

Federal estate taxes have been increased heavily in recent years. Combined with the State death duties the taxes upon estates of moderate size have been increased nearly sevenfold since 1931. The severity of these taxes coupled with the high income taxes and the

onerous capital-gains provisions have retarded the flow of capital into employment and wealth-producing enterprise.

The decision of an individual to invest capital in new business undertakings, or in the enlargement or expansion of an existing enterprise, depends in a large measure on whether or not his estate would have sufficient liquid assets to pay the Federal and State inheritance taxes due at the time of his death without disruption or heavy sacrifice. High estate and inheritance taxes, coupled with the other taxes mentioned, now certainly deter individuals of means from making investments in other than seasoned and readily marketable securities and develop a preference for tax exempts.

Senator GERRY. Mr. Osgood, may I ask you a question there?

Mr. OSGOOD. Surely, Senator.

Senator GERRY. Have you found, in your investigation, that with these very high estate taxes that we are now discussing, going concerns had to borrow large sums for their raw materials, and then if one of the large stockholders dies had his estate probably to sell out?

Mr. OSGOOD. I think the latter is more particularly true, Senator Gerry. We found in our own experience a number of cases of fairly large going concerns where the founder of the business, particularly the larger stockholder, dies that it is often necessary to go into the market and syndicate or sell securities to the corporation in order to pay the combined State and Federal taxes, which means, of course, the dissipation of ownership.

Senator GERRY. For example, where a business is built up, say by two brothers, or three brothers, and the business has grown from a small one to a very large one, and they are getting to be old men and they realize they have got to face these taxes, is not the logical thing to do to sell out the business and put the money into some other corporation where they can liquidate more quickly?

Mr. OSGOOD. Yes, there is. Of course, that is particularly true for a number of reasons. First, the corporation may have been owned by several individuals, it may have started in a partnership fashion, although in corporation form, and as it has grown and gotten older they are faced with two problems. First, to find the real market value of the particular securities. If the securities are not listed in any particular stock exchange, then the computation for Federal estate and State inheritance-tax purposes becomes very difficult. So they want to get their securities into what is known as marketable form. Now in order to list on most of the exchanges it means that practically 33 percent of the corporation's securities have to be in public hands. That is just about an average rule. That means that the dissipation of control in that case leaves the controlling stockholders practically 66 percent of the situation.

The second thing is, of course, that having parted with that portion of the control they want to keep their securities in such form that they can pay a tax upon the remainder of the estate in their hands, which means they may go to the liquid and marketable securities, and to that extent the control is dissipated.

Senator GERRY. Then you get to the other proposition, where they want to buy raw material for the purpose of carrying on the business, or enlarging it, increasing the value of the business, and they feel there might be a large estate tax possibly coming due by the death of one of the few large old stockholders, so that it will not be

possible to hold the control, or sell their stock to the corporation and keep their estate liquid, the corporation having used up the credit by borrowing.

Mr. OSGOOD. Yes, that is very true, and very often, when the situation gets to that point, they urge that the larger stockholders insure their lives for the benefit of the corporation and that way put cash into the corporation's treasury to pay off the borrowings that would be caused by that kind of a situation.

Senator GEORGE. Are you merely suggesting a change in the rates or suggesting a new clause?

Mr. OSGOOD. This short presentation will only take 5 minutes, Senator. If it develops that I have not answered your question I will be glad to go into it further.

Senator BROWN. Before you leave that subject, Mr. Osgood, we discussed it with the committee considerably, I have asked the expert of the committee to prepare an amendment along this line for the purpose of overcoming the hardships, as far as we can, of requiring an owner of a large estate to pay this tax within 18 months. Of course, under the present rule if undue hardship appears the Commissioner may extent it as much as 8 years.

Mr. OSGOOD. Yes; but of course with an interest penalty.

Senator BROWN. Six percent. My proposition was that we extend that period for 15 years, make the test a little less difficult than expressed in the words "undue hardship," and that we fix a rate of interest at something around one-half of 1 percent above the current rate which the Government is borrowing. Do you think that would be a desirable condition?

Mr. OSGOOD. Of course, it would be a great help. That presents another problem immediately, that is the closing of the administration of the estate in the State court. Probably you would have to keep your estate open until the tax is finally paid. Suppose a trust estate were following the term of an executorship—you understand what I mean by that—that is, if there were an executor and a trustee, then the trustee, under some kind of stipulation with the Government, might assume that long-term debt for the purpose of paying the debt and thereby close the administration.

Senator BROWN. You can arrange the situation where the security would be given the Government. The difficulty of going to bankers and getting any reasonable rate on a reasonably secured loan of, say, to put an extreme case, 70 percent of the amount of the estate, is appalling to me.

Mr. OSGOOD. It is not only that, but, of course, no commercial banker would be permitted, by the comptroller's office, to make a long-term loan of that character. That would mean he would have to go to some investment firm and get it underwritten, probably.

Senator BROWN. And usually be required to give up control of the corporation.

Mr. OSGOOD. Oh, yes.

Senator Brown. If he happened to be a large stockholder in the corporation.

Mr. OSGOOD. I think that is true; yes.

Senator BROWN. You think the amendment I spoke of is desirable, do you?

Mr. OSGOOD. I think the long-term extension at a very much lower rate of interest would be exceedingly fair. How long that

might be as a practical matter, I do not know. You must take into account the closing of the estate in the State courts.

Senator TOWNSEND. Some State laws require that the estate be closed in 12 months.

Mr. OSGOOD. Yes, sir; most of the laws do require, in effect, that the estate be closed in 12 months. As a matter of practice, before the first Federal estate tax came into force, or before some State laws went into effect, the general experience was that estates were closed in 18 months. It now very often happens, if there is litigation over values, as you know it takes probably anywhere from 18 months to 3 years sometimes to close the estate. Of course, that is inherent whatever the rate of the tax is. I do not think there are any new difficulties presented by the changes in the act.

Senator BROWN. I have in mind what the difference will be in the income tax extended over a period of time much longer than now obtains.

Mr. OSGOOD. I think it was in 1924, at the request of the Treasury Department and a number of the Governors of the States, that a special commission was appointed, of which I happened to be a member and of which Mr. Graves, the tax commissioner of New York, who is here in the room, was a member, and I think we reached the general principle that an estate tax ought not to absorb much more than 2 to 3 years annual income. Of course, with the greater recessions in the last 6 or 7 years it is no longer possible to rationalize on the income side of the picture, with the increase in the amount of the taxes.

Senator GERRY. Mr. Osgood, there is another question that arises. I think the Senator from Michigan brought it out. Your income tax is a net tax, while your estate tax is a gross tax. It is really a capital tax.

Mr. OSGOOD. Yes; it is a capital tax, because it would not be, as a general rule, paid out of any 1 year or 2 or 3 years' income.

The high estate and inheritance levies have other important economic and social effects. They cause dissipation of accumulated savings, that is capital, in the current operations of Government. At the same time, they tend to concentrate the ownership or control of many businesses in the hands of larger corporations, often those with headquarters outside of the community. This is particularly true of the smaller business when the owner, who usually has all of his assets tied up in such business, dies.

If greater employment of capital is to be fostered there should be an amelioration rather than any increased harshness in the application of the estate taxes.

The bill proposes some desirable changes. The mere computation of the Federal estate taxes would be simplified and the priority given to the credit for death duties paid to a State is to be commended.

It would allow, however, only $40,000 exemption against either the gift tax or the estate tax or both combined. It would reduce the annual gift tax exemption from $5,000 to $3,000. The first of these two changes would be effective as of January 1, 1938, as regards the estates of decedents dying after the passage of the bill; the second would apply 1 year later. Their effects warrant careful analysis.

For example, if a taxpayer exhausts his gift-tax exemption during his lifetime and dies leaving any estate, however small, even $1, a Federal estate-tax return must be filed, the history of gifts

during the years subsequent to 1937 reviewed, and a tax paid. The number of taxable estates of insignificant size and nuisance operations and their cost would be greatly increased. The actual cost of preparing and auditing such returns, on the part of both the Government and the taxpayer, would be greater than the revenue derived, and in effect would mean an added tax burden.

Under the bill, if the gift-tax exemption has been fully used, the estate-tax exemption is denied. This would have the effect of greatly increasing the taxes on modest estates. On an estate of $50,000, for example, the tax would be increased 1,400 percent; on an estate of $140,000, over 70 percent.

A taxpayer engaged in hazardous enterprise, such as is characteristic of most business today, must guess when he makes a gift whether he is likely to leave nothing when he dies and thus should claim the gift-tax exemption now, or whether he is likely to have in excess of $40,000 at the time of his death and thus would pay less Federal estate taxes by delaying his exemption until then. Such guesswork should not be forced by any tax law.

The reduction in the annual gift-tax exemption from $5,000 to $3,000 would subject gifts in excess of $3,000 to higher brackets than at present and make many gifts now exempt subject to taxation.

The lower the annual gift-tax exemption, the more the Federal Government must interfere with family affairs. If through a year a man allows his wife $10,000 for household expenses and she, through economies, saves $4,000 of it ($1,000 over the proposed $3,000 exemption) and keeps it for her own, has her husband made a taxable gift of $1,000 to her? How many husbands can account to the Government for the money given to their wives for household expenses? Can they prove it was actually for support and maintenance and not for the personal benefit of their wives? This problem is present in all such cases regardless of the gift-tax exemption, but the smaller the exemption the more acute the problem. Certainly the present $5,000 exemption obviates the necessity for the Government auditing as many household accounts.

There has been an effective decrease in the exemption without any Congressional action. This reduction in exemptions is accounted for by the tremendous decrease in the earning power of capital. In 5 years the gross yield obtainable on a range of well-selected investments has dropped from 5 to 3½ percent, without taking account of local taxes which must be paid and which may reduce the yield to less than 3 percent. This change in investment return means that the exemptions now allowed are only about one-half as effective as those originally intended. The bill proposes to further reduce them by one-half as regards the gift and estate exemptions and by two-fifths as regards the annual gift allowance.

Thus the bill would add to the problem of a person of moderate means who is endeavoring to make reasonably adequate provision according to the needs of his family.

There probably would be common agreement that there should be exempted from tax an amount of capital sufficient at the very least to provide an income for the support of a widow and one child. Probably there would be agreement upon a greater exemption in the case of two or more children. It is to be noted that a widow with

a minor child is entitled under the income-tax law to a $2,900 exemption ($2,500 as head of family and $400 for the child). One hundred thousand dollars is barely sufficient to provide an annual income of $3,000. Even a total exemption of $80,000 under present Federal estate-tax law (for estate and gift purposes) does not exempt sufficient capital to provide $3,000 of income under existing conditions. The logic of the situation urges that the exemptions should be increased rather than decreased.

I think a combination of exemptions of $100,000 is just about the minimum that ought to be granted under the whole theory of exemptions.

The proposed credit of 16⅔ percent should be considered from the viewpoints of its effects upon the revenues of the State governments and the probability that it will result in increases in the already high death duties of many of the States. Time is not afforded to present an analysis of this situation. In brief, the conclusion is that in the interest of State revenues, in protection of estates, and in encouragement of investment and enterprise, the 16⅔-percent credit should be increased if the present law is changed in this particular as suggested in the House bill. The degree of simplification resulting from a mere consolidation of schedules of the rates in present law is not sufficient justification for producing new disturbing effects. A pertinent table is appended.

(The table referred to is as follows:)

Federal estate taxes re 1938 revenue bill

Net estate before exemption	Gross Federal tax rate—present and proposed	Gross 1926 Federal estate tax rates	States' share, present credit—80 percent of 1926 rates	States' share, proposed credit—16½ percent of gross tax rate	Federal share, present gross rate minus present credit	Federal share, proposed gross rate minus proposed credit	Proposed law		States' share, if proposed credit is increased to 20 percent	Federal share, if proposed credit is increased to 20 percent	Present credit compared with 20 percent credit	
							Increase in Federal rate and decrease in States' share	Decrease in Federal rate and increase in States' share			Increase in Federal rate and decrease in States' share	Decrease in Federal rate and increase in States' share
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
	Percent	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
From $40,000 to $50,000	2	None	None	0.33	2.0	1.67		0.33	0.4	1.6		0.4
From $50,000 to $60,000	4	None	None	.66	4.0	3.34		.66	.8	3.2		.8
From $60,000 to $70,000	6	None	None	.99	6.0	5.01		.99	1.2	4.8		1.2
From $70,000 to $80,000	8	None	None	1.32	8.0	6.68		1.32	1.6	6.4		1.6
From $80,000 to $90,000	10	None	None	1.65	10.0	8.35		1.65	2.0	8.0		2.0
From $90,000 to $100,000	12	None	None	1.98	12.0	10.02		1.98	2.4	9.6		2.4
From $100,000 to $110,000	12	1	0.8	1.98	11.2	10.02		1.18	2.4	9.6		1.6
From $110,000 to $140,000	14	1	.8	2.31	13.2	11.69		1.51	2.8	11.2		2.0
From $140,000 to $150,000	17	1	.8	2.805	16.2	14.195		2.005	3.4	13.6		2.6
From $150,000 to $200,000	17	2	1.6	2.805	15.4	14.195		1.205	3.4	13.6		1.8
From $200,000 to $240,000	17	3	2.4	2.805	14.6	14.195		.405	3.4	13.6		1.0
From $240,000 to $300,000	20	3	2.4	3.3	17.6	16.7		.9	4.0	16.9		1.6
From $300,000 to $440,000	20	4	3.2	3.3	16.8	16.7		.1	4.0	16.0		.8
From $440,000 to $500,000	23	4	3.2	3.795	19.8	19.205		.595	4.6	18.4		1.4
From $500,000 to $640,000	23	5	4.0	3.795	19.0	19.205	.205		4.6	18.4		.6
From $640,000 to $700,000	26	5	4.0	4.29	22.0	21.71		.29	5.2	20.8		1.2
From $700,000 to $840,000	26	6	4.8	4.29	21.2	21.71	.51		5.2	20.8		.4
From $840,000 to $900,000	29	6	4.8	4.785	24.2	24.215	.015		5.8	23.2		1.0
From $900,000 to $1,040,000	29	7	5.6	4.785	23.4	24.215	.815		5.8	23.2		.2
From $1,040,000 to $1,100,000	32	7	5.6	5.28	26.4	26.72	.32		6.4	25.6		.8
From $1,100,000 to $1,540,000	32	8	6.4	5.28	25.6	26.72	1.12		6.4	25.6	Even	Even
From $1,540,000 to $1,600,000	35	8	6.4	5.78	28.6	29.22	.62		7.0	28.0		.6
From $1,600,000 to $2,040,000	35	9	7.2	5.78	27.8	29.22	1.42		7.0	28.0	0.2	
From $2,040,000 to $2,100,000	38	9	7.2	6.27	30.8	31.73	.93		7.6	30.4		.4
From $2,100,000 to $2,540,000	38	10	8.0	6.27	30.0	31.73	1.73		7.6	30.4	.4	
From $2,540,000 to $2,600,000	41	10	8.0	6.765	33.0	34.235	1.235		8.2	32.8		.2
From $2,600,000 to $3,040,000	41	11	8.8	6.765	32.2	34.235	2.035		8.2	32.8	.6	
From $3,040,000 to $3,100,000	44	11	8.8	7.26	35.2	36.74	1.54		8.8	35.2	Even	Even
From $3,100,000 to $3,540,000	44	12	9.6	7.26	34.4	36.74	2.34		8.8	35.2	.8	
From $3,540,000 to $3,600,000	47	12	9.6	7.755	37.4	39.245	1.845		9.4	37.6	.2	
From $3,600,000 to $4,040,000	47	13	10.4	7.755	36.6	39.245	2.645		9.4	37.6	1.0	

From $4,040,000 to $4,100,000	50	13	10.4	8.25	39.6	41.75	2.15		10.0	40.0	.4	
From $4,100,000 to $4,540,000	50	14	11.2	8.25	38.8	41.75	2.95		10.0	40.0	1.2	
From $4,540,000 to $5,040,000	53	14	11.2	8.745	41.8	44.255	2.455		10.6	42.4	.6	
From $5,040,000 to $5,100,000	56	14	11.2	9.24	44.8	46.76	1.96		11.2	44.8	Even	Even
From $5,100,000 to $6,040,000	56	15	12.0	9.24	44.0	46.76	2.76		11.2	44.8	.8	
From $6,040,000 to $6,100,000	59	15	12.0	9.735	47.0	49.265	2.265		11.8	47.2	.2	
From $6,100,000 to $7,040,000	59	16	12.8	9.735	46.2	49.265	3.065		11.8	47.2	1.0	
From $7,040,000 to $7,100,000	61	16	12.8	10.065	48.2	50.935	2.735		12.2	48.8	.6	
From $7,100,000 to $8,040,000	61	17	13.6	10.065	47.4	50.935	3.535		12.2	48.8	1.4	
From $8,040,000 to $8,100,000	63	17	13.6	10.395	49.4	52.605	3.205		12.6	50.4	1.0	
From $8,100,000 to $9,040,000	63	18	14.4	10.395	48.6	52.605	4.005		12.6	50.4	1.8	
From $9,040,000 to $9,100,000	65	18	14.4	10.725	50.6	54.275	3.675		13.0	52.0	1.4	
From $9,100,000 to $10,040,000	65	19	15.2	10.725	49.8	54.275	4.475		13.0	52.0	2.2	
From $10,040,000 to $10,100,000	67	19	15.2	11.055	51.8	55.945	4.145		13.4	53.6	1.8	
From $10,100,000 to $20,040,000	67	20	16.0	11.055	51.0	55.945	4.945		13.4	53.6	2.6	
From $20,040,000 to $50,040,000	69	20	16.0	11.385	53.0	57.615	4.615		13.8	55.2	2.2	
From $50,040,000 and up	70	20	16.0	11.55	54.0	58.45	4.45		14.0	56.0	2.0	

Column 1 gives the net estate, by brackets, prior to deduction for the specific exemption. It will be noted that it is necessary to break the table up into smaller brackets than are outlined in the text of the Revenue Law because of the differences in the various applicable laws.

Column 2 gives the rates of tax in each bracket under both the present law and the proposed law. Under the present law there are levied two taxes. One tax is at the 1926 rates (which are set forth in column 3). The second tax is computed at the 1935 rates minus the 1926 tax. Thus, the present Federal estate tax is the 1926 tax + (1935 tax − 1926 tax). As will be seen, this in effect means a tax at the 1935 rates. These are the same gross rates as are in the proposed law.

Column 4 indicates the amount of credit for State taxes given under the present law. This credit is equal to 80 percent of the 1926 tax rates. (See column 3 for 1926 tax rates.) Since this credit is deductible from the 1935 rates shown in column 2, the difference is shown in column 6 as the Federal Government's share of the tax under present laws.

Column 5 indicates the amount of credit for State taxes given under the proposed law. This credit is 16½ percent of the proposed rates shown in column 2. This represents the State's share under the proposed law and is deductible from the rates shown in Column 2. The result is the Federal Government's share under the proposed law as shown in column 7.

As will be seen, there is a discrepancy between the present and proposed law in its net effect. This discrepancy is pointed out in column 8 and column 9. Column 8 shows the net increase in Federal taxes under the proposed law or, expressed differently, shows the decrease in the State's share of the tax. Column 9 shows the reverse—i. e., the decrease in the net Federal tax in certain brackets or the increase in the State's share. It will be noted that under the proposed law the decrease in Federal tax and increase in State's share is entirely in the smaller estates.

Columns 10, 11, 12, and 13 show the result if the credit under the proposed law were raised from 16½ to 20 percent. As will be seen, a 20-percent credit is a more equitable distribution between the State and Federal Government.

We recommend that—

1. There be no decrease in the total exemptions allowed in gift and estate taxes.
2. There be no reduction in the annual gift-tax exemption.
3. The proposed credit of 16⅔ percent should be enlarged. There is much to be said for a larger credit on the basis that death duties should be left to the States almost entirely, if not wholly so.

Thank you very much.

The CHAIRMAN. Mr. Alvord.

STATEMENT OF ELLSWORTH C. ALVORD, WASHINGTON, D. C., REPRESENTING THE UNITED STATES CHAMBER OF COMMERCE

The CHAIRMAN. Your name is Ellsworth C. Alvord, and you represent the United States Chamber of Commerce?

Mr. ALVORD. Yes, sir.

The CHAIRMAN. All right, Mr. Alvord. You have a brief, have you not?

Mr. ALVORD. I would like permission to file a brief, Mr. Chairman.

The CHAIRMAN. All right.

Mr. ALVORD. Mr. Chairman, and gentlemen of the committee, I am going to depart, if I may, from what I have done in the past in appearing before your committee. I do not think it is necessary for me to repeat my views with respect to the undistributed-profits tax and the high tax on capital gains and high tax on individuals. They are all a matter of record and readily available. I have looked forward to the problem confronting you; it has seemed to me that perhaps the issue is one of estimates.

I take it that there is no disagreement upon the primary objective of the Congress at the present time with respect to taxes. That primary objective, I am confident, is that those features of our tax laws which substantially affect business adversely should be eliminated.

I take it that the ultimate objective of the Congress, which involves more than a consideration of tax laws, is first that the person now unemployed, whether or not on Government relief rolls, must be given private employment and transferred to private pay rolls.

Second, that the increase in unemployment, which has progressed at an alarming rate over the last 15 months, must be stopped; and

Third, that we must get back on the road to real recovery. With this in view I suggest a tax program for your consideration.

Senator CONNALLY. Mr. Alvord, you start out by bragging of the House bill; you say it is a wonderful bill.

Mr. ALVORD. Yes, sir.

Senator CONNALLY. Will you speak about such?

Mr. ALVORD. Yes, sir.

Senator CONNALLY. All right.

Mr. ALVORD. I think the House has done an admirable job, a much better job than I would suppose possible under the circumstances under which they were working, but that does not mean, Senator, that you cannot do a better job.

Senator TOWNSEND. You want to make some changes in the House bill, do you?

Mr. ALVORD. Yes, sir; I think a better job is very possible.

First, I would advocate a flat 15-percent tax on corporate incomes.

Senator CONNALLY. That will not get the revenue.

Mr. ALVORD. I am coming to that, Senator.

Senator CONNALLY. That is what we all have got to come to.

Mr. ALVORD. That is exactly why I prefaced my remarks as I did. That is why I am going to discuss estimates with you today instead of policy. I am quite convinced that every member of the committee will agree on policy.

Senator CONNALLY. I am not trying to heckle you.

Mr. ALVORD. I appreciate that, Senator. I next suggest a 12½ percent flat rate on capital gains, or, preferably, despite its complications, a maximum rate of 15 percent scaled down over a holding period of 10 years, 1 percent a year to 5 percent; and, third, a maximum individual surtax of 40 percent.

Before I discuss actual estimates, actual yield under such a program, I would like to place two very important matters before you for your consideration. The first is the yield under the present law, or under the House bill, and the second is the increase in your appropriations in the event that the ultimate objective, the stopping of the depression is not attained. The figures which I shall give you gentlemen will prove to you conclusively, I am sure, that you stand to lose a billion dollars in revenue if business continues at the present rate and does not have the pick-up which I think the Treasury estimated in the annual Budget submitted in January of this year.

Next, I think you realized unquestionably that we will have increased appropriations up to $3,000,000,000 for relief if factory employment continues to decline at about the same rate as it is now. So that you have on one side of about 4 billions of dollars to face. On the other side I think—I am not absolutely sure, but I think—that the highest estimate which the Treasury will give you under the program I suggest will be a loss in revenue of $300,000,000. I think the risk of losing $300,000,000 to save $4,000,000,000 is worth taking, particularly if I can prove to you that the risk is not substantial. I think I can prove to you that, as a matter of fact, instead of losing $300,000,000 you are going to gain, and you are going to gain substantially under the program I suggest.

Let me take up first the matter of capital gains. I give you in table 1, which I filed with my statement, the capital gains realized from 1925 through 1936, and the various rates of tax applicable. You will find that for the 4 years 1926, 1927, 1928, and 1929, your annual revenues from capital gains at a 12½-percent rate were about $350,000,000. Under the existing law, with rates going up from the 12½ and going up appreciably by reason of high individual surtaxes, you will find that you received in 1935 about $85,000,000. I do not have the 1936 figures. The 1936 figures will be higher than $85,000,000, probably $185,000,000, but still way below the $350,000,000 average.

Senator CONNALLY. Counting the percentage of those years the tax compared with the average of 1926 and 1927, did it not?

Mr. ALVORD. Until 1934 you had a flat 12½-percent rate. In 1934, you recall, you changed your system completely and put in a schedule of declining percentages based on the period of holding, so that the rate actually applicable would depend upon the particular bracket

of the individual, ranging from the recognition of a gain of 100 percent to the recognition of a gain of only 30 percent, if he held the asset for more than 10 years. For example, if the taxpayer were in the 50-percent bracket and held his assets for 10 years, his effective rate on his gain would be 15 percent. So that your rates are very greatly in excess of the 12½-percent flat rate.

Senator CONNALLY. What I was interested to know was that from 1926 to 1934, under the same rate they declined from $225,000,000 to $17,000,000.

Mr. ALVORD. Yes, sir.

Senator CONNALLY. So the rate had nothing to do with that.

Mr. ALVORD. I might just as well throw that at you now.

Senator CONNALLY. That is what I want you to do.

Mr. ALVORD. The reason for that is this, Senator; You cannot get money from gains if you have no gains.

Senator CONNALLY. Exactly.

Mr. ALVORD. So that your job, it seems to me, is to establish a system under which you will have gains.

Senator CONNALLY. That is true. If this shows us how to do that I am for it.

Mr. ALVORD. I think this will help very substantially, Senator. That is why I am spending time on it. You must have a tax rate under which taxpayers will take those gains. The figures which I give you show that notwithstanding the market levels of 1936 were at about the same level as they were in 1927 and 1928, the gains actually taken were very substantially less, and therefore your tax was very substantially less. I will not go into the details of the figures, unless you wish. They are here. The real point I want to impress upon you is that there is a law which I do not think Congress can amend or repeal, and that is the law of diminishing returns. There is a rate which will produce maximum revenues. If you get above that rate, and I do not care how high above you go, you are bound to get decreasing revenues.

The application of that law of diminishing returns is particularly clear in the case of corporations. Let me bring my corporation estimates in at this time.

There is nothing difficult or mysterious or complicated about estimates of revenues. In fact it is a very simple mathematical computation. I suggest if the Treasury and I differ with respect to prospective revenues it will be on one thing and not on mathematics. The one thing to which I refer is the estimate of future business. Now, I do not have all the current records which the Treasury has, and I do not claim that my figures possess the accuracy which theirs should possess, but I do point out the following: The Federal Reserve Board has an index of Industrial Production. If you take the Federal Reserve Board index down through the years and take your revenues for the corresponding years you will find a definite correlation. The proportion exists with remarkable regularity and consistency.

Suppose your corporate net income for all corporations for a particular year is 5 billions of dollars. It is very simple mathematics to see that a 1 percent rate will yield $50,000,000. Each 1-percent increase in the rate will yield, on a 5-billion-dollar base, $50,000,000. If we have a corporate rate of 10 percent, with a 5-billion-dollar base,

you get $500,000,000, and if you have a rate of 10 percent and a 10-billion corporation base you get a billion dollars. You get with your 10-percent rate on a 10-billion-dollar base precisely what you would get with a 20-percent rate on a 5-billion-dollar base. So that, purely from a financial point of view, those are the figures that you arrive at.

I agree wholeheartedly with the President of the United States when he says we have got to increase incomes up to 80, 90, or 100 billions of dollars. That is where the national income must be if we are going to support a Budget of 7 billions of dollars of expenditures. In his annual message to you in January he said to you there is no possibility of balancing our Budget except through increase in national income, and part of that, gentlemen, is an increase in your corporate income base.

Now, just for the purpose of illustration, if you take a look at table II, which I give you, you find in the years 1925 and 1927 we have a Federal Reserve Board index of industrial production of almost exactly what we had in 1936. In 1925 it was 104, in 1927 it was 106, and in 1936 it was 105. Compare your corporate yields and you will find almost no difference—$1,170,000,000 in 1925; $1,130,000,000 in 1927; and $1,113,000,000 in 1936, with 13- and 13½-percent rates applicable in 1925 and 1927, respectively, and high complicated normal and surtax provisions applicable in 1936.

Based on present levels of business you will note that the Federal Reserve Board index beginning in May of 1937, where it was 118, and 117 in August, has declined to 79 last month. All you have to do is take your ratio of the decline in the Federal Reserve Board index, apply it to your corporate-tax base in prior years, and you can make almost an exact mathematical computation of your corporate income-tax base for the present year.

Then what you should do is to sit down and say, "Where is business going? Are we going on down or are we going to stay where we are, or are we going up?"

I have made no effort to discuss with you the effect upon business of your present tax system and the present financial policies of the Government. Others much more competent and able than I have done that. Your Committee on Unemployment has heard probably the best industrial leaders, bankers, and labor leaders in the country. Their record is filled. Unfortunately it has not been printed.

Certainly I can give you no better authority than Mr. Bernard Baruch, who appeared about 3 weeks ago before that committee and gave what I consider one of the best and clearest statements of the effect of tax policies upon business. I think Mr. Baruch gave no specific tax program, but the program which I suggest to you is certainly directly along the lines of the policies which he was discussing.

The difference between the 15-percent rate and 17-percent rate is not very substantial. You have as a tax based about $3,840,000,000 based on your present Federal Reserve Board index.

The way to make money, gentlemen, is to get the other people making money so that your "kitty" will pick it up.

Senator GERRY. Mr. Alvord, have you any statistics showing the number of new corporations that have been formed in comparison with former years?

Mr. ALVORD. No, sir, I do not. I have seen them somewhere. I think one of the corresponding tables, which I saw at about the same

time, was on the issue of corporate securities, which will give you a very clear picture of the present situation.

Senator GERRY. I saw some statistics a little while ago, I cannot recall just where, but there has been a terrific dropping off.

Mr. ALVORD. Unquestionably there has been, but I do not have the statistics here. I would be glad to locate them for you if I may.

Senator GEORGE. Mr. Alvord. Did I understand you to say in the beginning, with reference to this capital-gains tax, that you preferred the sliding scale based on the period of holding?

Mr. ALVORD. I would prefer, as a matter of fairness, the scale of 15 to 5, but bear in mind that it has a good many complications.

Senator GEORGE. How does the period of income affect the revenue, or does it? Is there a tendency on the part of the taxpayer to defer the conversion or the change of his assets into a later period so as to get a lower tax?

Mr. ALVORD. If you have a high rate, as you have now, under the existing law, Senator; yes, sir, without any question. But if you start at a lower rate, such as 15 percent, I think there would be no postponement at all. I think then businessmen, investors, could determine whether they want to buy or sell, whether they want to invest, not by reason of tax liabilities, but by reason of the soundness of the particular investment. They are going to give some regard to the economics of the matter rather than almost entirely to tax liabilities, or probable tax liabilities.

The CHAIRMAN. What is your idea? That we deduct the capital losses from the capital gains?

Mr. ALVORD. As a matter of policy, Senator, I see no reason for a limitation upon the deductibility of capital losses. I think they ought to be deducted against ordinary income. Now, that is a matter of permanent policy. I have two qualifications for that.

First, I do not think you can afford to do it under your revenue requirements at the present time, because it will cost you a lot of money. It will cost you a tremendous amount principally by reason of the terrific decline in security values over the last 6 months, but I do think that if you are going to have limitations upon the deductibility of capital losses so you can only offset your capital losses against capital gains, then, as a matter of plain fairness, you ought to provide for a carry-over of your excess of losses in 1 year against capital gains in either of the 2 succeeding years. I would allow a carry-over for 5 years, because capital gains are a long-time proposition. Net capital gains are properly an average of gains and losses over a long period of time, and I do not think that ability to pay is reflected in capital gains over a short period of time. I think you ought to have a balance of gains and losses over at least a 5-year period.

The CHAIRMAN. Let me ask you, you appeared before this committee a lot of times when you were legislative expert for the committees. Have your views changed any?

Mr. ALVORD. Not in the slightest, sir, except as time, I hope, improves them.

Does that answer your question on capital gains, Senator George?

Senator GEORGE. Yes.

Mr. ALVORD. The same principle applies with respect to business losses. I think you ought to have a 2-year carry-over of business

losses. The 12 months' period for determining income, or ability to pay, is entirely arbitrary and much too short. Some businesses will have a reasonably regular annual turnover, a fairly steady annual income, other businesses, such as textiles, Senator, if they have one good year in four, they consider themselves lucky. If you tax their entire income in that one good year and do not consider at all the losses of the other 3 years, what you are doing is, in effect, multiplying their tax by four.

A similar point is involved in one of the provisions of the present bill, one of the technical provisions which says that a loss sustained from securities becoming worthless shall be treated as a capital loss. Let us look at that a minute. That is section 23 (g) (2) and section 23 (k) (2), I think. Suppose, under the bill, we limit capital losses to capital gains. Here is a corporation, or an individual who invests a little too unwisely. You can draw a line fairly well on that type of fellow. The small fellow who does not have access to the best advice predominates. Now the corporation in which he has an interest goes bankrupt and his entire equity is wiped out. You say in the bill, "Deduct that loss only against capital gains of the same kind." Well, gentlemen, he has no such capital gains. What you are doing is denying absolutely the deduction of that loss, and, as I have told you before, when you do that you are imposing a tax upon losses, not a tax upon income.

I think the fair thing to do is to leave losses on worthless securities exactly where they are under the present law.

Senator GERRY. They have changed that in this bill, haven't they?

Mr. ALVORD. Yes, sir. I was just discussing it. For the purpose of further illustration, go back to my table on revenue yields and you will find those revenue yields consistently tied in with industrial activity, even though all the tremendous holes in the revenue laws were not plugged in the prior years. All of these opportunities for evasion with which you have struggled for the last 3 years apparently existed, and yet you got your revenues.

I suppose this limitation of the loss on worthless securities is considered one of the holes which must be plugged. Still, I would have a great deal of difficulty explaining to the small man who bought the security that he had no loss when his corporation went into bankruptcy and his security became worthless.

I might make the same remark about the provision in the bill with respect to losses upon obsolescence. That, I think, is very important. If the bill is based on the theory that they are changing the law then it should not be adopted. But I do not so conceive it. The provision as I read it, is merely declaratory of the present law.

Here is your problem: I have a machine which I used for 5 or 6 years. It becomes obsolete; a better machine comes along. I take it out of the line of production and put in the new machine. Under all previous laws of our income tax system we have always said, "Deduct the loss on obsolescence when you scrap your machine." Your loss technically is the difference between the cost of the machine in the first place and the depreciation you have been allowed on it while you were using it. The loss was always considered an ordinary loss, allowable on scrapping the machine. Now, you sell the machine for scrap 2 or 3 months or a year later; that was treated as income. If it happened in the same year, what they did was merely decrease

your loss on obsolescence by the amount which you received on the sale.

Senator LONERGAN. Pardon me. Does that apply to a pleasure car or just a business car?

Mr. ALVORD. I am talking principally about machinery used in industry, Senator.

Senator LONERGAN. Yes, sir.

Mr. ALVORD. You do not allow either obsolescence or depreciation on a pleasure car.

Now, under the bill there is a provision that says this loss on obsolescence will be considered an ordinary loss. But it has always been considered an ordinary loss. Unless you state specifically that it is merely declaratory of the existing law, you might impose a tremendous retroactive tax upon corporations which have taken deductions for obsolescence and now find that they were improper because they did not have offsetting capital gains of the same nature. If obsolescence is not an ordinary business loss, I do not know what it is.

The CHAIRMAN. Mr. Alvord, getting back to your annual corporation rates you suggest 15 percent. Do you believe that an 18 percent flat rate would obtain as much revenue?

Mr. ALVORD. I would say just about the same amount as the present bill.

The CHAIRMAN. About the same?

Mr. ALVORD. Just about the same amount, I would say, yes, sir.

The CHAIRMAN. That is without taking into consideration a pick-up in business?

Mr. ALVORD. Whether you get a pick-up in business or not the 18 percent rate ought to give you about the same.

The CHAIRMAN. What do you suggest, if anything, with reference to corporations that make less than $25,000 a year, where the capitalization is what is known as a small corporation?

Mr. ALVORD. I would continue the present provisions of the present law and have graduated rates up to the $25,000.

The CHAIRMAN. On profits?

Mr. ALVORD. On income. We have always had that provision of law. At one time we did it by way of exemption so that a smaller income corporation would, in effect, pay much lesser rates. Graduated rates are a recognition of the same principle. So long as you do not get the $25,000 too high I think it is a perfectly fair adjustment.

Senator GEORGE. Mr. Alvord, going back to capital gains and losses for just one moment, would you separate your short term losses from the long term losses?

Mr. ALVORD. Yes, I would.

Senator GEORGE. Would you carry on that principle?

Mr. ALVORD. Yes; and I think a 1-year period is ample for that purpose.

Senator GEORGE. That is, your short terms would fall within the 1-year period?

Mr. ALVORD. Yes. I think that is necessary, Senator, in order not to relieve the speculator of taxation of his ordinary business profits. Although it is an arbitrary term, a 1-year period is the best dividing line I know. Investment transactions will be governed by the long-term rates, and I think the 1-year period is the best way to draw that line.

Senator GEORGE. So you would separate your losses?
Mr. ALVORD. Yes.
Senator CONNALLY. Mr. Alvord, may I ask you a question on the same matter that Senator Harrison asked, on this 18-percent rate? You mean the 18-percent flat rate would bring about the same as the 16 flat rate plus the 40 percent on undistributed profits?
Mr. ALVORD. As I got the Senator's question, under the House bill you have a flat 20-percent rate. It will be scaled down in proportion to the dividends you distribute to 16⅔ percent. The 18-percent rate will give you about the average, probably the average. I think it ought to produce about the same amount of revenue. But you can make much more money by telling investors, by telling business, by telling labor, all three, that the principle of the undistributed-profits tax is abandoned completely and forever and they no longer have to worry about the penalties.
From the point of view of increasing business activity, increasing your corporate income basis, getting more revenue, you should not go as high as 18 percent. I think that a flat rate—and I think 15 percent is high enough—will have a more beneficial effect on business, and therefore produce more revenue than all the penalties that you might impose. Does that answer your question, Senator?
Senator CONNALLY. I suppose it does, but I am asking you.
The CHAIRMAN. Is there anything else you want to discuss, Mr. Alvord?
Mr. ALVORD. I want to mention one or two things. With the abolition of the principle of the undistributed-profit tax, I assume also that the increased tax, in some instances, on intercorporate dividends will be abandoned. It was put in the bill as a limitation on your credit for dividends paid and if the dividends-paid credit goes out and a flat rate is restored, I assume you will go back to the ordinary 25-percent credit.
Senator CONNALLY. Suppose a corporation pays out practically all of its dividends, or has under $25,000 income, what rate it will be under the House bill, what flat rate—16⅔, you say?
Mr. ALVORD. Sixteen and two-thirds.
Senator CONNALLY. It will pay a flat rate of 16⅔?
Mr. ALVORD. Yes.
Senator CONNALLY. Whether it pays up to 20 percent or not will depend upon the amount they retained of undistributed profits?
Mr. ALVORD. That is right.
Senator CONNALLY. And you figure that up to 18 will about offset what you get out of the expectancy of the 20 percent?
Mr. ALVORD. Well, about that, yes, sir; and on the same basis of business activity, but I think business activity will increase if you get a reasonable flat-rate corporation tax. If you look at my table III, you will find that a 15-percent rate imposed today will produce as much as is estimated from the House bill, if you get but a 6-percent increase in business.
Senator GEORGE. Only 6 percent?
Mr. ALVORD. Six percent increase in business, yes, sir; it will produce almost exactly the same amount as the House bill.
Senator CONNALLY. Of course the 6-percent increase in business, the estimate of the House bill——

Mr. ALVORD (interrupting). Senator, are you going to get that increase under the House bill or the present law?

Senator CONNALLY. I do not know. I am asking you. Will it increase the tax on either one of the other plans, if it did?

Mr. ALVORD. Your job is to get increased revenue. The leaders of this country—financial, industrial, and labor—tell you that the present tax laws have a substantial depressing effect on business. I would follow their opinion and say, "Let us get down to a real movement to encourage business. Let us get some employment moving. Let us get people working actively, producing income. The more employment the greater income, and the greater income the more revenues."

Senator CONNALLY. Under your theory it would be more a question of psychology.

Mr. ALVORD. I suppose no one in the world would deny the existing situation is largely a matter of psychology. It is psychological in the sense that there isn't a man in the United States today who can sit down with any degree of confidence and predict the future.

Senator VANDENBERG. Is a revision of taxes all that is necessary?

Mr. ALVORD. No. But it is probably the only thing you can do.

The CHAIRMAN. Mr. Alvord, you have discussed the high surtaxes, your capital gains and your corporation tax.

Mr. ALVORD. Yes.

The CHAIRMAN. Which of these provisions, in your opinion, are of most importance to encourage business, if you confine it now to one?

Mr. ALVORD. I think the three tie in very closely together, Senator. The effect is cumulative. If I had to grade them—and it is difficult, because after all, you have got to acknowledge that each of them is exceedingly important—I would probably put the abolition of the undistributed-profits tax and 15-percent corporate rate first. I am not sure whether that comes before capital gains or not, but I think it does. Then I would put capital gains next; and the individual surtaxes next. But all three should be remedied.

Senator VANDENBERG. Would you broaden the income-tax base?

Mr. ALVORD. I have always been of the opinion, Senator, that the base should be broadened. My answer to you at the present time is, however, I just do not have the statistics available to know how far I would now broaden it. At the present time you have social-security taxes. You are collecting from these fellows who have never paid income taxes, seven-hundred-million-odd dollars this year, and it will eventually be over a billion dollars. I do not know how much those people can afford to pay. I think you can reduce it somewhat now, but before you reduce the base very substantially I think you should consider the burden which the social-security tax is now imposing upon that entire group of people.

Senator GERRY. Mr. Alvord, don't you make a distinction with a flat tax on a corporation, differentiating from an undistributed-profits tax, because in the undistributed-profits tax the tax goes on unless they distribute, while in a flat tax the corporation pays the tax whether it distributes it in dividends or puts it into new improvements, and one of the difficulties you have in the undistributed-profits tax is the fact that it is to make distribution to stockholders instead of putting the money into development, which means business improvement and reduction in unemployment.

Mr. Alvord. That is very, very true, Senator, and I might point out to Senator Connally what I mean by abolition of the principle. If you impose 3½ percent this year, Senator, what is there to assure a businessman that you will not boost that penalty to 42½ percent, as was proposed two years ago?

I have just one more point; that is, with respect to pension trusts. You are proposing in the law to require a pension trust for the benefit of employees, to be made irrevocable. The provisions of the present law, from 1921 on, were put in for the purpose of encouraging pension trusts, of getting funds set aside for the benefit of employees. I think the provision of the present law which says that the trust may be revocable is a perfectly sound provision and is adequately safeguarded by the Treasury regulations. The present bill says pension trusts must be made irrevocable and that, I am confident, will discourage the creation of pension trusts, and to that extent hurt employees.

Thank you very much.

Senator Bulkley. I do not understand that. Why should the pension trust discourage the corporation?

Mr. Alvord. Senator, consider yourself an employer for a minute. You are perfectly willing to set up a trust fund computed according to the best available actuarial science, to pay compensation to your employees after they reach 65 years of age. Now, you ask yourself, "Shall I make that revocable or irrevocable?" You are not at all sure what the situation will be 20 years from now. When your employee, who is now 45, becomes 65 and eligible to retire you do not know but what State pensions and Government pensions will be adequate. You just cannot anticipate all the things that might happen when you set up today a trust irrevocable thereafter. It is ample if you provide as the present law does, as I interpret it, that if that trust fund ever gets back to the employer it will be taxed to him. Give him his deduction when he transfers it over.

Senator Bulkley. It seems to me that there are two things that might be revocable. You are talking about making the whole thing revocable; that is, to the extent of funds already paid in, which seems to me a different thing, and then that you can revoke the system for future time, when large sums have already been paid in. Is there any difference there?

Mr. Alvord. That difference, they tell me, is in the House bill but I do not see it, because if any part of the corpus or income can revert to the employer it will be excluded from section 165.

Senator Bulkley. It seems to me that if you have a revocable trust then even if the employer would himself like to carry it on it might be reached by creditors of the employer.

Mr. Alvord. That is true; and there have been some cases such as that, but I think those cases are so few as not to cause any particular concern. As I read the bill, you practically have to make your trust irrevocable because otherwise, under certain circumstances, even if it goes to creditors it still is for the benefit of the employer by wiping out the debt. Part of the corpus, part of the income can revert to the employer. We would be better off by leaving the law as it is, although I see no objection to a provision adequately meeting the creditor situation.

Senator BULKLEY. I think I have your viewpoint. I do not care to argue about it.

Mr. ALVORD. In conclusion, I think you can do a very substantial job by remedying the many defects of the undistributed-profit tax retroactively. Everybody knew back in 1936 that the law was far from perfect; very far from perfect. It was admitted on the floor of Congress, and admitted by the administration, and everyone was assured that as defects, hardships, and unintended inequities appeared they would be remedied, the inference being they would be remedied retroactively. I think there are such amendments which you can make retroactively.

The CHAIRMAN. In other words, put it back to the time it went into effect.

Mr. ALVORD. Yes.

The CHAIRMAN. Well, don't give much hope to people on that proposition.

Mr. ALVORD. I think it is still very sound, and it cannot cost you much money. I can quote from your own language, Senator, in telling you that.

The CHAIRMAN. I do not care to be quoted because I have been wrong a lot of times.

(The brief submitted by Mr. Alvord is as follows:)

BRIEF OF ELLSWORTH C. ALVORD

INTRODUCTION

The revenue bill now pending before you is a commendable piece of work. Those responsible for its passage by the House of Representatives are to be congratulated. It is a most decided improvement over the present law. But it doesn't go quite far enough, to attain the true objectives, as I conceive them.

OBJECTIVES

Insofar as our tax laws are concerned, the primary objective should be to remove those features which are substantially contributing causes to the present depression.

The ultimate objectives should be—

(1) To stop the alarming increase in the ranks of the unemployed.

(2) To transfer to private pay rolls those now on relief rolls.

(3) To reverse present trends and to direct our country upon a course leading to true recovery.

RECOMMENDATIONS

The following recommendations are offered:

(1) Impose a maximum 15-percent rate on corporate incomes, with lower rates on incomes of less than $25,000.

(2) Impose a maximum 12½-percent rate on capital gains, or rates graduated from 15 to 5 percent over a 10-year period.

(3) Impose a maximum individual surtax rate of 40 percent.

(4) Remove retroactively a few of the most glaring mistakes of the undistributed-profits tax.

CONSEQUENCES

The immediate adoption of these recommendations will unquestionably give assurance that:

(1) Our revenue laws are designed to produce revenue, upon recognized principles of taxation and upon the basis of maximum yield.

(2) The principles of the undistributed-profits tax have been abandoned.

(3) Tinkering with our tax laws has stopped, and common sense has been restored.

(4) We have taken the first, and a most important, step toward a balanced budget and financial stability.

EFFECT UPON THE REVENUES

I feel that every member of this committee would readily approve the recommendations I have made, but for one question: What will be the effect upon the revenues?

I am in full sympathy with the principle advocated by the Treasury—that the revenue yield must not be diminished. I also approve unqualifiedly the statement in the President's Budget message for 1939 that "the tax revenues from practically every major source depend upon business conditions."

Before presenting an analysis of the revenue yield under the suggested program, two matters should be considered:

(1) The revenue yield under the present law—or under the bill now pending before you—if business conditions continue on the decline, or there is not the improvement in 1938 which the Treasury predicted in making the Budget estimates; and

(2) The increased appropriations which will be required for relief, if the tide of unemployment is not turned back.

You will note that there is omitted from consideration, for present purposes, the greater and more vital gains in our happiness and welfare if our objectives are attained.

On the one hand, we are facing losses in revenue of at least $1,000,000,000 and increased appropriations of as much as $3,000,000,000 a year for the next 2 or 3 or possibly 4 years. On the other hand, you are risking, under the program I have recommended, the loss of $300,000,000, at most, upon the basis of the Treasury's own estimates, if the program doesn't work.

Let us consider the effect upon the revenues resulting from the adoption of the suggested program.

The yield of our tax system cannot be measured solely by the rates imposed. The tax base is a fundamental factor. A tax base of $10,000,000,000 will produce $1,000,000,000 at a 10-percent rate. But a 20-percent rate will produce no more if the tax base is $5,000,000,000.

Likewise, a 10-percent rate imposed upon a $5,000,000,000 base will produce only $500,000,000. But if imposed upon a $10,000,000,000 base, its yield is doubled.

The law of diminishing returns applies with cruel vigor. There is a rate which will produce maximum revenues. A higher rate produces a lesser amount. The law of diminishing returns is beyond the control of Congress. It cannot be repealed.

My estimates are based upon the following principles:

(1) The rates of the present law, as well as those of the pending bill, are beyond the point of maximum productivity.

(2) The pending bill will not give the needed stimulus. I see no immediate increase in our present tax base, and under the bill I fear a further decline.

(3) The adoption of our recommendations will reverse present trends, will increase the tax base, and will yield greater revenues.

CAPITAL GAINS

As to capital gains, there is ample evidence in the Treasury's own statistics that a reasonable flat tax on capital gains will produce more revenue than the present system. I have set out these statistics in tabular form. (See table I.)

I note only a few of the more significant facts:

(1) In 1936 estimated total gains were only $1,418,000,000 as against $2,379,000,000 in 1926 and $2,895,000,000 in 1927, although the stock market level was about the same in each of these 3 years.

(2) In 1934, 1935, and 1936 revenue from capital gains was relatively insignificant, despite the fact that stock averages almost doubled in the period. However, in the 4-year period, 1926 to 1929, with a flat 12½ percent tax in effect, total revenues amounted to more than one and a half billion dollars.

(3) The last year to which the 12½ percent tax on capital gains was applicable was 1933. In 1934, although the securities index advanced almost 10 points, the total gains taken by taxpayers declined from $553,000,000 to $313,000,000.

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TABLE I.—*Total capital net gains and revenue from capital gains*

Tax year	Securities index [1]	Total net capital gains [2]	Revenue from capital-gains tax [3]
1926	100.0	2,378.5	225,485
1927	118.3	2,894.6	296,879
1928	149.0	4,807.9	576,001
1929	190.3	4,684.5	420,971
1930	149.8	1,193.1	−15,226
1931	94.7	471.6	−89,001
1932	48.6	162.9	−79,917
1933	63.0	553.2	16,167
1934	72.4	312.6	17,197
1935	78.3	730.7	85,257
1936	111.0	[4] 1,417.6	([5])

[1] Standard statistics index of 419 stocks, average for year.
[2] In thousands of dollars. Treasury Department statistics, report of subcommittee of Committee on Ways and Means, table 8, p. 88. Gains subsequent to 1933 are estimated before application of statutory percentages; 1936 figure estimated, no Treasury figure available.
[3] In thousands of dollars. Treasury Department statistics, report of subcommittee of Committee on Ways and Means, table 9, p. 90.
[4] Estimated.
[5] Not available.

The conclusions are obvious. A reasonable rate encourages business activity, serves to increase the tax base materially, and produces far more revenue than any plan which subjects the gain to unreasonably high rates. The present law drives capital into tax exempts, and prevents its investment in new enterprises. It unduly magnifies the investor's risk, for he bears all the losses if the venture is unsuccessful, but must give up most of his profits if it is successful. Assurances of a reasonable tax upon future capital gains will release an enormous amount of capital for productive enterprise and may well prove to be the key to a reversal of the business trend.

Furthermore, I am inclined to think that the Treasury does not expect any substantial amount of immediate revenue from the tax upon capital gains. The present is a particularly opportune time to change. The risks involved are most attractive. If you lose, you can't lose much. If you win, your gains are enormous.

INDIVIDUAL SURTAXES

Existing individual surtax rates require downward adjustment. The present schedule is much too high. A schedule ending with a 40 percent "top" will more closely approach the point of maximum productivity. It will replace the hampering effect of the present law with some real encouragement to individual initiative and enterprise. It will free funds frozen in tax-exempt securities. Excessive cash will be lured from its present hiding places. The more enterprise, the more employment; the more employment, the higher the tax base.

CORPORATION TAXES

Again, the record of the past is convincing that a reasonable flat rate corporation tax produces more revenue than the heavy normal taxes and surtaxes in effect for the past 2 years. This information is presented in tabular form also.

Table II shows that the industrial index in 1936 was 105, and that in 1925 it was 104, and in 1927, 106. These 3 years are therefore comparable from a business standpoint. The combined normal tax and undistributed profits surtax in 1936 produced $1,113,000,000 in revenue. In 1925, however, with a flat corporate tax of 13 percent, the Government collected $1,170,000,000 in revenue from corporations; and in 1927, with a 13½ percent flat tax, $1,130,000,000.

Again, it is estimated that in 1937 the normal and surtax on corporations produced $1,270,000,000 in revenue. Taking 1928 as a comparable year, according to the index of industrial production, it appears that a 12 percent flat tax on corporations yielded $1,184,000,000, a difference of less than $100,000,000.

The reason why a moderate flat tax in the twenties produced almost the same amount of revenue as that obtained in 1936 and 1937 is obvious. The corporate tax base was 10 and a half billions in 1928. In 1936 and 1937, while the undistributed-profits tax and other heavy taxes strangled business, the corporate net income amounted to only seven and seven and a half billions, respectively.

TABLE II

Year	Federal Reserve Board index industrial production[1]	Bureau Labor Statistics index of factory payrolls[1]	Corporate net income[2]	Rate of corporate tax	Revenue from corporation tax[2]
1922	85		6,964	12½	775.3
1923	101		8,322	12½	937.1
1924	95		7,587	12½	881.6
1925	104		9,584	13	1,170.3
1926	108		9,673	13½	1,229.8
1927	106		8,982	13½	1,130.7
1928	111		10,618	12	1,184.1
1929	119		11,654	12	1,193.4
1930	96		6,429	12	711.7
1931	81		3,683	12	399.0
1932	64		2,153	13¾	285.6
1933	76		2,986	13¾	416.1
1934	79		4,275	13¾	588.4
1935	90		5,14[illegible]	12½–15	707.9
1936	105		[3] 7,000	[4] 8–15	1,113
1937 (year)	110p.		[3] 7,500	[4] 8–15	[5] 1,270
May	118	105			
August	117	104			
December	84	81			
1938:					
January	81	71			
February	[3] (79)				

[1] 1923–25 average = 100.
[2] In millions of dollars.
[3] Estimate.
[4] Plus surtax on undistributed profits.
[5] Trade estimate.

Despite this record, the Treasury insists that the substitution of a moderate flat rate tax would cause a serious loss in revenue. It must be assumed that the tax base would be the same under each tax. It must take the position that our tax laws have no effect whatsoever upon business conditions. My position is that the substitution of a flat 15 percent tax will encourage greater business activity and larger corporate profits. The revenues will be increased, not decreased.

The point can be illustrated by a third table (table III). The present level of business activity, as indicated by the Federal Reserve Board index, is around 80. If this low level continues throughout the year, corporate income will not exceed $3,840,000. On this base, the House bill would not yield more than $1,344,000 in tax revenue from both corporations and individuals. On the other hand, if the adoption of a 15 percent flat tax increased business activity by only 6 percent it would produce the same amount of revenue. And the flat tax would produce more revenue than the House bill to the extent that it improved business conditions by more than 6 percent over the present level.

TABLE III.—*Estimated revenue yield from present House bill, based on present business level, and estimated increase in business level necessary to produce same amount of revenue with flat 15-percent corporate tax*

	Index of industrial products	Corporate net income	Corporate tax yield	Individual tax yield	Total yield
House bill	80	3,840	670	674	1,344
Flat 15-percent tax	[1] 85	[2] 4,250	638	720	1,358

[1] Increase, 6 percent.
[2] Increase, 11 percent.

CARRY-OVER OF NET BUSINESS LOSSES

A single 12 months' period is admittedly an arbitrary basis for determining income and ability to pay taxes. It necessarily results in inequitable burdens. For example, a corporation may have a loss of $50,000 in 1 year and an equal gain in the next. Although it has no net income for the 2-year period, it will be taxed on $50,000. The nominal rate is in effect doubled.

Again, the use of a single year's earnings as a basis for taxation results in unevenness of tax impact as between different types of corporations. The normal history of the heavy goods industry is a succession of loss years followed by a period of relatively large profits. One good year out of four is the aim of the textile industry. In contrast, other lines of business will have profits relatively uniform from year to year. Their effective tax rate approaches the nominal rate.

Operating losses of 1 year should be carried forward for at least 2 years, as the most effective method of alleviating many of the existing inequities.

CARRY-OVER OF NET CAPITAL LOSSES

The bill permits the net capital loss of 1 year to be carried forward and deducted from net capital gains of the subsequent taxable year. This provision is liberal only by comparison with the wholly inequitable provisions of existing law, which permit no carry-over whatever. The true result of a taxpayer's capital transactions cannot be determined over a period of 1 or 2 years, or even in 5. Many taxpayers may have capital transactions over a period of years which result in no net capital gain or loss. Yet, under existing law, and under the bill, they are required to pay taxes on their gains without adequate recognition of the offsetting losses in other years. A 5-year carry-over for capital losses would provide a more reasonable period by which to measure a taxpayer's ability to pay taxes on capital transactions. For the benefit of the small taxpayer and the more occasional investor, net capital losses of $2,000 should be deductible in any 1 year from ordinary income.

EMPLOYEES' PENSION TRUSTS

Under section 165 of the present law, a pension trust for the benefit of employees is exempt from tax, and contributions to it are allowable deductions, if the plan conforms to specified requirements. Since the enactment of the original provision in 1921 the Congress has recognized that the trust might be revocable. The House bill proposes to change the present law and to require that the trust be irrevocable.

It is our opinion that the establishment of pension trusts should be encouraged, and that the House bill will have the contrary effect. We believe the provisions of the present law are sound and that the revenues are adequately safeguarded.

WORTHLESS SECURITIES

Section 23 (g) (2) and section 23 (k) (2) of the House bill provide that a loss sustained from securities becoming worthless shall be treated as a capital loss. There is a fundamental objection to the principle involved in these provisions.

Losses from worthless securities are real losses, which are basically different from "capital losses." In the case of a "capital loss," the taxpayer controls the year in which the sale—and, therefore, the loss—occurs. He can frequently offset the loss by taking a corresponding capital gain. In the case of worthless securities, the taxpayer has no such control over the year in which the loss is sustained. Frequently, there will be no capital gains against which the loss can be offset. In effect, therefore, the provision results in the arbitrary taxation of the loss.

In addition to this fundamental objection, the provisions have certain technical deficiencies. They provide that the loss shall be regarded as being sustained as of the first day of the year when the securities became worthless. This may result in treating what is really a long-term capital loss as a short-term capital loss. Moreover, the provisions create confusion as to the determination of the holding period of the asset. For instance, if a worthless security upon which a capital loss has been taken should become valuable, how is the holding period determined—from the date of acquisition, or from the date the capital loss was taken?

LOSS ON OBSOLESCENCE

Section 117 (a) (1) of the House bill now defines "capital assets" so as to exclude "property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l)." The Ways and Means Committee report states that this is intended to permit a full loss due to obsolescence in a case where, for example, a machine has become obsolete, is removed from use, and is then sold. According to the committee report, the loss sustained on such a sale might under the present law be regarded as a capital loss.

It is our opinion that the proposed provision is merely declaratory of existing law. When the present capital gains provisions were enacted in 1934, they continued without change the provisions with respect to losses due to obsolescence, retirement of obsolete property, etc. The Treasury Department has consistently recognized, in its regulations, that the limitations with respect to the sale or exchange of capital assets were inapplicable to losses arising from obsolescence. (Regs. 94, art. 23 (e)-3.)

The statement in the committee report, therefore, casts doubt on the propriety of this deduction for prior years. It should be corrected.

Moreover, even if the change is accepted merely as a clarifying amendment, it is too broad in its application. As now drafted, it applies to depreciable property and would tax as ordinary gains the gain from the sale of buildings held by a real estate operator. Certainly, this is not within the contemplated scope of the amendment. The provision should be limited to properly subject to obsolescence.

INTERCORPORATE DIVIDENDS

The House bill proposes to limit the credit for intercorporate dividends not only to 85 percent of the dividends received but also to 85 percent of "adjusted net income"—statutory net income less so-called "liberty bond" interest.

This new limitation will apply whenever the corporation receiving dividends has a net loss from operations. For example, suppose two corporations each receive $100,000 from dividends. One has a net operating profit of $20,000; the other a net operating loss of $20,000. The former will get the full credit of $85,000 for dividends received. The latter, however, will get a credit of only 85 percent of $80,000, its adjusted net income, of $68,000. In effect, 85 percent of the loss, amounting to $17,000, becomes subject to tax. This result is unsound and discriminatory. It is unnecessarily severe upon corporations which distribute to their stockholders all the dividends they have collected. Certainly, corporations operating at a loss have a lesser liability to pay.

The existing tax burdens upon corporate dividends are extremely heavy. The earnings and profits, out of which the dividends are paid, have already been subjected to taxation in the hands of the corporation paying the dividend.

We have frequently pointed out the double and multiple taxation resulting from further taxation in the hands of the receiving corporation. The increase proposed by the House bill should be eliminated.

SALARY PUBLICITY

The present law provides (section 148 (d)) that a corporation must submit with its income tax returns the names of all employees receiving salaries in excess of $15,000, such names to be a matter of public record. During the last session of Congress a bill passed the House repealing this section, but the Senate took no action. The bill as originally reported by the House committee omitted this section, but on the floor of the House it was reinserted and so amended as to apply to salaries in excess of $75,000.

Publicity of salaries has nothing whatever to do with levying or collecting taxes. It is alien to and has no legitimate place in a tax measure.

The salary publicity provision has been in the revenue act for nearly 4 years. No evidence has been produced that it has served any useful purpose. On the contrary, there is ample evidence that it has been used for objectionable purposes. The list of names has been a veritable gold mine for salesmen of all kinds, blackmailers, kidnapers, and others compiling lists of prospects or victims for doubtful purposes.

Removal of this section from the law will eliminate an element alien to a revenue act.

RETROACTIVE AMENDMENTS TO THE UNDISTRIBUTED PROFITS TAX

In 2 years of operation, the undistributed-profits tax has worked tremendous hardships upon many innocent corporations. Many illustrative examples are set out in our separate report, which has been given to your committee. As stated by the chairman of this committee: "For each corporation which has been justly penalized by this tax, there are probably a hundred which have been unjustly penalized because, for legal or moral reasons, they could not distribute their earnings in dividends."

Since this fact is recognized, it seems obviously proper to give those corporations which were "unjustly penalized" in 1936 and 1937 appropriate retroactive relief. Not to do so would be a grave injustice.

It has been urged that retroactive relief would be unfair to the corporations which did declare out earnings in the past 2 years. On the contrary, this seems to me the very reason why retroactive relief should be granted. Those corporations which could distribute, did distribute. The corporations which were unable to distribute are to be penalized. They are deserving of relief, and such relief, on the Treasury's own figures, would not be costly.

The following amendments are necessary and appropriate:

(1) An alleviating general credit of a substantial percentage of net income, for the taxable year 1937.

(2) An appropriate amendment, applicable to the taxable years 1936 and 1937, to conform section 26 (c) (2) of the Revenue Act of 1926 to its original purpose, so as to allow a credit for earnings applied to debts or sinking funds whenever the contract requirement is that they be so applied, either in the year earned or the following year.

(3) An amendment providing that corporations whose net income is subsequently redetermined and increased upon audit of their returns shall not be taxed retroactively for having failed to distribute such income in the year it was earned, if a distribution is made within 60 days after the deficiency is determined.

During the hearings before the Committee on Ways and Means, it was stated that the subcommittee had unanimously agreed to the insertion of such an amendment in the bill Certain "deficiency dividend credit" provisions were added to the bill on the floor of the House, but they were limited in application to title 1A (personal holding companies) and title 1B, which was later stricken from the bill. If the 3⅓ percent undistributed-profits tax comprehended by the "20-16" tax is permitted to remain in the bill, obviously a like credit should be granted. And, in any case, such a credit should be written into the bill to provide for deficiencies in 1936 and 1937 income which are subsequently assessed.

CONCLUSION

Opportunities for private employment must be provided for those able to work who are on relief. Industry must be unshackled. Confidence must be restored. Government revenues must be stabilized. Our national income and standard of living must be increased substantially above present levels. Fears of vindictive taxation must be removed. The use of our tax system as an experimental laboratory must be abandoned.

Adoption of the recommendations we have suggested will be an important contribution to these ends—the most important single contribution, we believe, which can be made during the remainder of the present session of the Congress.

(The following summary of recommendations of the United States Chamber of Commerce was submitted by Mr. Alvord.)

SUMMARY OF STATEMENTS MADE BY REPRESENTATIVES OF THE UNITED STATES CHAMBER OF COMMERCE

We believe:

That the prime objective of present revenue legislation should be to encourage business activity in the interests of economic welfare. If business activity can be brought to a satisfactory level, revenues will automatically take care of themselves.

In order to stimulate business activity, the obstructive effects of certain taxes and certain excessive rates must be ameliorated, the tax structure simplified and inequities reduced.

As a means of attaining the objective, we support certain principles and certain provisions of the present revenue bill and oppose others as obstructive.

While our testimony deals with a limited number of other subjects, we devote special attention to the following:

TAXATION OF CORPORATIONS

We support:

The taxation of corporate income through a normal tax only no higher than that of present law.

The proposal to carry losses forward; the carry-over, however, should be for a period of 2 years rather than 1.

The proposal to allow triennial determination of capital-stock values for tax purposes; it is urged, however, that such determination be permitted at least biennially, and preferably annually.

A relief provision permitting credit, since the adoption of the undistributed-profits tax for earnings obliged under debt contracts to be paid out, or set aside for retirement of debt.

We regard as obstructive:

The undistributed-corporate-profits tax as being unsound in principle and urge its complete elimination.

The proposed treatment of intercorporate dividends and urge full credit for 85 percent of dividends received from domestic corporations.

CAPITAL GAINS AND LOSSES

We support—

A flat-rate tax on capital gains accruing from assets held longer than 1 year; in order not to impede the free flow of capital, this rate ought not to exceed 12½ percent, and 10 percent would be preferable. In addition to other advantages, a flat tax would permit simplification of the law, as, for example, it would make unnecessary the present elaborate schedule pertaining to time assets have been held with its encouragement to delay capital transactions.

A carry-over of net losses; the period of carry-over, however, should be not less than 3 years, and preferably 5.

We regard as obstructive—

The proposed change in definition of capital assets so as to include worthless corporate securities.

ESTATE AND GIFT TAXES

We support—

A combination of estate-tax schedules for the purpose of simplification, provided taxes are not increased thereby.

The priority of credit for death taxes paid the States.

We regard as obstructive—

The combination and reduction of the present estate- and gift-tax exemptions.

The reduction of the present gift allowance to $3,000.

INDIVIDUAL SURTAXES

We support—

An adjustment of the surtax schedules to a maximum rate of 40 percent.

MISCELLANEOUS

We recommend that the present $1,000 credit allowed trust incomes be retained; that the salary publicity provision be completely repealed; that the present provisions pertaining to employees' pension trusts be retained.

The CHAIRMAN. Mr. J. D. Conover, Washington, D. C., representing the American Mining Congress.

STATEMENT OF JULIAN D. CONOVER, WASHINGTON, D. C., SECRETARY OF THE AMERICAN MINING CONGRESS

Mr. CONOVER. Mr. Chairman and gentlemen of the committee, my name is Julian D. Conover, Washington, D. C. I am secretary of the American Mining Congress. I have a brief which I should like to present, in which we are urging the amendment of the bill which you have before you in seven specific ways.

The CHAIRMAN. Just hand your brief to the reporter.

Mr. CONOVER. I should like to cover each of those points in a sentence or two, and will then be glad if the record can show the entire brief, as if read in full.

The CHAIRMAN. Very well.

Mr. CONOVER. First we recommend the complete elimination of the undistributed-profits tax and substitution therefor of a flat rate of corporation tax. We believe the repeal of the undistributed-profits tax would stimulate business and increase the tax base from which the Government obtains revenue to such an extent that it

would far more than offset the apparent loss of revenue from elimination of this tax.

Senator VANDENBERG. Would you suggest a flat rate?

Mr. CONOVER. Yes, sir.

Senator VANDENBERG. You believe a change in the tax bill will produce a great stimulation of business in and of itself?

Mr. CONOVER. We believe it would have a substantial influence in stimulating investment and reviving business.

The CHAIRMAN. All right, Mr. Conover.

Mr. CONOVER. Second, as to those years to which the undistributed-profits tax may be applicable, we urge that you grant relief as to certain specific provisions which have been shown to produce hardship.

The first of these is as to sinking funds. The present law has a limitation that such funds must be set aside within the taxable year in order to receive credit. The common practice of corporations, provided in indentures, is to set aside such funds following the close of the year, after the earnings have been determined and audited. We urge that earnings which are thus set aside after the close of the taxable year, amounts which are set aside for sinking-fund purposes within the next succeeding taxable year, be allowed the same credit as now provided by section 26 (c) (2).

As to deficiency assessments, we urge the allowance of a reasonable period following assessment of a deficiency, within which distribution of dividends may be made as a dividends-paid credit. Such a provision would remove the injustice which now exists where the Commissioner determines there is additional adjusted net income above that which the taxpayer has computed. We believe there should be a period of 60 or 90 days, following any such determination, within which an additional distribution might be made which would be entitled to a dividends-paid credit. Taxpayers frequently are not able to determine accurately their statutory net income, because of the many uncertainties in the application of the law; they endeavor to distribute their full adjusted net income, but if they find they are mistaken, if the Commissioner decides there is additional adjusted net income, they should then be permitted to make a corresponding additional distribution. They should not be subjected to a retroactive surtax if the profits thus revealed are promptly distributed.

I should like to say that this matter was also presented to the Committee on Ways and Means, and it was subsequently stated by Mr. Vinson that his subcommittee had unanimously agreed to allow such relief for additional dividend distributions; but apparently that provision was omitted from the bill through inadvertence.

We also urge that expenditures for construction, equipment, and development or for payment of indebtedness not otherwise provided for be made deductible in computing adjusted net income, to the extent of at least 30 percent of the net income. This would allow a substantial measure of relief to those concerns which have suffered real hardship under the undistributed-profits tax, and who urgently need such relief at this time.

Third, we urge a provision for the carrying over of net losses of at least 2 preceding years as a deduction from the current year's income. In the bill you have before you there is such a provision as to the undistributed-profits tax but not as to normal tax. We believe that

this provision, which was contained in former revenue laws, should be restored. This point is of particular importance to the mining industry. We customarily have several years of bad times, in which it is necessary to incur heavy losses to keep the organization together and to keep the mine workings in condition so as to be able to produce when prices are favorable, and it is extremely important that a carry-over of losses be allowed in order to even things up and thus base the tax more truly upon the actual income from the operations.

Fourth, we urge that you strike from the bill the present complicated provisions for recognition of capital gains and losses and return to a flat rate of 12½ percent, applying this to the net gain realized from the sale of capital assets held for more than 1 year.

Senator CONNALLY. Are you wedded to that? Suppose we go back to the flat rate and make it 15 percent.

Mr. CONOVER. Senator, we believe the 12½-percent rate, the same as in previous years and which produced substantial revenue, would be more satisfactory than a 15-percent rate.

We believe such a rate would stimulate the flow of capital which is so badly needed at the present time and would produce a very much larger revenue than these complicated provisions in the bill before you.

As a permanent policy we are also opposed to any limitation on the deductibility of capital losses against ordinary income; but if, because of the revenue demands at this time, it is not deemed practicable to allow full deduction of capital losses, we urge a provision which will allow a 2-year carry-over of such losses.

We also oppose the classification of worthless securities as capital losses. These are entirely distinct from the ordinary sale or exchange of capital assets; the investor has no control over the period in which the loss is determined and is not able to offset such a loss against gains from other assets. Losses from worthless securities have always been recognized as ordinary losses and we believe that practice should be continued.

Fifth, as to the declaration of value of capital stock for purposes of capital-stock and excess-profits taxes, we urge that a redeclaration be allowed in 1938 instead of 1939——

The CHAIRMAN. The provision with reference to 3 years—you have no objection to that?

Mr. CONOVER. That is part of it.

The CHAIRMAN. You have no objection to that?

Mr. CONOVER. We think that is a splendid improvement upon existing practice. It recognizes a very necessary feature of the law, that there should be a periodic redeclaration, and we recommend 2 years——

The CHAIRMAN. You think it should be moved up a year?

Mr. CONOVER. We think a redeclaration should be allowed in 1938 and thereafter at least every 2 years. In our mining properties, even in established operating mines, good practice does not permit the development of the ore bodies more than 2 years in advance of operations. The conditions which determine the earning value of a property vary greatly from yea to year, and a 2-year period for redeclarations is the minimum which recognizes the actual facts of the situation. There are also numerous adjustments which are required by the law and which are so complicated and on such varying bases, some of which bear no relation to the basis of the original declaration,

that unless frequent redeclarations are allowed, the adjusted value is likely to bear no relation to the actual value of earning power of the property.

The CHAIRMAN. That would apply more particularly to oil and mining?

Mr. CONOVER. We know it would apply very definitely in mining, with which we are more familiar than with other lines of industry.

Sixth, we urge that losses due to obsolescence be allowed in full. In the report of the Ways and Means Committee discussing section 117 (a) (1) there is an implication that in the case of losses due to obsolescence, such as where an obsolete machine has been discarded and sold for its second-hand value, the full amount of the loss may not be recognized. This is at variance with regulations of the Treasury Department, in which these losses have been treated, not as losses from the sale or exchange of capital assets, but as ordinary losses, which are fully deductible.

We suggest that this section 117 (a) (1) be amended to state specifically that the limitations of this section are not applicable to to deduction for loss due to obsolescence of depreciable property, and that in reporting such amendment it be made plain that this is the intent of prior acts, in other words, that this is a declaratory provision confirming the intent of such acts that losses due to discarding or sale of obsolete equipment be recognized in full.

The seventh point we urge is that recognition, in the provisions dealing with inventories, be given the established practice in the mining and metallurgical industry of balancing current sales against current purchases or intake, through recognition of what is known as the "last in, first out" method. That is a subject which will be presented to you by our next witness, Mr. Callahan.

In conclusion, we call your attention to the statement of the American Mining Congress submitted to the Committee on Ways and Means on January 22, which appears at page 886 of their record. We believe that favorable action on the amendments which we have urged will do much to revive business activity, to release much-needed capital for productive enterprise, to create increased employment, and to provide increased reevnue for the Government. Thank you, sir.

The CHAIRMAN. Thank you very much.

Mr. CONOVER. I have presented a copy of my brief to the reporter.

The CHAIRMAN. It will appear in the record.

(The brief referred to is as follows:)

STATEMENT OF JULIAN D. CONOVER, SECRETARY, AMERICAN MINING CONGRESS, ON THE REVENUE BILL OF 1938, PRESENTED AT HEARINGS OF THE COMMITTEE ON FINANCE, UNITED STATES SENATE, MARCH 19, 1938

To the Honorable Committee on Finance, United States Senate:

The American Mining Congress in behalf of all branches of the mining industry respectfully urges the following amendments to the revenue bill now under consideration:

1. Complete elimination of the undistributed-profits tax and substitution therefor of a flat rate of corporation tax.

We opposed enactment of the undistributed-profits tax in 1936, continue to be opposed to it, and recommend that it be repealed. Such action would greatly and immediately stimulate business and industrial activity to an extent that would more than offset any loss of revenue the Government might sustain through such repeal. The experience of our industry under this tax fully warrants our attitude. The tax has obstructed development of new mining enterprises and the expansion

of existing ones, and has discouraged the restoration of activities of properties which had suspended or curtailed operations.

Mining enterprises begin with prospecting, carried on by an individual or a small group, usually organized as a corporation. Perhaps years are spent in reaching a point where actual expenditure of considerable sums of capital are warranted by the developments which have taken place. When this point is reached, two courses are open; either the owners of the property, who have spent years of labor in bringing it to this state, must, in order to secure new capital, surrender a large equity in that which they have created themselves, or they must pour back into the enterprise earnings which are derived from operation. Frequently the corporation has agreed to pay for the property all or a portion of the proceeds over an extended period.

This brings about a situation where the undistributed-profits tax is a tremendous obstacle. If this tax is continued in any form, a hardship will be worked upon those who have devoted their lives and efforts to the operation thus far. They are obliged to distribute the earnings as they accrue or pay a penalty tax upon any sum which they devote to payment for the property, to the purchase of plant and equipment, or to the development of the ore bodies which have been discovered. In the ordinary course of things, all of this is paid out of current earnings. Mining investors expect this to be done so as to bring their investment to a sound financial status as rapidly as possible, and expect to await income return until the proceeds of operations exceed current expenditure requirements.

We know definitely from experience under the present law that any tax upon undistributed profits is a real deterrent to investment in the mining industry as well as a hardship upon those already engaged in it, who have made substantial efforts and sacrifice in the creation of present and potential wealth for the Nation.

This is not a matter for argument as to income-tax theory, but a practical situation which confronts the mining investor. The gravity of the situation is being manifested in concrete form in published reports of mining companies to their stockholders for the year 1937, in which they set out the deferment or abandonment of plans to satisfy financial obligations or to expand their operations as a result of the undistributed-profits tax.

2. Relief from the undistributed-profits tax, as to those years to which it may be applicable, in the case of certain provisions which experience has demonstrated produce hardship or injustice, specifically:

(*a*) As to sinking funds set aside in the normal course of business after the close of the taxable year.

The provisions of section 26 (c) (2) of the present law, which permit deduction in computing the undistributed-profits tax only as to sinking funds set aside prior to the close of the taxable year, practically nullify the relief which this paragraph was designed to afford. The normal and usual corporate practice is to set aside such funds following the close of the year, after the earnings have been determined. We urge that all earnings of a taxable year allocated to sinking-fund requirements within the next succeeding taxable year be accorded the same treatment as those now covered by section 26 (c) (2) of the existing law.

(*b*) As to the allowance of a reasonable period following assessment of a deficiency within which distribution of dividends may be made as a dividends paid credit.

The necessity for such a provision arises from the fact that determinations by the Commissioner of net income in excess of that computed by the taxpayer are usually not made until long after the close of the taxable year. The present law provides that dividends, to receive credit in the computation of undistributed-profits tax, must be paid before the close of the taxable year. The taxpayer should be permitted to make an additional dividend distribution corresponding to the amount of any additional adjusted net income subsequently determined by the Commissioner, and to receive credit therefor.

This question was presented before the Committee on Ways and Means of the House by Mr. E. C. Alvord (see record of hearings on Revision of Revenue Laws, 1938, p. 488) in which he stated in part:

"* * * Obviously it is grossly unfair to penalize corporations which attempted to distribute all their income in 1936 and 1937 for errors subsequently discovered in the return. An amendment should be adopted providing that there shall be no retroactive surtax if the profits thus revealed are promptly distributed."

Later in the hearings (p. 538) Mr. Vinson, chairman of the subcommittee whose recommendations were under discussion, referring to this particular recommendation, stated that as he recalled it there was unanimous agreement on the part of the subcommittee to include that very thing in their recommendations and that

he was glad Mr. Alvord had called it to their attention because otherwise it might have been omitted.

We cannot, of course, say whether the failure to include this provision in the bill was simply inadvertence, but we cite this record of the hearings as indicating that the subcommittee had been in agreement as to the proposal which we are now urging upon you.

(*c*) As to expenditures for construction, equipment, and development or for payment of indebtedness not otherwise provided for.

Many corporations have been so situated that it has been impossible for them to do otherwise than apply all or a substantial amount of their earnings to construction, equipment, and development of their properties or for payment of indebtedness not allowable as deductions in computing adjusted net income. These have been essential expenditures to permit them to continue to function and were necessary incidents to their earning the net income which is the subject matter of this tax. We urge that amendment be made to the Revenue Act of 1936 to allow such expenditures as deductions in computing adjusted net income subject to the undistributed-profits tax at least to the extent of 30 percent of the net income.

(*d*) We also wish to protest against the amendment made by the House to section 26 (b) of the existing law, by which the 85 percent credit for dividends received is limited to an amount not in excess of 85 percent of the adjusted net income. The effect of this limitation is to reduce the amount of the credit for dividends received by parent corporations which sustain a loss from their own operations. Thus an increasingly heavy effective rate is levied upon losing corporations least able to bear it. This is palpably inequitable and should be removed by deletion of the words "or not in excess of 85 percent of the adjusted net income" from lines 5 and 6, page 46, of H. R. 9682.

2. Provision for the carrying over of losses of at least 2 preceding years as a deduction from the current year's income.

Previous revenue acts have provided for a 2-year carry-over of losses. In the inherent uncertainties of mining operation it is very essential that there be guarding provisions in the law which will permit the managements of properties to meet the unfavorable operating conditions which often develop. Mining enterprises frequently carry on for several years without profits in the anticipation of subsequent earning capacity and it is inequitable to place limitations which exclude operating or development losses over such a period as a proper cost to apply against earnings when made.

Mining operations must be continuous or the company is subjected to heavy cost to maintain its plant and workings. The maintenance of the mining operation over a period of low prices and consequent loss is the only thing that makes it possible to keep the organization together and to be prepared to supply essential minerals when required. The action of mining organizations in providing employment through unfavorable periods should not be penalized by disallowing losses then incurred as a charge against subsequent earnings.

4. Elimination of the present complicated provisions for recognition of capital gains and losses and restoration of a flat rate of 12½ percent on the net gain realized from the sale of capital assets held for more than 1 year.

The present high and graduated rates of tax on capital gains discourage investment. Capital is available for productive enterprise only when investors can acquire assets with opportunity to diversify or otherwise change their holdings without sacrificing their capital through taxation. Because of the inherently great risk in mining enterprises this is especially applicable to investments in our industry. On the other hand, a reasonable fixed rate of tax on capital gains would immediately stimulate the flow of capital which is urgently needed for the continued upbuilding of our industry.

The Government derives no revenue from capital gains transactions which never take place. Revenue from such transactions is obtained only under a rate of tax which will not discourage the sale or exchange of capital assets. A flat rate of 12½ percent would produce substantially larger revenue than the rates contained in the pending bill.

As a permanent policy we believe that any limitation on the deductibility of capital losses against ordinary income is not justified. If, however, under present revenue demands, it is not deemed practical to allow full deduction of capital losses, we urge a provision which will allow a carry-over of net capital losses for a 2-year period.

Certainly, there should be no further limitation upon the allowance of capital losses, such as is provided in sections 23 (g) (2) and (3) and sections 23 (k) (2) and (3). Losses sustained as a result of the worthlessness of securities have always

been considered ordinary losses. The investor cannot control the period in which this class of loss is determined, and should be allowed full deduction therefor.

5. A provision that a new declaration of value of capital stock for purposes of capital stock and excess-profits taxes be allowed in 1938 instead of 1939, and that redeclarations of value be permitted thereafter every 2 years instead of every 3 years as provided in the House bill.

We are deeply gratified that the necessity for periodic redeclarations of value has been recognized in the House bill. We submit however that such redeclarations should be allowed at intervals of not more than 2 years. In mining properties in the development stage, the conditions which determine value vary greatly from year to year and frequent redeclarations are necessary to avoid hardship, and injustice. Even in established operating mines, good-mining practice limits the development of the mineral deposit to approximately 2 years in advance of current operations, and a 2-year redeclaration period is the minimum which will give adequate recognition to those physical facts which determine the value and earning power of the property.

The numerous adjustments required by law in these declarations are complicated and are on various bases, some on bases which bear no possible relation to the basis of the original declaration. In former years, when frequent redeclarations were permitted the tax yielded substantial revenues with a minimum administrative difficulty or legal contests. We believe it will continue its substantial revenue yield if redeclaration is permitted every 2 years.

The first declaration under the 1938 act should be in 1938, in accordance with the established practice of allowing a new declaration under each general provision of the revenue act.

6. Allowance of losses due to obsolescence.

The pending bill would make a change in section 117 (a) (1) in the definition of capital assets to exclude from that definition "property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1)." The reason which is stated in the House committee's report (H. Rept. No. 1860, p. 34) seems to be to provide particularly for full loss due to obsolescence in a case such as is there cited, of a machine which had become obsolete and was removed and sold for its second-hand value in order to provide for installation of a new and improved type of machine. The statement is made in the committee's report that under present law the loss thus sustained on sale of the obsolete machine might be laregly disallowed because of the provisions of the present section 117 (d).

We believe that this is an erroneous statement of the situation under existing law. The Revenue Act of 1934 which first introduced the provisions of section 117 continued without change the prior provisions with respect to allowance of loss due to obsolescence, retirement of obsolete property, etc. This has been continuously recognized under the Treasury Regulations (e. g. Treasury Regulations 94, article 23 (e), (2), and (3). These contain the definite statements that the limitations of section 117 with respect to sale or exchange of capital assets have no application to losses due to discarding of capital assets. We urge that this is the proper interpretation of present law, and that no amendment should be made with any contrary explanation.

We approve of any desirable amendment which will place beyond question the intent of the law in this regard. We would subscribe to an amendment to section 117, which would state specifically that the limitations of this section are not applicable to deduction for loss due to obsolescence of depreciable property. We urge that the committee report in connection with such an amendment should make clear that its sole purpose is to express the proper intention of prior acts.

7. Recognition, in the provisions dealing with inventories, of the established practice in the mining and metallurgical industry of balancing current sales against current purchases or intake, through recognition of what is known as the "last in, first out" method.

This is a problem of specific application to our industry which will be presented in detail by our next witness, Mr. D. A. Callahan.

We also respectfully invite your attention to the statement of the American Mining Congress submitted to the Committee on Ways and Means of the House of Representatives on January 22, which appears at page 886 of the record of that committee's hearings.

We believe that favorable action on the amendments which we have urged will do much to revive business activity, to release much needed capital for productive enterprise, to create increased employment, and to provide increased revenue for the Government.

The CHAIRMAN. Mr. Callahan.

STATEMENT OF D. A. CALLAHAN, OF WALLACE, IDAHO, REPRESENTING THE AMERICAN MINING CONGRESS

Mr. CALLAHAN. Mr. Chairman, I am representing the American Mining Congress and I have here a brief which I will not read, but I just want a few minutes to tell you orally what this is all about.

The CHAIRMAN. Very well.

(The brief referred to is as follows:)

STATEMENT OF D. A. CALLAHAN, WALLACE, IDAHO, ON THE REVENUE BILL OF 1938, PRESENTED AT HEARINGS OF THE COMMITTEE ON FINANCE, UNITED STATES SENATE, MARCH 19, 1938.

To the honorable Committee on Finance, United States Senate:

I am appearing here in behalf of the American Mining Congress to urge an amendment to section 22 (c) of the bill. In doing so I am representing the entire industry from the producer to the fabricator of metal products.

This provision, which is a repetition of the present law, confers upon the Commissioner of Internal Revenue the authority of prescribing the basis of inventories which will clearly determine the income of a taxpayer. Under this law the Treasury Department refuses to permit those engaged in the metal smelting, refining, and fabricating industries to apply current costs to current sales in determining the cost of goods sold. The American Mining Congress urges that this section be amended to permit these industries to use this method.

This method has been recognized as best accounting by the industries themselves for reporting to stockholders, for paying dividends, and for all other corporate purposes. It has been approved by leaders in accounting professions, by the Securities and Exchange Commission, and by the Treasury Department itself, for silver tax purposes.

In order to arrive at an understanding of just what this means, I shall outline the processes through which raw metal must pass before reaching the market as a finished and merchantable product.

First the ore is taken from the ground, is crushed and ground, and the waste material separated usually through what is known as the flotation process. This reduces the metal to the form known as concentrates.

Next the concentrates are shipped to the smelter where they go through several processes before emerging as a merchantable product. Certain of the metals must go through processes of refining in order to remove all impurities.

Metallurgical improvements over the past several years have resulted in the final production of a practically pure form of metal. These processes consume a considerable period of time and during this period the smelter and refiner must carry large inventories because the smelting and refining business is a continuous process and must not be impeded or delayed by lack of metal in the form of concentrates, and the smelting and refining company must carry stocks of refined metal to meet the demands of the market.

In these various steps from the mine to the market of the finished product, there is a community of interest between the producer of the raw materials, the smelter, the refiner, and the fabricator. In a great many cases the producing company makes a contract with a smelting company under the terms of which settlements are made upon the basis of the market price on the day the concentrates are shipped to, or received by, the smelter. This contract provides, among other things, for a smelting charge or toll, and in many cases, the smelter acts in effect as the selling agent for the finished product. This is necessary because small producers cannot maintain the selling organization and have not the means which will enable them to wait for returns until the finished product is finally sold to the fabricator. By sampling and assay the exact refined metal content of the concentrates is determined at the time of delivery and the producer is then paid the market price, for the refined metal equivalent of his product, less a specified charge for smelting and refining. At that point the producer's responsibility in respect to that production is terminated and that of the smelter and refiner begins.

Basically, smelting and refining is a custom business and a substantial part of present-day operations are conducted on a direct toll basis. Obviously, however, the small producer of crude ores is not financially able to carry the metals through the smelting and refining period. Accordingly, a substantial part of the business

must be conducted on what is known as the ore purchase contract basis which I have described.

Experience has taught the custom smelter and refiner that he cannot afford to speculate on metal price fluctuations. The risk of loss is too great, the processing period is too long, metal prices are subject to extreme and rapid fluctuations. A large part of the price of the refined metals represents the cost of the crude ores. There is no adequate metal futures market for hedging.

Accordingly, the custom smelter and refiner protects himself by selling the metals produced from the crude ores which have been purchased at the price paid for them. In the absence of a metal futures market there is only one method available for obtaining this result and that method is employed in the industry to the fullest practical limit. It consists of selling, concurrently with the purchase of crude ores, an amount of refined metal equivalent to the metal content of the ore purchased. The price paid for the metals in the ores is thereby matched with the price received for the refined metals. The effect of subsequent fluctuations in metal prices is neutralized, the smelting and refining fee charged the producer is protected, and the profits from operations on the purchase contract basis coincide with those derived from toll operations. This, of course, cannot be carried out with absolute mathematical exactness, but it is the basic buying and selling policy of the industry, and in ordinary times it can be and is carried out with remarkable accuracy. This accuracy results from two factors: (1) Close cooperation between the receiving and selling departments, and (2) the ability to determine the exact refined metal content of the crude ore or concentrates. This second factor is essential to a matching policy and distinguishes the metal-process industries from the ordinary manufacturers who do not and cannot employ it.

Notwithstanding the fact that the custom smelter and refiner conducts his business so as to eliminate the risks of market fluctuations, he is obliged under the present rules of the Internal Revenue Bureau to reflect such fluctuations in the computation of his taxable net income. This result is produced, because he is not permitted to apply the cost of current purchases against current sales, which conforms to the basis of conducting his business, but is obliged to apply the so-called first-in, first-out rule in determining the cost of goods sold. This latter rule assumes that the raw materials purchased first are used first; and correspondingly, that those purchased last are used last.

This rule cannot fairly be applied to the smelting and refining industry, because in order to operate efficiently the custom smelter and refiner must maintain a substantial amount of stocks on hand. These stocks include: (*a*) The metal impounded in the system necessary to permit continuous smelting and refining operations, (*b*) sufficient metals on hand to assure compliance with toll contract commitments, and (*c*) an adequate supply of metals to carry out the policy of currently selling against intake. The first-in, first-out rule goes back through the entire inventory, picks up the cost of the earliest purchase, and applies it to the present sale. As a result, the entire net fluctuations in market price since the date of the earliest purchase, which was probably several months before, is reflected as profit or loss on each sale of refined metals—although from the business point of view, the sale is made for the very purpose of eliminating the effect of such fluctuations. This introduces a speculative element into the computation of the taxable income which is wholly absent in the conduct of the business.

The method of matching current sales against current purchases has desirable results for both the producer and the processor. It assures the processor of his operating profit or toll and enables him to pay the producer upon delivery of his metal to the smelter. It also assures the producer of a market free from the speculative element which would result if the smelter purchased his metals and held them for future sales. So long as this practice is followed, the method of accounting employed by the smelter and refiner should conform thereto and taxable net income should be based upon such method.

Mr. CALLAHAN. Last week on Friday, Mr. Peloubet, on behalf of the Copper and Brass Mill Products Association, presented a statement and brief, which covers this situation very thoroughly. Mr. Glass also presented a brief covering the same principle. I understand that in the brief filed by the American Institute of Accountants the same principle is recognized and urged.

For a number of years there has been difficulty with the Treasury Department under the authority given by the present law where they

fix the basis of inventories. Although 2 years ago we appeared and asked this specific amendment be adopted and we were instructed to take it up with the Treasury, as Mr. Peloubet informed you, nothing has been done.

Now, the smelter, with which we as producers deal, basically is on a toll basis, just the same as the old grist mill. In the old days, we took our wheat to the mill and they took their toll, and after a while they decided we did not have to wait on our grist but they would give us the equivalent of what we brought and we could go right home with it. So the smelter basically and primarily is on a toll basis. The majority of companies, however, deal with the custom smelter on a contract basis by which the smelter, takes in their ore, ascertains the metallic content of it, and then in order to keep their basis upon a toll basis, sell against that which they have received upon the same market. In that way they are able to practically duplicate their toll operation because they are able to ascertain the metallic content of the concentrate which they receive, and by close supervision of the details of their business they are able to keep their business on a toll basis. They have discovered that if they store it and run into up and down markets, they are running extreme risks; in other words, in some years they will make money and in others the losses will be tremendous.

Senator CONNALLY. In effect, you hedge; it is the same operation; you take in ore today and sell an equivalent amount to offset it, and your books are balanced?

Mr. CALLAHAN. That is it, Senator.

The CHAIRMAN. The Treasury Department under the law has a right to remedy this situation.

Mr. CALLAHAN. Yes, sir.

The CHAIRMAN. And you have had conferences?

Mr. CALLAHAN. Yes; and they say they cannot do it and it is necessary in order to make it possible for them to do it that an amendment to the law be passed. The Senator has indicated to Mr. Peloubet, Mr. Glass, and others that you are going to take this matter up with the Treasury, and we know you are, and I am going to ask that in any consideration of this in an executive session or otherwise, someone representing our organization may also be present for a discussion of this particular problem.

The Treasury have taken a decided stand upon this. They have some very bright young men who have told them it would not be justified, because, theoretically, they claim this is annual business and we must go back to the very first receipts we have and balance this purchase against the present sale. As a matter of fact, that is not the practice of the industry, and is not the way in which it does its accounting.

We who are in the producing end are interested in their keeping their business on the present basis of planning sales against purchases, which makes it practically a toll operation, in order to make the market absolutely free. All we do is ship our concentrates to them, and when the smelter receives them we want to know we are getting the benefit of the prevailing market, because we deal on the basis of either the day they receive it or we ship it to them. We are very much interested in a free market.

The CHAIRMAN. Have you conferred with our experts of the Treasury and gone over this matter?

Mr. CALLAHAN. Oh, yes.

The CHAIRMAN. We have some very smart young fellows representing the joint committee, and you might discuss it with them, but, of course, we could not permit a representative of yours to come into an executive session when we are considering this bill. I have asked Mr. Parker to go over this matter and we will give every consideration to it.

Mr. CALLAHAN. I would like at some time, Mr. Chairman, that the members of your committee hear the arguments on this side and on the other side and then let you be the judge as to who is right.

The CHAIRMAN. We will do that.

Mr. CALLAHAN. We want the accounting to determine the net income of the industry on the basis of the current year and on the basis it makes its own accounting to its stockholders and to the Securities and Exchange Commission and on the basis to which the Treasury has given recognition in assessing the silver tax. That is the way the industry is doing its business and that is the way they would like to make their accounting.

Senator LONERGAN. I come from Connecticut, and we have a great number of brass mills there. Suppose the manufacturer pays 10 cents a pound for copper and the price increases to 15 cents a pound before a commitment which he has made on the finished product actually goes on the market and suppose it goes to 8 cents a pound, how does it work?

Mr. CALLAHAN. What the industry tries to do, and they do it by close cooperation between the receiving and selling departments of the business, is this: They try to plan the amount of intake so that the seller is getting the benefit of the price prevailing on that particular day. That keeps the market moving in a free manner; they balance the sales against the intake. The other method of taking the ore and storing it and selling against the first receipt, as the Treasury says should be done, means constant speculation due to fluctuation in prices and makes for loss or gain which is abnormal. That is the one thing the processors are anxious to get away from and that is the method upon which they conduct their business. They are in the toll business and get their money out of the toll for smelting and processing these metals.

Senator LONERGAN. Would the Treasury fix the loss on a given date?

Mr. CALLAHAN. No; the rule they follow is first-in, first-out. You have to go back through the inventory and get the first thing in the inventory that was not disposed of on that date.

The CHAIRMAN. Thank you, sir.

Senator Hardwick.

STATEMENT OF HON. THOMAS W. HARDWICK, WASHINGTON, D. C.

Mr. HARDWICK. Mr. Chairman and gentlemen of the committee, there are three propositions I want to submit to the committee, and while they are not of tremendous general importance, they are very important to some very respectable taxpayers in this country.

54885—38——32

I represent, among others, Pond's Extract Co., the largest concern of its kind in the United States, which has been engaged in the business of producing Pond's extract and cold and cleansing creams since 1849. I want to suggest before I go any further that I have leave to file my brief which will explain these matters in detail and I will only sketch them—I have three amendments to the bill. First, an amendment to section 701 of the House bill, page 299, line 6 by inserting after the word "soaps" the following "cold and other cleansing creams."

Of course, I know when it comes to removing a tax it is a difficult thing, but still when we are dealing with billions of dollars, it is a small item involving a million or a half million and is not of tremendous importance.

The Scriptures say, "Many are called but few are chosen." Well, now, there is some rule in the Scriptures about choosing them, but there seems to be none in this House bill about choosing.

The CHAIRMAN. That is on page 332 of the Senate bill.

Mr. HARDWICK. Yes, sir. They took off in this bill the taxes on furs, chewing gum, sporting goods, golf balls, golf sticks, and all of that sort of business, and they took it off jewelry last time. They have pretty nearly emasculated section 603. The intent was they were to take it off things that were not luxuries, and still they have taken it off all of these items and have left it on cold and cleansing creams and Pond's extracts, which are used to protect the skin and cure bruises, cuts, and abrasions, and it seems to me if you are going into the business of taking off the tax in these smaller items you should take it off household necessities rather than golf balls, tooth paste, furs, and jewelry.

Again I quote, "Many are called but few are chosen." I do not know on what principle the House committee chooses those sorts of things instead of the common household necessities that I represent in this matter.

The second proposition, which is also in the brief and I will not elaborate, just after the war, just about the time my own service in this body ended, we took off most of the war excise taxes; we had a penny tax on coca-cola, ginger ale, and almost every other kind of soft drink; but in 1932, under the necessity to raise Government revenue, we imposed a number of new taxes in the nature of a manufacturers' excise tax and that was embraced in the 1932 act. At that time these taxes were put on as temporary in character, a temporary expediency, because we had to grope around for pennies. So at that time they did not give to this group the same right of appeal to the Board of Tax Appeals which they gave to every other group of taxpayers such as payers of income tax, gift tax, and inheritance tax; they could all come to the Board of Tax Appeals on the question of deficiencies.

In the last revenue bill the Senate put an amendment of a character that would correct that in the bill, but the conferees rejected it; the House would not accept it. While I do not know the secrets of the conference I understood there was to be some effort on the part of the Treasury to work that out before we had another tax bill, but it was not done, and we are left where we were.

We think there should be exactly the same right of appeal and that we should be fed out of the same spoon that all of the other groups of

taxpayers are. Now, is it any answer, as the Treasury Department undertakes to say, that because the taxes are payable by the month, that that the appeal would not do? As a matter of fact taxes themselves are payable by the month, but the deficiencies are assessed by the year or more, so far as the statute of limitations will permit.

Now, the third proposition is one I want particularly to insist on above all others, and I think, maybe, if you will do this one thing, it will cure the situation as far as administration under this bill is concerned. I do not think I violate any authorities by saying this was rejected on a tie vote in the House committee, and I believe in view of the close division in the House committee you will not have much trouble in getting it accepted in conference. The manufacturer or importer of certain goods included in the manufacturers' excise tax under section 603 pays a tax of 10 percent, or in some instances 5 percent on the price of the thing sold. In determining what the price of the thing sold is, the statute provides, in section 619, I believe it is, of the act of 1932, that in determining the sale price, transportation, delivery, insurance, installation, or any other charge shall be excluded from the price, but not the tax, only if the amount thereof is established to the satisfaction of the Commissioner in accordance with the regulations, first, if the article is sold at retail; second, if it is sold on consignment, or third, if sold otherwise than through an arms' length transaction and at less than the fair market price. Now, we insist in the following amendment to that, namely, to amend the House bill by inserting at page 305, at the end of line 24, a new section to be known as section 709 (a), and to read as follows:

Section 619 of the Revenue Act of 1932 is amended as follows:

"In the case of a sale by a manufacturer to a selling corporation the transaction shall be presumed to be otherwise than at arm's length if either the manufacturer or the selling corporation owns more than 75 percent of the outstanding stock of the other, or if more than 75 percent of the outstanding stock of both corporations is owned by the same persons in substantially the same proportions. Sales by a manufacturer to a selling corporation shall in no other cases be presumed to be at arm's length. This provision shall apply to all taxes paid under this title after the date of its enactment."

Senator CONNALLY. The presumption would be in the case of 75 percent it would not be an arm's length transaction?

Mr. HARDWICK. I will put it this way: If there was 25 percent independent ownership and 75 percent common ownership, the presumption would be it is an arm's length transaction, rebuttable, of course, if the fact is otherwise. We have that all through our statutes. I have compiled a number of cognate provisions in other statutes where the same provisions were made in the case of associated or affiliated corporations.

Senator CONNALLY. Taxing provisions?

Mr. HARDWICK. Yes, sir. Usually the general rule is 20 percent; the general rule is if there is as much as 20 percent independent ownership the transactions were held to be at arm's length unless they could show in fact they were not. We have put our test a little higher. I have cited about a dozen statutes on that.

Senator CONNALLY. Is your amendment retroactive, or is it only to operate in the future?

Mr. HARDWICK. It is made retroactive to apply to all transactions pending, but if the committee does not think that is fair, it is not a

matter of particular importance; but I want the principle established and the yardstick put there so we will have no trouble in the future. As I say, 20 percent is the rule everywhere lese, but we will submit to 25; but where we have independent ownership in a concern like this which sells its product to a selling corporation——

Senator CONNALLY. Why not sell it themselves; why do they want a selling corporation?

Mr. HARDWICK. They had this selling corporation for 26 years before this law was passed. They have changed their method some, but they had it for 26 years before the statute was passed, and their purpose was not to avoid tax.

Senator CONNALLY. Why the utility of it?

Mr. HARDWICK. Because they can get advertising and make arrangements for distribution and secure drummers, if needed, more cheaply. The selling corporation is organized to produce business, and they can do it cheaper than the producing corporation can. It is just a question of brokerage. We sell our stuff at so much, fixed by contract, to the Lamont Collieries Co., headed by Col. Thomas W. Lamont, and they distribute that and other products which they buy from other corporations. They get cheaper rates than we can get. Generally they handle advertising and distributing costs much cheaper than we can do it, and we can get a better price than we could get by distributing ourselves.

We say, gentlemen, this third proposition is so patently right and so in accordance with every provision any Congress ever made on this subject it ought to be applied, and if the Treasury will not apply it without the statute being changed to require them to do it, then that should be done.

The CHAIRMAN. Do you have in your brief the suggested amendment?

Mr. HARDWICK. I have them separately, yes, sir; and I will hand them to the reporter and ask him to incorporate them as part of my remarks.

The CHAIRMAN. That may be done.

Mr. HARDWICK. I thank you for your attention, gentlemen.

The CHAIRMAN. Thank you, Senator.

(The brief and amendments attached thereto are as follows:)

MEMORANDUM BRIEF WITH RESPECT TO EXCISE TAX ON COSMETICS

THE ELIMINATION OR REDUCTION OF THE TAX

It is urged, as heretofore, that under present-day conditions cosmetics are properly classifiable as a necessity rather than a luxury, and that the excise tax on cosmetics generally should, therefore, be terminated.

If it be felt, nevertheless, that certain cosmetics, such as rouge, lipstick, and the like fall properly within the luxury class, it is urged that in any event the tax should be removed on cold creams and other cleansing creams which are strictly utilitarian and which have to do directly with the health and care of the skin. Everyone is familiar with the cleansing qualities of these creams and of the beneficial effect of cold cream, especially on a chapped or irritated skin. The taxes on jewelry, candy, and soft drinks have already been terminated. It is now proposed by the Ways and Means Committee to remove the tax on furs, chewing gum, sporting goods, toilet soaps, toothpaste, dentifrices, tooth and mouth washes and various other products. This it is estimated would eliminate about 40 percent of the revenue now raised under section 603 of title IV of the Manufacturers'

Excise Tax Act of 1932. The repeal of some of these taxes is recommended because they are imposed on articles in common use. Certainly, on the same reasoning, it is right and proper that the tax should be removed on cold and cleansing creams, which are so widely used as cleansing and healing agents and which are generally regarded as clear necessities. Their function is essentially medicinal.

If the excise tax on cold creams and other cleansing creams were removed, it is estimated the loss in revenue would amount to $1,200,000. Both as a matter of fairness, and as a matter of good business in the Government's own interest, we believe that the tax on these creams should be removed. At the very least, we urge that the tax thereon for 1938 should be substantially reduced, with the idea of canceling it entirely another year. If the tax on these creams were to be reduced only 50 percent and the 5 percent rate applied thereto, the resultant tax loss to the Government should not exceed $600,000. The encouragement to the cosmetic industry and the enhanced business activity in the industry, which such a reduction would bring about, would, by reducing unemployment and expanding business in the cosmetic field, result in gains which would far outweigh the small revenue loss involved. It would relieve also the millions of people to whom the use of cold or other cleansing creams is just as much a daily habit and necessity as is the use of soap.

THE RIGHT OF APPEAL TO THE BOARD OF TAX APPEALS

This question has already been before the Congress and received its serious consideration. There is pending at the present time House bill No. 244, Seventy-fifth Congress, first session, introduced by Mr. Vinson of Georgia, the purpose of which is to allow appeals to be taken in proper instances to the Board of Tax Appeals from excise tax determinations. The justice of this is obvious. When the excise tax was originally adopted, it was assumed that the amounts involved would be relatively small and the tax of only temporary duration, and probably for these reasons no right of appeal from the determination of the Bureau was granted. As the situation has worked out in actual practice under existing conditions, there have been various deficiency assessments or proposed assessments, running into large amounts, at least one of which has been well over a million, and others of which approximate that amount. As the law stands, the taxpayer, in the case of such a deficiency claim by the Government, has no right of appeal whatever from the determination of the Treasury Department, but is forced to pay the tax (if intended he be able to do so) and then to sue the Government for a refund. There is no prior opportunity for the taxpayer's case to be heard by any impartial body. The Department is itself the plaintiff, the jury, and the judge.

In the interests of common fairness, and equally in the interests of the avoidance of litigation and the prompt determination of the tax indebtedness it is submitted that the principle of the Vinson bill should be incorporated in the tax law.

THE DEFINITION OF ARM'S-LENGTH TRANSACTIONS

The following amendment to section 619 of the Revenue Act of 1932 has been suggested:

"In the case of a sale by a manufacturer to a selling corporation the transaction shall be presumed to be otherwise than at arm's-length if either the manufacturer or the selling corporation owns more than 75 percent of the outstanding stock of the other, or if more than 75 percent of the outstanding stock of both corporations is owned by the same persons in substantially the same proportions. Sales by a manufacturer to a selling corporation shall in all other cases be presumed to be at arm's length. This provision shall apply to all taxes paid under this title after the date of its enactment."

The purpose of this is to define on some practical basis the term "arm's-length" transaction, at least insofar as stockholdings are concerned. As matters now stand, neither the Government nor the taxpayer has any measuring rod by which accurately to determine whether a transaction is or is not at arm's length. It is in the interests of each of them that such a measuring rod be provided. It would help the taxpayer to know where he stands and it would save the Government and the taxpayer alike thousands of dollars in needless litigation expense.

Attached hereto is a compilation of various Revenue Statutes from which it is apparent that the usual percentage of interlocking ownership considered as neces-

sary to constitute an affiliation ranges from 80 percent to 95 percent. In view of these cognate provisions in other revenue acts, it is submitted that the foregoing proposed amendment to section 619 of the Revenue Act of 1932 is extremely liberal to the Government.

Respectfully submitted.

THOMAS W. HARDWICK.
ROYAL C. JOHNSON.
HAMEL, PARK & SAUNDERS.
BLAKE & VOORHEES.

JANUARY 1938.

COMPILATION OF VARIOUS REVENUE STATUTES

Act of 1921, section 202 (a) (3) * * *: For the purposes of this paragraph, a person is, or two or more persons are, "in control" of a corporation when owning at least 80 percent of the voting stock and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

Act of 1921, section 240 (c): For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (2) if substantially all the stock of two or more corporations is owned or controlled by the same interests.

Act of 1924, section 203 (i): As used in this section the term "control" means the ownership of at least 80 percent of the voting stock and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

Act of 1924, section 240 (c): For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns at least 95 percent of the voting stock of the other or others, or (2) if at least 95 percent of the voting stock of two or more corporations is owned by the same interest. A corporation organized under the China Trade Act, 1922, shall not be deemed to be affiliated with any other corporation within the meaning of this section.

Act of 1924, title VI, excise taxes, section 601 (a): If any person who manufactures, produces, or imports any article enumerated in section 600, sells or leases such article to a corporation affiliated with such person within the meaning of section 240 of this act, at less than the fair market price obtainable therefor, the tax thereon shall be computed on the basis of the price at which such article is sold or leased by such affiliated corporation.

Act of 1926, section 203 (i): As used in this section the term "control" means the ownership of at least 80 percent of the voting stock and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

Act of 1926, section 240 (d): For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns at least 95 percent of the stock of the other or others, or (2) if at least 95 percent of the stock of two or more corporations is owned by the same interests. As used in this subdivision the term "stock" does not include nonvoting stock which is limited and preferred as to dividends. This subdivision shall be applicable to the determination of affiliation for the taxable year 1926 and each taxable year thereafter.

Act of 1926, section 601 (a): If any person who manufactures, produces, or imports any article enumerated in section 600, sells or leases such article to a corporation affiliated with such person within the meaning of section 240 of this act, at less than the fair market price obtainable therefor, the tax thereon shall be computed on the basis of the price at which such article is sold or leased by such affiliated corporation.

Act of 1928, section 112 (j), definition of control: As used in this section the term "control" means the ownership of at least 80 percent of the voting stock and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

Acts of 1928, and 1932, section 141 (d), definition of "affiliated group": As used in this section an "affiliated group" means one or more chains of corporations connected through stock ownership with a common parent corporation if—

(1) At least 95 percent of the stock of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations; and

(2) The common parent corporation owns directly at least 95 percent of the stock of at least one of the other corporations.

As used in this subsection the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

I

Amend section 701 of the House bill, page 299, line 6, by inserting after the word "soaps" in said line the following: "cold and other cleansing creams."

II

Amend the House bill at page 304, end of line 2, by inserting a new section to read as follows:

"Sec. 705 (A). From and after the passage of this act, deficiencies in respect of taxes imposed by section 603 of title IV of the Revenue Act of 1932, as amended, shall be assessed, collected, and paid in the same manner and subject, insofar as applicable to the same provisions of law as deficiencies in respect of taxes imposed by title I of the Revenue Act of 1936."

III

Amend the House bill by inserting at page 305, end of line 24, a new section to be known as section 709 (A) and to read as follows:

"Section 619 of the Revenue Act of 1932 is amended as follows:

"In the case of a sale by a manufacturer to a selling corporation the transaction shall be presumed to be otherwise than at arm's length if either the manufacturer or the selling corporation owns more than 75 percent of the outstanding stock of the other, or if more than 75 percent of the outstanding stock of both corporations is owned by the same persons in substantially the same proportions. Sales by a manufacturer to a selling corporation shall in all other cases be presumed to be at arm's length. This provision shall apply to all taxes paid under this title after the date of its enactment.")

The Chairman. The next witness will be Prof. Fred R. Fairchild, of New Haven, Conn., representing the Manufacturers Association of Connecticut.

STATEMENT OF FRED R. FAIRCHILD, NEW HAVEN, CONN., REPRESENTING THE CONNECTICUT MANUFACTURERS ASSOCIATION

Mr. Fairchild. Mr. Chairman and gentlemen of the committee, I have just returned from a 4-day trip occasioned by the death of a member of my family, which explains my failure to be here on Saturday and also my failure to have prepared a formal statement for you, and I shall therefore have to speak somewhat extemporaneously. I want to express my appreciation of your allowing me to transpose the appointment to today, and I shall be very brief, indeed.

I represent the Manufacturers' Association of Connecticut. Connecticut is a small State, but it is an important State industrially, a State of small manufacturing concerns rather than huge enterprises, and yet, altogether, representing a very substantial part of the total manufacturing industry of this country. Connecticut contributes, I believe, close to 2.7 percent of the total Federal taxes based on income.

I may say that my representation of this association does not in any way restrict my freedom to express my own personal convictions as to what is good for industry generally and the country as a whole.

I am not a practitioner and will not deal in technical details such as you have heard from many other witnesses more competent than I to discuss them. I prefer to talk in terms of general principals on certain outstanding features of the tax problem which you are facing.

First of all I want to express my commendation of the spirit and motives which apparently have been at the basis of the consideration of this bill in the Ways and Means Committee and in the House of Representatives, a spirit and motive which I am sure also actuate this committee.

It is very evident that back of this measure there lies the desire to improve the tax system, to make it one that is more defensible as a permanent system, and one less adverse in its effects upon industry. With that spirit, of course, I am heartily in agreement, and the points I have to make have to do with the further carrying out of that principle in certain respects.

First, as to the undistributed earnings tax, I am sure that very few friends of that tax are now advocating its retention. I commend the action already taken in removing from the present bill almost all of the abuses of that particular tax, and I am only going to suggest you go the whole way and leave nothing in the bill which will continue even the principle of the tax on undistributed earnings of corporations. I do not need to go into the arguments about that——

The CHAIRMAN. Of course you do not mean 102.

Mr. FAIRCHILD. Certainly not.

The CHAIRMAN. You mean the 16–20 section?

Mr. FAIRCHILD. Yes; in which there is a rate of 20 percent which may be reduced to 16, based on the amount of earnings distributed in dividends.

The effect of a change in the bill removing this particular tax would have an effect upon industry far out of proportion to the small loss in revenue. I have heard a previous witness describe its effect as being psychological, and I think that is correct. The removal of the entire principle of the undistributed-profits tax would be an evidence of the desire of Congress to treat business with fairness and with some forbearance. It would lead the investors and the leaders of American business to believe that not only have they obtained relief from this pernicious principle of the tax on undistributed income, but also that in the future they may expect their industry to be treated with corresponding fairness and consideration. It would result in the general improvement of conditions because it would give to the investor confidence and therefore result in the expansion of business, and the encouragement to the businessman would not only help industry but would have a most beneficial effect upon the Federal revenues.

I should like also to suggest, if that should prove possible, the removal of the excise-profits tax. I realize that is asking a good deal; nevertheless, I think it is something worthy of your consideration, substituting such flat rate on income of corporations as would make good the corresponding loss of revenue. I find that my friends in industry are not crying so much about the total burden of taxation; I think we all realize the expenses of this National Government of ours are going to be very heavy in the next few years, that there is no escape, and we realize correspondingly heavy burdens of taxation must be endured with such grace as may be possible. I think industry is in that frame of mind. What we do hope may be granted is some considerable degree of relief from the uncertainties, guesswork, and speculation as to what our tax burdens may be, and here something would be accomplished by removal of this tax.

Senator CONNALLY. You mean if the businessman has a flat rate he would know in advance, like he does his labor costs, and can figure that?

Mr. FAIRCHILD. Yes, sir.

Senator CONNALLY. And as long as he depends on the revenue as to what he distributes, there is an element of uncertainty that deters business activity; is that what you mean?

Mr. FAIRCHILD. Precisely.

If complete repeal of the excess-profits tax is not feasible——

The CHAIRMAN. You are talking about the excess-profits tax?

Mr. FAIRCHILD. Yes, sir.

The CHAIRMAN. Not the undistributed-profits tax?

Mr. FAIRCHILD. I am talking about excess-profits tax combined with capital-stock tax.

The CHAIRMAN. I see.

Mr. FAIRCHILD. The bill already permits a 3-year readjustment of the basis of the capital-stock tax, and permission to use a 3-year average of the excess profits tax would fit nicely into that provision and somewhat ease the uncertainty of the burden. Also, a matter of minor detail, I would suggest you consider the feasibility of basing the capital stock valuation definitely on the value of the net worth of the corporation, based upon its book value in place of the complete freedom which the taxpayer now has to base it. Of course that is now all tied up with adjustment of the excess-profits tax, and if that tax were removed, it would remove another uncertainty. Changes made from year to year should be only on account of actual additions to the capital invested and not based on the present statutory definitions.

Now I would like to say a word about the treatment of capital gains and losses. I have personally been on record for many years as in opposition to the whole idea of the treatment of capital gains and losses as equivalent to income or loss, from an income point of view. I realize it is probably quite out of the question to ask the whole thing be swept away, which I believe would be sound fundamentally, because in my opinion the increase in value of capital assets is not income and the decline in value is not a loss to be deducted from income. However, if this were entirely swept away the effect upon the revenues of the Federal Government, I think, would have been very slight over the past 10 or 20 years, provided, mind you, that the original fairness of treatment, in which losses were completely offset against gains, had been allowed to continue. As a matter of fact, we have whittled away at the permission to deduct losses until now it has been very much reduced. So it is perfectly true that, as the law now stands, doing away entirely with the treatment of capital gains and losses as taxable income would result in a loss of revenue. But the present treatment, I think, on its face, is unjust and unfair. The taxpayer has to pay a tax on the capital gains but is not allowed a corresponding deduction for capital losses. To remove this provision entirely would restore even-handed justice and would have an effect upon industry and taxpayers generally which would far outweigh the loss of revenue, because that would mean that Congress is apparently determined to treat the taxpayer with fairness and to permit his taxable net income to agree more directly with his true income, out of which alone he can pay dividends and share profits. It would be a measure of fair and equitable treatment which would result in a corresponding stimulus to business activity and would bring in additional revenue sufficient to compensate for any loss of revenue which, on the face of the thing, might be

occasioned. So I would suggest that capital losses be allowed completely against capital gains and that the carry-over be allowed for 3 or 4 or 5 years, and that we go back to the flat rate of tax, regardless of the time held, at least over 1 year, instead of the very complicated graduation according to the time held as in the existing statute, and the still more complicated arrangement in the bill before you.

Another feature of this bill in need of revision as it first appeared was the special tax upon closely held corporations, which has come to be known as the third basket. I realize that is out of the present bill, and I sincerely hope this committee may feel no inclination to return to the bill the third basket. In support of that, let me express my feeling that a very great deal in our American prosperity depends upon just this group of taxpayers who are affected by this so-called third basket tax. They are the comparatively small companies, companies closely held, family businesses, and even though they may rise to fairly large amounts representing the holdings of an individual, they are small compared to the great corporations which engage in industry. These are the men whose foresight and daring spirit are largely responsible for the progress and improvement of business, for the development of new lines and the pushing ahead of industry, in new and untried fields. It is that sort of thing which has made this Nation a great industrial nation. It is true some of those men make fortunes and it is also true some suffer grievous losses. I do not think that this American Nation can afford any sort of tax system which seems to deal unjustly with those businessmen, or which puts discouragement in their path, for, after all, if the gains are to be heavily taxed and the losses are to be completely borne, the chances of going out in venturesome, hazardous, and untried lines of industry may not look so good.

One technical matter of administration I should like to mention. The Connecticut manufacturers, at least, would appreciate very much the possibility of delaying the date of the filing of their return to as late as May 1. These business companies are getting to be more and more loaded down with taxation and other reports to the Federal Government and to their State and to other States in which they do business, and the actual physical task of preparing this voluminous body of reports by March 15 is getting to be a tremendous one. A postponement of that date would be a very great relief.

Now may I conclude with a few words of general principle? The Treasury Department experts, and Congressional experts also, have given us voluminous estimates of the changes in revenue which might be expected to come from particular changes in tax statutes, and these estimates have been skillfully worked out by experts, and of course are of the greatest value to us all and to you gentlemen, especially. But I think we need to be on our guard against false interpretations which proceed from the assumption that while changes are made in the tax rates the tax base itself will remain unchanged. The point I would like to bring to your attention is that these changes in the tax law will in themselves have an effect upon the tax base. I have already mentioned the encouragement that would

be given to business and investors by certain changes which would insure a greater spirit of fairness, tolerance, consideration, and removal of punitive features of the tax. To calculate the effect of that on the revenue requires that you make some sort of estimate as to how this may change the amount of industry. If, as I believe is true, changes of this sort are going to encourage industry and stimulate capital investment, the lower tax rate may very likely produce a higher revenue than the higher rate which is the alternative. If by means of expansion of the base you thus increase your revenue sufficiently to offset the apparent loss from a more lenient tax system, remember that you also reduce expenditures, because one of our great expenditures is now, and is destined to be, unemployment relief. The most beneficial thing you can do to help the Government to approach a balancing of its Budget is to remove this heavy burden, or reduce it, in connection with unemployment relief and reduce that heavy expenditure by getting men back into industry.

I am not one of those who believes the present depression is solely due to taxation or Government finance as a whole, but I do agree with many others that taxation at this present moment is a very important factor. If by a more lenient and more fair tax attitude Congress can give notice to the public that fairness is to prevail and industry is not going to be compelled to face, in addition to all the normal hazards of industry, a hazard of uncertain and punitive taxation, I feel confident that courage and hope will be brought back to investors and business men and that the wheels of industry may start revolving more rapidly and one more block preventing the restoration of industrial recovery may be removed.

I have no estimate in dollars and cents as to what those effects may be, but I think where we are dealing with a Budget that is definitely unbalanced already by a huge sum, the balancing of which Budget does not seem to be promised by anyone in the near future, and with expenditures in terms of billions for unemployment relief, and deficits in terms of billions, Congress can very well afford to gamble a little bit on this beneficial effect of a more lenient and more fair taxation system in the hope it will tend to solve our financial troubles by giving us more revenue and reducing the cost of the Government, especially for unemployment relief.

The CHAIRMAN. Have you anything else to say?

Mr. FAIRCHILD. That is all.

The CHAIRMAN. How long have you been a professor at Yale?

Mr. FAIRCHILD. Since 1913. Before that I was assistant professor and instructor.

The CHAIRMAN. We are very much obliged to you for coming down.

Mr. FAIRCHILD. I appreciate your courtesy.

The CHAIRMAN. Mr. Mollin, representing the American National Livestock Association.

Have you a brief, Mr. Mollin?

Mr. MOLLIN. No; I have not. My remarks will be very brief.

The CHAIRMAN. Very well.

STATEMENT OF F. E. MOLLIN, DENVER, COLO., REPRESENTING THE AMERICAN NATIONAL LIVESTOCK ASSOCIATION

Mr. MOLLIN. The American National Livestock Association represents the cattle growers of the western part of the United States. We have about 130 local, regional and State associations affiliated with us, with our membership in Louisiana and the 17 States west of the Missouri River.

Before I start on my remarks I want to read a telegram which I received from the Central Cooperative Association of St. Paul, Minn.

F. E. MOLLIN,
Raleigh Hotel, Pennsylvania Avenue at Twelfth Street:

Central Cooperation Association is very much interested in retention of excise tax of 6 cents per pound on imported pork products and 3 cents on pork joints in internal revenue bill as passed by House. You can make this statement before Senate Finance Committee for us if you desire.

I want to urge the retention of that excise tax on pork products and the adding to the bill of the excise tax of 3 cents on canned beef. Pork is the principal competitor of beef, and 3¼ cents rate in the present tax structure is inadequate to give protection to the American industry. The imports of canned beef——

Senator CONNALLY. Is it your theory that the tariff rates on importations of ham have a tendency to stimulate increased importations of canned beef?

Mr. MOLLIN. I think anything we do to help the pork industry is of interest to the beef producers because we cannot expect to prosper when they are in the dumps. There has been a rapid increase in the imports of canned ham and the imports of canned beef has been such that there is no canned beef produced in this country today.

The CHAIRMAN. Why not?

Mr. MOLLIN. They cannot compete with South America, despite the 6-cent tax. You can walk into any market in the United States and ask for American canned beef and you will fail to find it. There is the one little packer in the Northwest who cans some beef, and some large packers supplied some for the C. C. C. camps.

The CHAIRMAN. I cannot understand that.

Mr. MOLLIN. A year or so ago we tried to get an independent packer in the Middle West who puts out a big line of canned products to can beef, but he investigated it and said he had contemplated trying to do it but found he could not compete. In the first place they have so sharply reduced the importations of Argentine beef into England that they have a surplus they must do something with. They cannot get the cattle into this country because of the sanitary embargo, and therefore they put it in the can and price is not much of an object. I found there was about a 2½-cent differential on landed cost of the South American canned beef after paying our tariff, it is 2½ cents below the American cost. We believe an excise tax of 3 cents would help balance that situation. I think the South American canned beef might still undersell the American product, but I know many people would pay more for American canned beef, but it is not there to buy. We do not expect it would shut out the imports. I know when the Tariff Act was written in 1930 they told us if we raised the tariff from 20 percent ad valorem, as in the old bill, to 6 cents straight duty, there would not be a pound of canned beef coming into this

country, but we received, in the last full year prior to that tariff bill, about 90,000,000 pounds of canned beef, and in the year 1926, 87,000,000 and in 1937, 88,000,000 pounds. So we are right back with the 6-cent duty, to the level that existed prior to the Tariff Act of 1930.

The CHAIRMAN. How have prices of beef fluctuated since that time?

Mr. MOLLIN. There have been violent fluctuations. We had very high-priced cattle last fall. That was not due to shortage of cattle but to shortage of feed; we had the drought.

The CHAIRMAN. The prices I have here, since we put this 6 cents on—and some of us followed the leadership of Senator Connally on that proposition—in 1934, it was 3.88; in 1935, 6.5; in 1936, 6; 1937, the average price was practically 7 cents a pound.

Mr. MOLLIN. That is the farm price.

The CHAIRMAN. The average farm price of beef cattle.

Mr. MOLLIN. Yes, sir. So far this year the feeders of cattle in chief have lost millions of dollars. In the North Platte Valley of Nebraska it was estmated the feeders' loss in one county alone will be $3,000,000. They bought these cattle last fall on the basis of the high prices, and the market slipped away and they are taking terrific losses throughout the country on these fed cattle.

If you reduce these 1937 imports of canned beef into a basis of 750-pound cows, it is the equivalent of 652,000 cows that came over in cans in 1937. The rate on a thousand-pound steer is 3 cents—under the Canadian agreement it is reduced to 2 cents, or $20. The dressed weight would be 500 pounds. That is a low dressing percentage, but on the 6-cent rate on dressed beef, it would be $30. Reducing that product to canned beef, figuring 225 pounds, and I think that is fair on that type of animal, at the rate of 6 cents you have a duty of $13.50. If you had a double duty, including the excise tax of 3 cents, making 9 cents, it would put it to $20.25, which would balance with the reduced duty under the Canadian agreement and still be far below the present duty on dressed beef.

The CHAIRMAN. You are advocating retention of the excise tax on pork?

Mr. MOLLIN. We are especially interested——

The CHAIRMAN. Are you advocating on canned beef——

Mr. MOLLIN. Three cents; yes, sir.

The CHAIRMAN. You are advocating that in this bill, too?

Mr. MOLLIN. Yes, sir.

I would like to call your attention to the fact that while I stated there was no canned beef available in America, we have tremendous facilities for canning beef. In the drought purchase program, which Senator Connally knows all about because he took such a great part in it, they canned 800,000,000 pounds of American beef in 1934 and distributed it in relief. It saved the cattlemen and yet furnished the United States Government a tremendous amount of cheap meat. So we have the facilities. If we had a little more protection so as to be able to put those facilities to work—if you got in 60,000,000 pounds at 9 cents you would get just as much revenue as if you got in 90,000,000 pounds at 6 cents, and yet you would provide a chance for American canners to produce the beef and for those who want American canned beef to buy it.

Senator HERRING. You are interested in the excise tax on beef?

Mr. MOLLIN. Yes, sir, and also the retention of the tax on pork, because we are closely related to pork.

Senator CONNALLY. You want to superimpose a 3-cent excise tax on the existing tax?

Mr. MOLLIN. Yes, sir. I gave an illustration of the maladjustment of the rates on the live animal, the dressed beef and canned beef. On the pork side, nobody thought much about importing pork when they wrote the tariff bill in 1930; I suppose you could have had a 6-cent duty, but they put it at 3¼, as we were exporting hundreds of millions of pounds——

Senator HERRING. We still are.

Mr. MOLLIN. For several months we have been on an import basis, but we probably will go back on the export——

Senator HERRING. We exported four times as much as we imported.

Mr. MOLLIN. But from 1890 to 1930, inclusive, we exported more than a billion pounds for every year except 5.

Now these people have established a market and found out the American people like it and I must give them credit for being good salesmen.

Senator HERRING. The high domestic price was largely responsible.

Mr. MOLLIN. It gave them an opening. They say over there—although I cannot vouch for the truth of the statement—you could put live hogs down to 6 cents a pound but they would still come in. I attended a meeting while this matter was under discussion——

Senator HERRING. You think there should be a differential in favor of beef?

Mr. MOLLIN. No; I think there should be an adjustment. Today your pork duty is three and a quarter and your beef is six. If you are going to put a 6-cent tax on pork you should put 3 cents more on beef.

Senator HERRING. As they have been?

Mr. MOLLIN. No; they are out of balance today, three and a quarter on pork and six on beef.

Senator HERRING. But if you bring the pork up to the beef would it not be on an even basis?

Mr. MOLLIN. You still would not have American canned beef in this market; they cannot compete.

The CHAIRMAN. Was there something else, Mr. Mollin?

Mr. MOLLIN. There is one more factor in this situation. The bulk of the South American beef is produced in plants owned by American packers and they are not very anxious to have a situation that will encourage independent packers to compete, and that has been a great drawback in this matter.

I would like to ask one question, Senator, if I may.

The CHAIRMAN. Yes.

Mr. MOLLIN. Are you considering processing taxes in this hearing?

The CHAIRMAN. I hope we are not. That is going to be up before the committee but I would not like to have you discuss it now. If the committee determines to consider the processing tax we are going to give an opportunity to be heard to different people who are opposed to it.

Mr. MOLLIN. Thank you.

The CHAIRMAN. The committee will recess until 2 o'clock and resume the hearing in the District of Columbia Committee room.

(Whereupon, at 12:15 p. m. the hearing was recessed until 2 p. m.)

AFTER RECESS

(The committee reassembled at 2 p. m., pursuant to recess.)
The CHAIRMAN. The committee will be in order.
The first witness this afternoon is Mr. A. Harding Paul.

STATEMENT OF A. HARDING PAUL, WASHINGTON, D. C.

The CHAIRMAN. Have you a brief there, Mr. Paul?
Mr. PAUL. I have.
The CHAIRMAN. I wish you would file it and take about 10 minutes. We have a host of witnesses this afternoon, so the quicker everybody can get through, and the more concise you can be in your remarks, the sooner we can complete the hearing.
Mr. PAUL. Thank you, Mr. Chairman. I shall be brief.
My name is A. Harding Paul. I am an attorney of Washington, D. C., and I appear here to discuss a serious situation confronting personal holding companies, a situation which to my mind not only affects such companies but also business in general.
The only present, complete record available to the public having reference to personal holding companies is the Statistics of Income of the Treasury of 1934, Part 2. At page 43 of such statistics the net income of all personal holding companies filing returns for 1934, some 4,457 in number, is shown to be $170,989,000, and on the same page the dividends and debt retirements of such corporations, the latter being still permitted as deductions and therefore apparently not subject to criticism, total $190,060,000, divided as follows: Dividends, $156,073,000; debt retirements, $33,987,000.
In other words, dividends of approximately $19,000,000 more than net income reduced by debt retirements of all personal holding companies were paid to the stockholders of such companies in 1934. There would thus appear to have been no tax avoidance in the aggregate in 1934 by personal holding companies. 1934 was the first year that Congress separately defined these companies in section 351, and there is no earlier public data. Because the Treasury's Statistics of Income have not been published for years subsequent to 1934 there are no later statistics concerning such companies as a group available for public scrutiny at the present time.
But in the tax evasion and avoidance hearings conducted last year, Commissioner of Internal Revenue, Hon. Guy T. Helvering, indicated that up until April 30, 1937, 4,516 returns of such companies had been filed for 1936, and that an analysis of certain of the companies selected at random revealed for the whole group a tax savings by means of the various personal holding companies deductions allowed of $9,237,000. (Record of hearings, p. 175.) Particular attention is invited to exhibit D, record of hearings, page 184, introduced into the hearings by Commissioner Helvering and describing which, the Commissioner said: (record, p. 176):

> Exhibit D is a composite of the information shown on exhibits A, B, and C with respect to 80 cases. These 80 cases were selected at random from the group shown on the other exhibits.

This exhibit D shows a net income for the 80 companies of $33,548,690 or an average of $419,358 per company. Assuming that the 80 companies were truly representative of the entire group of 4,516

personal holding companies, the total income of all during 1936 was $1,892,204,000 and on a 5-percent yield basis, which would be normal, the total assets of such companies would have been $37,880,414,560.

Commissioner Helvering pointed out that the count of 4,516 did not represent all the personal holding companies which would file returns for 1936 and, of course, this number did not include a large number of foreign personal holding companies which were in existence.

At the outset and to avoid any misunderstanding, I want to make it clear that it is not my contention that the Revenue Act of 1937 locked up $37,000,000,000 of assets in personal holding companies. What I do say is that if the Treasury was justified in estimating on the basis of the cases submitted to the Tax Evasion and Avoidance Committee, that all personal holding companies avoided income taxes to their stockholders during 1936 of less than $10,000,000, due to deductions not permitted to individuals, then this committee is equally justified in assuming that there were approximately $37,000,000,000 of assets owned by such companies. It is my own view based upon the analysis of their net income for 1934 and after making certain allowances for deductions which were undoubtedly taken in arriving at such net income, and also for increases in income from 1934 to 1936, that all personal holding companies at the time of the passage of the Revenue Act of 1937 possessed assets worth from $4,000,000,000 to $6,000,000,000.

If it is true that such revenue act froze these assets so that capital transactions involving capital gains are no longer reasonably feasible, as was pointed out to you by Mr. Clinton Davidson in his presentation before this committee Friday, then in my judgment, the passage of the Revenue Act of 1937 was one of the primary causes of the depression in the stock market with its consequent effect on values and business generally. Certainly, after the passage of such act personal holding companies could not make investments with the hope of gain. This sudden withdrawal of such a large segment of the total buying power of the Nation could have but one normal reaction—persons and corporations willing to sell tended to exceed those desiring to buy. Whenever such a condition confronts any market it sells off.

To illustrate what happened, I desire to call your attention to a chart of the Dow-Jones industrial averages, reflective of the action of leading stocks traded in on the New York Stock Exchange at the time the proposed Revenue Act of 1937 first saw the light of day. It is, of course, a matter of record that the bill was introduced in Congress on Friday, August 13, 1937. As you can see from the chart prior to the introduction of this bill the market was following an upward course and on Saturday, August 14, it reached the high of the movement of 190.38 as indicated by the Dow-Jones averages. After only a week end of consideration the House of Representatives passed on Monday, with 1 hour's debate, the proposed act and on that very day, August 16, the market turned down in what was to develop into one of the sharpest declines in the history of the stock exchange. A low point in the Dow-Jones averages was reached on October 19 of 115.83—this was a decline of 75 points within less than 3 months. These averages closed Saturday at 120.43.

I do not want this record to indicate that it is my opinion that the introduction of the Revenue Act of 1937 and its subsequent enactment

into law was the sole cause of the stock-market decline, but I strongly believe it was a vital contributing cause. I am not alone in this belief.

On August 1, 1937, the market value of all stocks listed on the New York Stock Exchange was $59,393,000,000; on January 1 of this year the market value of such stocks was $38,869,000,000.

I feel certain that if this committee and Congress believed that a complete repeal of the Revenue Act of 1937 would as quickly restore the $20,000,000,000 of lost purchasing power which followed its enactment, it would immediately repeal that act in its entirety. Nevertheless, insofar as it contains provisions to stop tax avoidance, the Revenue Act of 1937 is good, but insofar as it tends to prevent capital transactions and investment for profit by personal holding companies and their stockholders, it is unquestionably bad. When it is also remembered that the owners of personal holding companies were not law breakers, but many formed these companies for the sole purpose of coming within the privileges of a law enacted by Congress (Revenue Act of 1934), it seems particularly harsh to retroactively punish them with the highest surtaxes in the history of the country. To unfreeze this situation, it is recommended that one or more of the following suggestions be acted upon:

1. That the 1937 act be amended so as to permit personal holding companies to file partnership returns. No loss in revenue from an amount which would be collectible if the stockholders individually owned the assets of the personal holding company would result. On the contrary, because the corporation would still be required to pay capital stock and excess profits taxes to the Treasury, there would be more taxes paid by individuals operating under the aegis of a personal holding company than as a partnership or individually. Canada, in effect, requires such a treatment of its personal investment companies. Furthermore, there can be no proper objections to such a plan on the ground of administrative difficulties or constitutional limitations since the corporation could be made primarily liable for the taxes in case the stockholders failed to pick up their proper pro rata share of the corporation's income.

2. The second alternative suggestion is that personal holding companies, or for that matter, all corporations, be permitted to obtain the benefit of the capital gains rates of tax applicable to individuals upon realization of capital gains. This procedure would also result in no loss of revenue from the amount which would be collectible from the individual stockholders if there were no corporation and such stockholders owned the assets collectively. On the contrary, it would require such stockholders to pay normal taxes and surtaxes or a further capital-gains tax before they could get their share of such capital gains in cash, and of course, the corporation would still be liable for the capital stock and excess-profits tax.

It is believed either one of the above two steps will obtain more revenue for the Treasury than either of the two plans suggested below. Furthermore, adoption of either of the above suggestions would permit such personal holding companies as desire to continue, to do so, although at a tax disadvantage to individuals and partnerships. Because of this tax disadvantage, gradual liquidation of most of these companies could be expected to result, but in an orderly manner. It is also contended there is a misconception that all personal holding companies serve no useful purpose and should, therefore, be dissolved.

However, and because such misconception is prevalent, it is suggested that if it is the will of Congress that they do dissolve they should be permitted to do so in a reasonable manner.

Specifically, it is suggested they be permitted to be liquidated without the recognition of gain or loss, as recommended by the American Bar Association, or if it is believed that the Government should obtain some immediate revenue from their liquidation, that an excise tax of 5 percent be assessed upon the gain but without affecting the basis of the assets received upon liquidation in the hands of the stockholders upon future sales or exchanges.

This was the recommendation proposed by Mr. Davidson here Friday. Finally, if none of the foregoing are believed to be a feasible solution of the problem, then in the interest of fairness to the taxpayer, as well as the Government's own interest in the protection of our economy, it is suggested that a longer period of time for the liquidation of such corporations than is now possible should be provided for.

In partial recognition of the difficulties confronting the liquidation of many of these corporations, the House in the present bill proposes in section 56 (c) (2) to provide for an extension of time of 5 years in which to pay the tax which will be assessed upon the gain derived by the stockholder. This provision is entirely unsatisfactory since, in the first place, it imposes in many cases an inordinately high immediate tax liability and requires the stockholder to assume such debt without regard to whether or not upon the sale of the assets received in liquidation, the gains which are taxed can actually be realized during such 5-year period. Furthermore, the proposal suggests the necessity of furnishing a protective bond which increases the expense of the liquidation without benefit to either the Government or the taxpayer. On the other hand, if a period of 5 years in which to liquidate is granted, both the Government and the taxpayer will receive the benefit and assume the risks of increases or decreases in the value of the assets of the corporation during the period of liquidation. No objection to this extension of time for liquidation has been voiced except as to the possibility that the Treasury might lose a capital gain in the event some stockholder died. Protection to the Treasury with respect to this hazard can readily be provided in the statute by requiring that stockholders, their heirs, and assigns shall assume the payment of all income taxes due, as is done in the case of the death of a person who has entered into an installment sales contract.

FOREIGN PERSONAL HOLDING COMPANIES

Whatever is done to remedy the condition confronting domestic holding companies, the Congress can in any event certainly further the interests of the country by extending the time for the liquidation of foreign personal holding companies as defined in the Revenue Act of 1937. Except in special cases applicable to but few corporations such companies were only granted a period for liquidation at capital gains rates from the date of the enactment of the Revenue Act of 1937 on August 26th to December 31, 1937, slightly over 4 months. If liquidation was not accomplished by that time then 100 percent of the gain on a subsequent liquidation is to be recognized.

Due to many factors, among them, one, illness to stockholders; two, absence of stockholders from the country; three, impossibility of marketing a large block of securities in the swiftly declining market which followed upon the enactment of the Revenue Act, a great many

of these companies were unable to liquidate last year. Today they cannot liquidate without having their gains taxed, not at any capital gains rates, but at the extraordinarily high ordinary income-tax rates applicable to individuals. In the aggregate these companies possess large amounts of what is now immobile capital. Their plight is so serious that unless something constructive is done a great many law suits over the interpretation and constitutionality of the novel provisions contained in the Revenue Act of 1937, relating to them, will confront the Government, and more citizens may expatriate themselves to save their assets. To drive this capital permanently from the country is certainly not sound economics and will not increase the revenue. Extension of time to liquidate at capital gains rates will not only increase the revenues resulting from liquidation but will rehabilitate practically all of this capital into the hands of American citizens.

In conclusion, I can only urge that the Senators of this committee will not let the tax avoidance of a few personal holding companies persuade a policy of inaction, for without action it is as certain as taxes themselves that a tremendous amount of investment capital now tied up in foreign and domestic personal holding companies will remain frozen and that practically no revenues from their capital transactions will be received by the Treasury. If, on the other hand, effective action is taken at once, there is no doubt in my mind but that an immediate and substantial increase in the revenues derived from the capital gains of these corporations will result and that some contribution toward bettering the economic condition of the country will be accomplished.

Thank you for your courtesy in permitting me to appear before you.

(The chart referred to by Mr. Paul is on the following page.)

Senator VANDENBERG. How much of that 75-point decline is represented in total dollars?

Mr. PAUL. Around $20,000,000 from August 1 to January 1.

Senator CONNALLY. I would like to ask this witness a question, Mr. Chairman.

The CHAIRMAN. All right.

Senator CONNALLY. How about the personal holding companies, or foreign holding companies in the Bahamas?

Mr. PAUL. My plan is to give them a longer period of time to liquidate. The foreign holding companies ought to liquidate by December 31, 1938.

Senator CONNALLY. Yes.

Mr. PAUL. My reason for a longer period than was granted in the Revenue Act of 1937 is if the stockholders were not in this country or if they had too large a block of stock to dispose of it was impossible for them to liquidate by December 31, 1937.

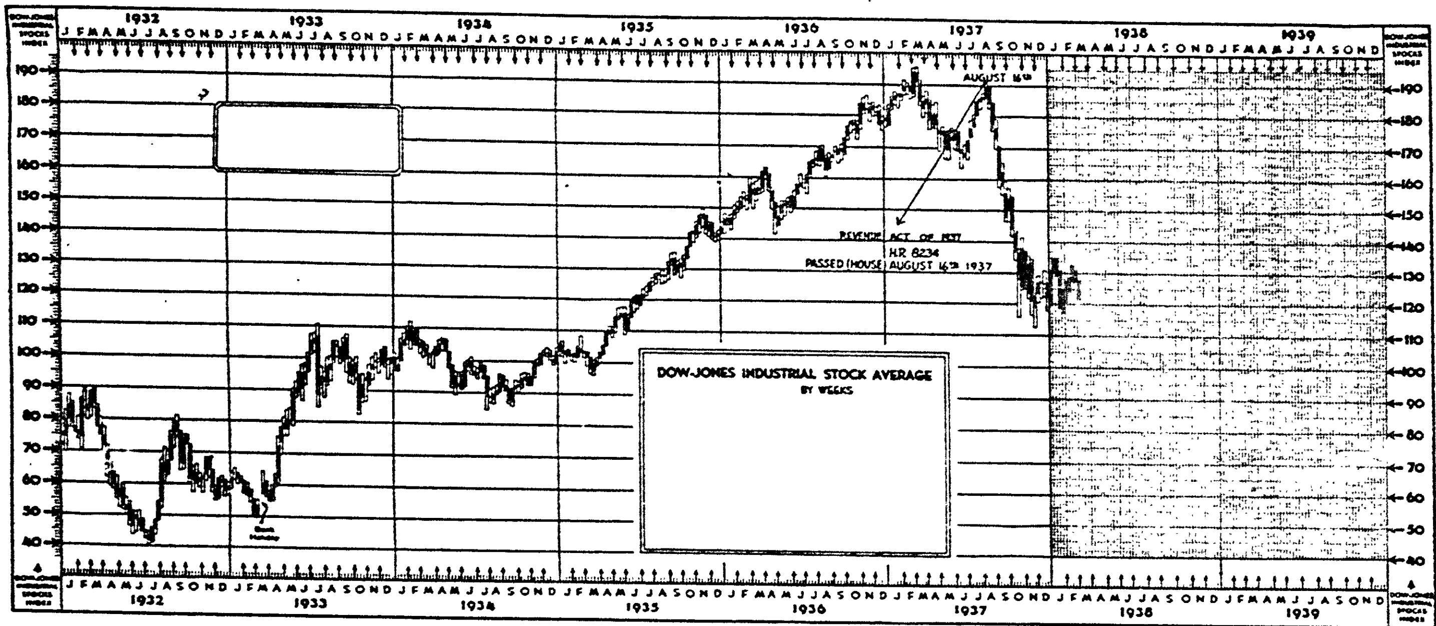
Senator CONNALLY. Under the present law what tax do they pay?

Mr. PAUL. A tax up to 80 percent.

Senator CONNALLY. You advocate putting them under capital gains?

Mr. PAUL. Yes; that is right. You understand that is only with reference to their gains. So far as their ordinary income is concerned I suggest they pay the regular rate.

Senator CONNALLY. How do you figure that?


DOW-JONES INDUSTRIAL STOCK AVERAGE
BY WEEKS
AUGUST 16th
REVENUE ACT OF 1937
H.R. 8234
PASSED (HOUSE) AUGUST 16th 1937
1932
1933
1934
1935
1936
1937
1938
1939

Mr. PAUL. Capital gains? That would be the difference between what their basis is for their stock and what they get out of it by liquidation. The difference between those two figures I recommend should be taxed as capital gain.

Senator CONNALLY. I assume you are a tax attorney?

Mr. PAUL. Yes, sir.

Senator CONNALLY. Whom do you represent?

Mr. PAUL. I am offering these as my own personal suggestions.

Senator CONNALLY. Thank you.

The CHAIRMAN. The next witness is Mr. Wilson Compton, of Washington, D. C., representing the National Lumber Manufacturers' Association.

STATEMENT OF WILSON COMPTON, REPRESENTING THE NATIONAL LUMBER MANUFACTURERS' ASSOCIATION, WASHINGTON, D. C.

The CHAIRMAN. Do you have a brief, Mr. Compton?

Mr. COMPTON. Yes; Mr. Chairman, I have a brief memorandum here, but I think I will conserve the time of the committee by simply filing it and making a few supplemental remarks.

The CHAIRMAN. Very well, proceed. Your time is limited to 10 minutes.

Mr. COMPTON. I have not a general matter to present, but a very special one, which is entirely in section 705 of the bill. They are the lumber items. They relate to a matter, which as you know heretofore has been quite controversial over a period of time, and the suggestions I wish to leave with you, are, I think, ones which if incorporated in the law, will make it possible hereafter to deal with this problem much more intelligently, with much less exaggeration and considerable less confusion than has heretofore been the rule.

May I call attention to the fact that the import taxes on lumber are in two parts. One of them in the Tariff Act of 1930 by statute, $1, another in the Revenue Act of 1932, $3, a total of $4, reduced by trade agreement, reciprocal trade agreement, to $2, which is the present status.

This refers only to the excise tax coming from the Revenue Act of 1932.

This amendment is in three parts. The first two I think I can accurately say are entirely noncontroversial. They relate to definitions. May I speak for a moment on them, Mr. Chairman?

The CHAIRMAN. Proceed.

Mr. COMPTON. The first one would define lumber. The reason for that is that in the Tariff Act of 1930 the tax was imposed on lumber and sawed timber. That language was used in the act of 1930. In the Revenue Act of 1932, the corresponding language was merely the word "lumber." The question therefore has arisen whether the term "lumber" does or does not include sawed timber. That is involved in the dispute and litigation. The industry, and I think the Treasury Department thinks there is no ground for dispute, but the dispute is there nevertheless. Sawed timber is lumber in large sizes. That is subsection A of section 705. The effect of that would be to make the word "lumber" for the purpose of the import excise tax mean the same as the words "lumber and sawed timber" in the tariff act.

The second one is also a matter of definition.

Senator BROWN. I do not see how you get this down to $2. Is it not still $3?

Mr. COMPTON. That has been reduced to $1.50 in the reciprocal trade agreement.

Senator BROWN. It is $1.50?

Mr. COMPTON. Adding 50 cents under the tariff act, a total of $2.

The next feature of this amendment relates to "board measures." In the tariff act of 1930 a definition of "board measure" was included. In the excise tax of 1932 that definition was not included. The result, therefore, has been further dispute and litigation over the question as to what "board measure" means, and the effect of this amendment would be "board measure" for the purposes of both tariff and excise taxes would mean the same thing and would mean exactly the same thing it means under the Tariff Act of 1930. That too, is noncontroversial, so far as I know, and I think I am correctly informed.

The second section of the amendment, which I think is subsection B, relates to the conditions under which the amendment if made will be effective. That language is a safeguard suggested, in fact requested by the State Department so that there be involved no possible conflict between the effect of these amendments, if made, and the present trade agreements undertaken with foreign countries. Obviously, the industry itself is anxious that that conflict be avoided, if there is any. The State Department is not sure there is a conflict. It only wants to be sure that if there is a conflict the amendments, if made, be not effective until they cease to be in conflict. Manifestly we are as much interested as the State Department because we are asking for concessions, and if it is indicated the existing agreement is not maintained, naturally the agreements under which we expect to be the beneficiary we cannot expect will be maintained.

Those two subsections A and B are noncontroversial.

Subsection C refers to excise taxes under the Revenue Act of 1932 and proposes certain exemptions from the excise tax.

Those exemptions are in four enumerated species, northern white pine, Norway pine, western white spruce and Engelmann's spruce.

As to the first three, the industry as a whole has no objection. By the industry as a whole I mean the entire group for which I am authorized to speak here, the associations in the lumber industry affiliated with the National Lumber Manufacturers' Association, with the exception of the Northeastern Lumber Manufacturers' Association, which has had its separate representative before this committee. The 14 associations for which I speak, support the policy which I have mentioned, which is that they do not ask for, but they do not object to the exemption of these species, the first three. They do object to the inclusion in the exemption of the Engelmann's spruce.

Now, you may ask why they decline to object to exemptions on three species and object to the fourth. The reason is this, and I think particularly on this point there is an opportunity on the part of Congress to deal with this controversial tariff matter in a manner which will further reduce the likelihood of controversy. The principle back of that is the majority of groups in our industry are not disposed to further ask tariff protection on species which collectively they regard as scarce, or which are in fact commercially nonexistent in this country.

They are equally anxious, so far as they are able to do so, to secure the maintenance of a reasonable protection for those woods, which are not generally present and no prospective surplus supply in this country. Northern white pine, Norway pine, and western white spruce, they specifically regard as in the classification of scarce species or commercially nonexistent species for which there is a substantial consumer demand in this country, and for which the American supplies are regarded as scarce.

Engelmann's spruce, on the other hand, is a distinctly surplus species in this country. I doubt whether many members of this committee, unless they are familiar with the lumber industry, ever heard of Engelmann's spruce. It is not an important species, but it is important for this purpose. The domestic supply of virgin timber of Engelmann's spruce is several hundred times the annual production. There is not any present or prospective possibility of there being a shortage of Engelmann's spruce.

Senator TOWNSEND. In what section of the country is it being grown principally?

Mr. COMPTON. Engelmann's spruce is grown almost entirely in the Rocky Mountain area. It is in seven or eight Rocky Mountain States, principally in Montana, Idaho, and from there on south.

The CHAIRMAN. What is the average annual importation of Engelmann's spruce?

Mr. COMPTON. Of Engelmann's spruce?

The CHAIRMAN. Yes.

Mr. COMPTON. The official statistics do not divide it so that I can answer that with absolute accuracy. The best information we are able to secure is that the imports are somewhere around 40 million feet of Engelmann's spruce, 40 or possibly 50 million.

The CHAIRMAN. What is the production in this country?

Mr. COMPTON. The production is about equivalent to that.

The CHAIRMAN. To what?

Mr. COMPTON. The production is about equivalent to 40 million feet.

The CHAIRMAN. So we are importing about the same amount as we produce in this country?

Mr. COMPTON. Yes, sir.

The CHAIRMAN. Our consumption then is about 80 million?

Mr. COMPTON. Yes; but the capacity to produce is not that limited.

The CHAIRMAN. Is that due to the fact, Mr. Compton, that this particular species of wood is grown in the Rocky Mountain section and that that they import from Canada is along the border line of the United States elsewhere where the freight rate is so high that they cannot get it from these places where it is produced in the United States?

Mr. COMPTON. No; I think quite the contrary. The freight rates would be greater on the imported product. I assume the committee does not wish to get into the whole controversial issue of the lumber tariff.

The CHAIRMAN. I am sorry that any of it is here.

Mr. COMPTON. It ought to be said in all frankness the industry is responsible for bringing before the Ways and Means Committee these first two subsections, but is not responsible for bringing before the

Ways and Means Committee the third subsection which, if enacted, would have the effect of some exemptions from the import excise taxes, but that having been brought to the attention of the Ways and Means Committee, we did state here exactly what I have stated here, that we did not object; Mr. Barr also made that statement. We have no objection to that.

The Ways and Means Committee approved of that and so reported it, but on the floor of the House, an amendment was adopted by a small vote to include Engelmann's spruce in the exempted species, which raised an entirely different question, a question of entirely different character, and does raise fundamentally the whole question of protective taxes on lumber imports.

Now, frankly, one thing as an industry we are interested in and that is a thing to which I have given a good deal of time in recent years to try to find some basic policy by which the handling of the tariff matter in the lumber industry could be made much more intelligent with much less controversy and that has been found, to the extent it has been found at all by the approval of 14 organizations in this industry of the policy which I mentioned, namely—but I will read it exactly. This is taken from the language which was given to the State Department on the Reciprocal Trade Agreement with Canada somewhat less than 3 years ago. This language is exact, so it is not merely opinion:

> With respect to species of lumber relatively scarce or commercially non-existent in the United States, that is, northern white pine, Norway pine and western white spruce, that the import duties and taxes be reduced to the extent which the law permits.

That language was applicable because the law only permits the reciprocal trade agreement agencies to reduce the tariff by one-half.

Also, that the National Lumber Manufacturers Association asked, and this is again quoted:

> Reasonable and effective protective tariff be maintained on imported lumber of species in surplus supply in the United States, and on imported lumber directly supplanting lumber of species in surplus supply in the United States.

Now, this brief which I will leave with you frankly states that there is a strong dissent from that stand by the Northeastern Lumber Manufacturers Association.

Senator VANDENBERG. Are they more exposed than the rest of these associations?

Mr. COMPTON. Well, they are more than some and not more than some others.

The CHAIRMAN. Do you discuss in your brief the difference between this Engelmann's spruce and the western white spruce?

Mr. COMPTON. I do.

The CHAIRMAN. I will not ask about it if you have discussed it, because it was stated before the Ways and Means Committee and on the floor of the House that you could not tell the difference between those species.

Mr. COMPTON. Well, that is really not an accurate statement. It is difficult to tell the difference between some species. I think even the most expert technician can be confused as to border-line cases. I have seen pieces of western white pine and ponderosa pine where you could put them down on the table before this committee and ask the smartest technician to pick out which is which and he could not do it.

That happens to the greatest experts. But these words are distinguishable and are distinguished in the trade. I know a party on another species sent to the United States Forest Products Laboratories a cut of two pieces on two different days and their return on each of the two times was different, but it was from the same piece of wood, but that does not imply the United States Forest Products Laboratory is not completely capable.

The CHAIRMAN. Was there something else, Mr. Compton?

Mr. COMPTON. That is all I have Mr. Chairman.

(The brief referred to by Mr. Compton is as follows:)

I. REPRESENTATION

The National Lumber Manufacturers Association in this matter represents the following groups of manufacturers of lumber in the United States:

American Walnut Manufacturers Association; Appalachian Hardwood Manufacturers, Inc.; California Redwood Association; Douglas Fir Plywood Association; Mahogany Association, Inc.; Maple Flooring Manufacturers Association; Northern Hemlock and Hardwood Manufacturers Association; Northern Pine Manufacturers Association; Southern Cypress Manufacturers Association; Southern Hardwood Producers, Inc.; Southern Pine Association; the Veneer Association; West Coast Lumbermen's Association; Western Pine Association.

The Northeastern Lumber Manufacturers Association it should be frankly stated, strongly dissents from the position of the National Lumber Manufacturers Association.

II. TARIFF POSITION OF THE NATIONAL LUMBER MANUFACTURERS ASSOCIATION

In 1935 in connection with the negotiation of a trade agreement with Canada the National Lumber Manufacturers Association directly recommended that:

"With respect to species of lumber relatively scarce or commercially nonexistent in the United States, i. e., northern white pine, Norway pine, and western white spruce, that the import duties and taxes be reduced to the extent which the law permits."

This position was supported by the great majority of the associations in the industry. It was not supported by the Northeastern Lumber Manufacturers Association which then, as now, strongly dissented.

Also, the National Lumber Manufacturers Association, at the same time, asked that:

"Reasonable and effective protective tariffs be maintained on imported lumber of species in surplus supply in the United States, and on imported lumber directly supplanting lumber of species in surplus supply in the United States."

This view, we believe, is generally supported throughout the industry.

The position of the National Lumber Manufacturers Association was stated by its executive committee on December 9, 1936, in the following language of its resolution:

"The National Lumber Manufacturers Association will seek the continuance of the lumber excise tax; as stated in its original application on the Canadian Trade Agreement early in 1935, it has no objection to exemption from the tax on the three species there mentioned, namely, northern white and Norway pine and western white spruce; it is understood that the association itself assumes no responsibility regarding any such exemption and that the effort to secure it is the responsibility of interested parties; further, that to this position the National Lumber Manufacturers Association asks the adherence of the federated associations."

That position has had the concurrence of the associations affiliated with the National Lumber Manufacturers' Association, except the Northeastern Lumber Manufacturers' Association. This is a mere matter of fact and of record.

III. SECTION 705 (A)

Section 705 (a) of H. R. 9682 provides:

"(a) Section 601 (c) (6) of the Revenue Act of 1932 is further amended by adding at the end thereof the following: 'In determining board measure for the purposes of this paragraph no deduction shall be made on account of planing, tonguing, and grooving. As used in this paragraph, the term "lumber" included sawed timber'."

Definition of "lumber": This provision is to settle present controversy over the interpretations of section 601 (c) (6) of the Revenue Act of 1932. In the Tariff Act of 1930 Congress used the words "sawed lumber and timber." In the Revenue Act of 1932 it used the simple word "lumber." The customs court has so far held that the enumeration of "sawed timber" in the tariff act and failure to enumerate it in the revenue act indicates a congressional intent to exclude "sawed timber" from the term "lumber" in the revenue act. This obviously was not the intent. The term "lumber" has always included sawed timber which is merely lumber of large sizes. But the matter is involved in needless dispute and litigation. It should be clarified. This amendment will do it.

DEFINITION OF BOARD MEASUREMENT

Similarly, in the Tariff Act of 1930, it is specifically provided that "in estimating board measure for the purposes of this paragraph no deduction shall be made on account of planing, tonguing, and grooving." Section 601 (c) (6) of the Revenue Act of 1932 simply provided for "board measure." It was believed that section 601 (a) which provided that the excise tax should be "levied, assessed, collected, and paid in the same manner as a duty imposed by the Tariff Act of 1930" would include also its provision for determining board measure. The court so far has not so interpreted it. It has held been that in estimating board measure for the purposes of the revenue act a deduction for planing, tonguing, and grooving is allowable. This results in the absurdity of the same carload of imported lumber being measured as one quantity for tariff purposes, and an entirely different quantity for the import excise tax and both being "board measure." As a matter of fact, in estimating board measure deduction for planing, tonguing, and grooving is never made in actual practice.

Section 705 (a) of the pending bill will correct both of these situations. As modified by section 705 (b) there has been no objection from any source to its enactment.

IV. SECTION 705 (B)

Section 705 (b) provides:

"(b) Each sentence of the amendment made by subsection (a) shall become effective (1) on the sixtieth day after the date of the enactment of this Act unless in conflict with any international obligation of the United States or (2) if so in conflict, then on the termination of such obligation otherwise than in connection with the undertaking by the United States of a new obligation which continues such conflict."

This provision is to avoid possible conflict with obligations arising out of reciprocal trade agreements. Section 705 (b) is the language proposed by the State Department to meet this possible situation. It would make the provision of section 705 (a) effective upon the termination of any international obligation with which it is in conflict.

V. SECTION 705 (C)

Section 705 (c) provides:

"Section 601 (c) (6) of the Revenue Act of 1932 is further amended by inserting after the amendment made by subsection (c) of this section the following: 'The tax imposed by this paragraph shall not apply to lumber of northern white pine (pinus strobus), Norway pine (pinus resinosa), Engelmann spruce, and western white spruce."

Section 705 (c) proposes the exemption of several species of lumber from the import excise tax. As the bill was reported from the House Ways and Means Committee, this provision (then numbered sec. 704 (c) provided for such exemption for northern white pine, Norway pine, and western white spruce lumber. This proposed exemption was not objected to by the lumber industry generally as above stated. Acting in its behalf, we offered no objection to its enactment. In fact, we advised the committee that we did not object to it.

But, on the floor of the House, an amendment was adopted by a small vote to include Engelmann's spruce in the exempted species. To this addition we do object strongly and for the following reasons:

(*a*) Northern white pine and Norway pine are comparatively scarce in virgin-timber supply in the United States; and western white spruce is commercially almost nonexistent in the United States. Both are available in export surpluses in Canada.

In response to a Senate resolution in 1930, the United States Forest Service furnished the following estimate of the total stand of virgin and second-growth northern white and Norway pine:

Stand of Northern white and Norway pine

[In millions of feet]

Region	Virgin	Second growth	Total
New England	2,507	5,883	8,390
Middle Atlantic	4	3,526	3,530
South Atlantic and Central	155	165	320
Lake States	2,124	268	2,392
Total	4,790	9,842	14,632

As to western white spruce in the United States, there is no conclusive estimate of timber stand. But its timber supply is very meager. It grows in scattered stands from the Black Hills in South Dakota northward and westward. It reaches its best growth in the northern part of the Canadian provinces of Saskatchewan, Manitoba, and Alberta. Exact figures of production of western white spruce lumber likewise are not available. But the domestic production at least does not exceed 2,000,000 feet per year, and is probably less.

Because there is a known market demand for western white spruce lumber which cannot be adequately met from the quantities and qualities available from domestic production, the National Lumber Manufacturers Association has taken the position that it does not object to the reduction or removal of the excise tax insofar as it applies to these species.

(*b*) Engelmann's spruce timber, on the other hand, is available in great surplus supply in the United States. It is distinctively a surplus species.

There is no scarcity of Engelmann's spruce in the United States. It grows abundantly throughout the Rocky Mountain States. Practically all of the spruce timber in the West, except for the Sitka spruce found on the Pacific slope, is of this variety. The Forest Service has estimated the spruce saw timber stand of this area, in the States of South Dakota, Montana, Wyoming, Colorado, Idaho, Utah, New Mexico, Arizona, Washington, Oregon, California, and Nevada to total 61,582,000,000 board feet. Excluding the Sitka spruce, estimated at 12,000,000,000 feet, from this figure, there remains 49,582,000,000 board feet of spruce, practically all Engelmann's.

Current production of Engelmann's spruce is estimated at approximately 40,000,000 board feet a year. Even if this production is doubled or trebled, the domestic timber supply is adequate for several hundred years. With allowance for regrowth there is assurance of a perpetual abundant supply of this timber in the United States.

There is no reasonable ground for the removal of the excise tax on Engelmann's spruce. It is definitely a surplus species, and imports of it compete directly with the domestic production. To exempt it from the tax would obviously raise the whole question of the lumber tariff on our surplus woods. That question should not be raised. Certainly at least it should not be raised in this revenue bill.

(*c*) Conclusion: The exemption of Engelmann's spruce is highly controversial and is undesirable.

VI. RECOMMENDATIONS

The National Lumber Manufacturers Association recommends—

(*a*) That the words "Engelmann spruce" be eliminated from subsection (*c*) of section 705 H. R. 9682 (p. 303, line 25).

(*b*) That the remainder of subsections (a) and (b) of section 705 be enacted without change.

The CHAIRMAN. The next witness is Mr. Alfred H. Benjamin, representing the Anglo-American Trading Corporation of New York.

STATEMENT OF ALFRED H. BENJAMIN, REPRESENTING ANGLO-AMERICAN TRADING CORPORATION OF NEW YORK

Mr. BENJAMIN. Mr. Chairman and gentlemen, my brief is very short, and I would like to elaborate on it. How much time have I?

The CHAIRMAN. If you will give us the brief——

Mr. BENJAMIN (interposing). I have submitted a brief. Gentlemen, I beg to submit for your consideration my objection to the proposed amendment to the tax bill in the form of an excise tax of 6 pounds on imported pork and pork products.

The writer appeared before the Finance Committee of the Senate in 1929 and 1930, when the Hawley-Smoot bill was before that esteemed body, and predicted that the tariff in the aforementioned bill would be detrimental to the welfare of our Nation.

I simply put that in to let you gentlemen know I was associated with the meat trade for many years.

We have had the experience since 1930 of having our factories closed and millions of men and women thrown out of employment, due to retaliatory measures taken by foreign countries, resulting in the loss of our export trade to a serious degree. Therefore, I believe that it would not be in the interests of agriculture or industry in this country to permit any excise tax to go into effect at this time.

The excise tax of 6 cents per pound as proposed would amount to a virtual embargo on these pork products, and we would see a complete stoppage of imported pork products.

The United States Government is now receiving duty of 2¼ cents per pound on frozen pork and 3¼ cents per pound on canned hams and other canned-pork products, but with the imposition of this additional tax we would see a cessation of these imports, and the revenue as gained in the present tariff would no longer be forthcoming. The aforementioned fresh frozen pork must be processed by curing and smoking in the United States, thereby giving employment to American labor.

Lithuania, for example, has exported to this country in 1937 $1,140,000 chiefly pork and pork products, against purchases from the United States of $1,290,000, consisting chiefly of cotton, tobacco, fruits, and the balance made up of manufactured articles.

What is true of this comparatively small country is true of other countries now shipping pork to the United States. We must buy from them if we are to sell to them.

Senator KING. You believe in reciprocal trade treaties being negotiated by Mr. Hull?

Mr. BENJAMIN. Absolutely, unquestionably. The increased trade which has manifested itself as a result of the reciprocal trade agreements made, or in the making, with various countries can be vastly increased if these reciprocal trade agreements are not offset by duties or taxes as the one proposed on pork and pork products.

Senator KING. Have you any figures showing the export of lard, pork, and pork products?

Mr. BENJAMIN. Senator King, am I right?

Senator KING. Yes.

Mr. BENJAMIN. In answer to that, the Department of State with the aid of the Department of Agriculture and the Department of Commerce have furnished statistics.

Senator KING. I am familiar with that.

The CHAIRMAN. Put those in the record.

Mr. BENJAMIN. We have imported 78,000,000 pounds of pork products during the year 1937 as against 199,350,000 exported.

The CHAIRMAN. Your time is about out now. Will you put anything else you have in the record please?

Mr. BENJAMIN. Could I have just a few more minutes, please?

The CHAIRMAN. Yes, sir.

Mr. BENJAMIN. The duty of 2½ cents per pound on fresh pork must not be confused with the duty of 3¼ cents per pound on canned hams. The fresh or cured pork is processed in this country. The canned hams are not processed here.

We have 1,500,000 more hogs on the farms beginning 1938 than we had during 1937. Consequently our imports will be less this year than last year, due to this increased supply in the United States.

In addition to the 2½ cents per pound duty that the Government collects on fresh pork and 3¼ cents per pound on cured pork, this product pays in the way of a tax an additional 2½ to 3 cents per pound, made up of freight at the rate of $35 per ton of 2,240 pounds, on the gross weight, which is paid to the American vessels carrying the product under refrigeration to this country.

Senator KING. What part of the entire imports is processed in the United States?

Mr. BENJAMIN. Only the fresh pork and cured pork; all the canned hams are processed in other countries.

Senator KING. Thank you.

Mr. BENJAMIN. I have found in my travels through Europe last year that they have not a large supply of hogs available by reason of the fact that Germany has an agreement with all these Baltic nations and Poland, and has her hands on everything that appertains to food products. Therefore, their supply of pork for export is limited. On the other hand, our supply in the United States is increasing annually. Consequently, we have nothing to fear with the small competition they have to offer.

When you consider these countries buy our cotton, fruits, tobacco, automobiles, automobile accessories, as well as many other commodities which give employment to labor in this country, we should try to keep that connection, and I think the reciprocal trade agreements are the best thing that has been devised in maintaining good will, which is essential to our export trade.

(Subsequently Mr. Benjamin submitted the following tables and brief:)

NEW YORK, N. Y., *March 15, 1938.*

To the Honorable Members of the Finance Committee, United States Senate, Washington, D. C.

GENTLEMEN: I beg to submit for your consideration my objection to the proposed amendment to the tax bill in the form of an excise tax of 6 cents per pound on imported pork and pork products.

The writer appeared before the Finance Committee of the Senate in 1929 and 1930, when the Hawley-Smoot bill was before that esteemed body, and predicted that the tariff in the aforementioned bill would be detrimental to the welfare of our Nation as a whole.

We have had the experience since 1930 of having our factories closed and millions of men and women thrown out of employment, due to the retaliatory measures taken by foreign countries, resulting in the loss of our export trade to a serious degree. Therefore I believe that it would not be in the interests of agriculture or industry in this country to permit any excise tax to go into effect at this time.

The excise tax of 6 cents per pound as proposed would amount to a virtual embargo on these pork products, and we would see a complete stoppage of imported pork and pork products. The United States Government is now receiving duty of 2½ cents per pound on frozen pork and 3¼ cents per pound on canned hams and other canned pork products, but with the imposition of this additional tax, we would see a cessation of these imports, and the revenue as gained in the present tariff would no longer be forthcoming. The aforementioned fresh-frozen pork must be processed by curing and smoking in the United States of America, thereby giving employment to American labor.

Lithuania, for example, has exported to this country in 1937, $1,140,000, chiefly pork and pork products, against purchases from the United States of $1,200,000, consisting chiefly of cotton, tobacco, fruits, and the balance made up of manufactured articles.

What is true of this comparatively small country is true of other countries now shipping pork to the United States. We must buy from them, if we are to sell to them.

The increased trade which has manifested itself as a result of the reciprocal trade agreements made or in the making with various countries can be vastly increased if these reciprocal trade agreements are not offset by duties or taxes as the one proposed on pork and pork products.

Respectfully submitted.

ALFRED H. BENJAMIN.

TABLE I.—*United States foreign trade in pork products*

	Exports		Imports	
	Lard	Pork products, including lard	Lard	Pork products, including lard
	1,000 lb.	*1,000 lb.*	*1,000 lb.*	*1,000 lb.*
1928	759,722	1,060,922	8	12,870
1929	829,328	1,173,028	1	8,516
1930	642,486	919,886	2	4,657
1931	568,708	728,608	3	3,979
1932	546,202	662,502	8	5,782
1933	579,132	721,132	1	2,927
1934	431,237	581,737	(1)	1,647
1935	96,355	185,055	37	10,531
1936	111,292	178,792	3	41,846
1937	136,150	199,350	247	76,078

[1] Less than 500 pounds.

Source: Foreign Commerce and Navigation of the United States; Monthly Summary of Foreign Commerce.

TABLE II.—*United States exports of pork products to all countries and to the United Kingdom, 1936*

	Total exports	Exports to United Kingdom	Percent exports to United Kingdom are of total exports
	1,000 lb.	*1,000 lb.*	
Pork carcasses, fresh or frozen	152	11	7.2
Pork loins, fresh or frozen	2,594	1,264	48.7
Hams and shoulders, cured	42,163	36,828	87.3
Bacon	4,095	1,156	28.2
Sausage casings, hog	6,949	3,067	44.1
Cumberland and Wiltshire sides	467	261	55.9
Other pork, pickled or salted	10,520	593	5.6
Canned pork	7,937	6,454	81.3
Total, pork products (not including lard)	74,877	49,634	66.3
Lard	111,292	63,547	57.7
Total, pork products, including lard	186,169	113,181	60.8

Source: Foreign Commerce and Navigation of the United States.

TABLE III.—*Concessions received by United States on pork products in 17 trade agreements concluded to date*

Pork, fresh or frozen:
  Duty reduced: 5 agreements (Haiti, Canada, Colombia, Guatemala, France).
Hams:
  Duty reduced: 6 agreements (Cuba, Canada, Honduras, Colombia, France, and Salvador).
  Quota obtained: Belgium.
  Duty bound: Guatemala.
Bacon:
  Duty reduced: 5 agreements (Cuba, Canada, Honduras, Colombia, and France).
  Duty bound: Guatemala.
Salted and pickled pork:
  Duty reduced: 5 agreements (Cuba, Canada, Colombia, Guatemala, and France).
  Duty bound: Haiti, Sweden.
  Quota obtained: Belgium.
Canned pork:
  Duty reduced: 6 agreements (Cuba, Belgium, Canada, Honduras, Colombia, Costa Rica).
  Duty bound: Guatemala, Salvador.
Lard:
  Duty reduced: 7 agreements (Cuba, Haiti, Canada, Switzerland, Colombia, Nicaragua, Costa Rica).
  Quota obtained: Belgium, Czechoslovakia, Switzerland, Netherlands.
  Bound free: Belgium, Netherlands.
  Duty bound: Guatemala.

United States imports, domestic products, and average price of beef, 1928–37

[All figures in pounds are on a dressed-weight basis]

Year	Imports			Federally inspected slaughter of cattle and calves	Imports of beef as percent of inspected slaughter	Average farm prices of beef cattle	Imports of cattle (dressed weight)
	Canned beef	Other beef	Total beef				
	Million pounds	*Million pounds*	*Million pounds*	*Million pounds*	*Percent*	*Cents per pound*	*Million pounds*
1928	105	58	163	4,727	3.4	9.12	135
1929	160	51	211	4,728	4.5	9.15	129
1930	112	19	131	4,704	2.8	7.46	50
1931	39	3	42	4,751	.9	5.31	18
1932	49	2	51	4,394	1.2	4.07	19
1933	83	1	84	5,046	1.7	3.63	10
1934	93	1	94	5,602	1.7	3.88	12
1935	153	10	163	5,167	3.2	6.49	105
1936	176	6	182	6,090	3.0	6.00	127
1937	176	7	183	5,530	3.3	6.95	154

Source: Compilation of the Department of Agriculture.

STATISTICS WITH REGARD TO IMPORTS OF BEEF

On a dressed-weight basis imports of beef, slaughter of cattle and calves, percent imports are of inspected slaughter and average farm price of beef cattle are given in the attached tabulation supplied by the Department of Agriculture. (Data for dressed-weight imports of cattle are also shown.) From this table various observations may be made:

(1) During recent years over 90 percent of total beef imports consisted of canned beef whereas for 1928 and 1929, canned beef imports were 64 and 76 percent, respectively, of the total imports. In total, beef imports during the past 8 years have not equaled the 1929 figure.

(2) The ratio of beef imports to Federally inspected slaughter of cattle during the past 3 years has been under 3.5 percent. During 1929 imports of beef were 4.5 percent of Federally inspected slaughter. It should be realized that Federally

inspected slaughter represents about two-thirds of the total slaughter for the United States.

(3) Imports and prices to beef producers vary directly. In periods of high prices, imports are greater while smaller imports enter when prices are low. During 1932 when beef imports were small, prices to farmers were only 4.07 cents per pound. For 1937 imports totaled 183,000,000 pounds but the average farm price was 6.95 cents per pound.

(4) Even, adding the imports of cattle to the imports of beef which should be done to show the relative importance of total imports, such imports were 6.1 percent in 1937, 5.1 percent in 1936 and 5.2 percent in 1935 of the Federally inspected slaughter. For 1928 this ration was 6.3 percent and for 1929, 7.2 percent.

COMMENTS ON DESIRE TO EQUALIZE THE DUTIES ON CANNED BEEF AND LIVE CATTLE

Some observers have made the statement that on an equivalent dressed-weight basis the duty on canned beef is less than on cattle. They wish, therefore, to equalize the two rates. Although it is true that in 1936 the duty on canned beef was 3 cents a pound on a dressed-weight basis, and on cattle weighing over 700 pounds was either 3.7 cents if entered under the quota or 5.6 cents if entered at the full rate of duty after the quota was exhausted. This comparison fails to take account of the value of the imported product. The equivalent ad valorem duty on cattle weighing 700 or more in 1936 was 43.1 percent; for canned beef it was 62.8 percent.

STATEMENT OF JOHN W. MAHER, WASHINGTON, D. C.

The CHAIRMAN. Mr. Maher, do you have a brief on this subject?

Mr. MAHER. No; I do not.

The CHAIRMAN. Proceed.

Mr. MAHER. Gentlemen, my name is John W. Maher, a practicing lawyer in the District of Columbia.

I do not, however, appear here as a paid lawyer or advocate. I appear here representing the interests of my brother-in-law in the State of Maine, Mr. W. H. Dalton, who is also president of the Northeastern Lumber Manufacturers Association. He found it inconvenient to be here and asked me to appear here for him.

Gentlemen, I was glad to hear Mr. Compton straighten out the stand of the National Lumber Manufacturers Association on the question of where they stood on this taking the excise tax off of northern white pine, Norway pine, and western white spruce. That association does not ask that the excise tax be taken off. They simply say they do not oppose the taking off of that tax and they say that to procure the taking off of that tax shall be the burden of the interested parties, that they shall come here and seek to get that tax off. Those interested parties have come, and who are they? The record to this moment discloses there are two of them, and two only. One is the Pas Lumber Co., Ltd., of Canada, the largest manufacturers of western white spruce and not concerned at all primarily in northern white pine or in Norway pine. The other is Shevlin, Carpenter & Clarke Co. of Minneapolis, operating in Canada and exporters into this country of 40 percent of all pine, northern white pine and Norway pine coming into the United States at this time. Those concerns located in Canada when the excise tax on these woods was more than it is today, and must have decided before they invested their capital there that they could make a fair return in the American market on products manufactured there, even at a $3 excise tax. That has been reduced to $1.50 and they now ask, not the National Lumber Manu-

facturers Association, but the two interested manufacturers from Canada, that that tax be entirely lifted off.

It has been sought to create an impression here that this Northeastern Lumber Manufacturing Association is a rather insignificant thing. That statement was directly used before the House committee.

What, as a matter of fact is the Northeastern Lumber Manufacturers Association? It is composed not of two but of ninety, I know, of the largest manufacturers in the northeastern section of our country; the northeastern section including New England States, Pennsylvania, and New York. Into that area, gentlemen, is imported 70 percent of all Norway pine and white pine being exported from Canada today, and in that area stands 11,000,000,000 feet of the 14,000,000,000 feet of Northern white pine available in this country today. The argument advanced here is that we must allow these species to come in here without excise tax because, and only because, if we were to supply the demand in this country we would deplete these woods. That is not a fact.

The Department of Commerce figures, and I will ask you to please assume the figures I give you are Government figures and are incorporated in records already on file with this committee—the Department of Commerce figures show the average cut over the years 1934, 1935, and 1936 in the Northeastern States to be 273,000,000 feet.

But the process of simple division and plain arithmetic will satisfy any man that 273,000,000 goes into 11,000,000,000 forty-four times.

Now, mark you, that that 11,000,000,000 feet of northern pine and Norway pine in the northeastern section of this country is of saw-cut size, stock you could cut and use today and we have 44 years within which to consume it. Then, are we in any need of importing northern white pine and Norway pine for the next 44 years? What is going to happen at the end of 44 years? It is definitely of record through the Copeland Committee Survey that those woods in those States replace themselves; in other words, in addition to those 11,000,000,000 feet which is now of saw-cut size. There is in those States an undetermined amount which next year will be of saw-cut size and which the following year will be of saw-cut size and the committee tells us in their report, which I intend to file with this committee, that the turn-over which takes into consideration the cut, the loss by fire, the loss by worms and birds, they take that into consideration, that the woods in Maine in this species have a perpetual supply. I do not mean the woods of Maine, but New York, Pennsylvania, and Maine have a perpetual supply. There is no danger of their being depleted, and there is no figure advanced here to prove the contrary.

Now, gentlemen, the Shevlin, Carpenter & Clarke people are not interested, they tell us, in importing into this country the lower grades of northern pine. All they want to import here, or export over here, is that type of pine which they say, is in scarcity over here, that type, they say, is virgin pine.

Now, gentlemen, to be very frank with you, if it could be worked so that Shevlin, Carpenter & Clarke Co. of Minneapolis can export virgin timber over here of high grade, eliminating low grades, and confine that to that area of the country, we would not be here objecting at all. But that cannot be done. Taking the excise tax off here is not going to aid the Shevlin, Carpenter & Clarke Co. alone. It is

going to aid every single manufacturer in Canada. Those manufacturers who today are shipping into this country, mark you, 22½ percent of all the northern white and Norway pine this country consumes. They are doing that today, paying the excise tax and competing with our market. The amount they are exporting into this country in those two woods amounts to 33⅓ percent of the total production per year of the Northeastern States, 70 percent of it is shipped into the Northeastern States.

It was said here the other day that you did not have to worry about the State of Pennsylvania getting it, or the State of New York, because the freight rates were so they could not compete. Senators, do not let us forget the Lakes have a $2 rate cheaper than rail, and into Tonawanda today, from one company formerly owned by Shevlin, Carpenter & Clarke, comes 20,000,000 feet. The Tonawandas on the border line of Pennsylvania for the last 150 years have been recognized as the concentration point of the imports of these woods, and from those Tonawandas, those woods are distributed over the eastern market—Pennsylvania, New York, and Albany. The freight rate from Canada to Buffalo by rail is less than it is from the Northeast to Buffalo.

All you are asked to do here is to give to one company—mark you, I say there is but one proponent of this bill insofar as northern white pine and Norway pine is concerned, and that is the Shevlin, Carpenter & Clarke Co., interests, and they are the largest importers to this country from Canada—the right to import these species of pine excise tax free. The Pas Lumber Co. is interested in the western white spruce, and they contend, which we concede, that they are the largest manufacturers of that particular item.

One thing more; it was stated before this committee that the State of Maine apparently was a little greedy; that they imported from Canada 5,000,000 feet per year when they exported to Canada 8,000,000 feet.

Gentlemen, we are not concerned with the State of Maine. We are concerned with the northeast section of the country, but I think it fair to answer that question. It is true 8,000,000 feet per year of northern white pine is exported from the State of Maine to Canada. How does it come about? Some years ago there was a law passed in the British Empire making it mandatory that match block material for shipment to England had to be manufactured in Canada. Large interests operating at that time in this country moved to Canada, and the 8,000,000 feet Maine is exporting is being taken by those American-owned companies to St. Johns. What kind of wood are they taking? They are taking the kind of wood the Shevlin, Carpenter & Clarke Co. tell you there is a scarcity of. You are led to believe that if the Shevlin, Carpenter & Clarke Co. can succeed in getting this excise tax off, that what will come in will not compete with what we manufacture, because what will come over here is high-grade material. I have here a comparison by the United States Tariff Commission in May of 1937, showing the amount, quantities, and values of these species brought here from Canada.

In 1934 they brought over 91,000,000; in 1935, 88,794,000; and in 1936, 92,085,000.

The average value of the material brought over in 1934 was $23.72. That did not compare with the price in the New England States and the Northeastern section for high grades. It is the price for material between Nos. 3 and 4 grade.

In 1935 the unit value was $23.99, again Nos. 3 and 4.

In 1936 it was $26.23, again Nos. 3 and 4.

What kind of material do they have in Canada?

The CHAIRMAN. Your time has expired.

Mr. MAHER. Thank you.

The CHAIRMAN. Have you something you want to put in the record?

Mr. MAHER. I think, Senator, practically everything is in the record in the form of a brief filed by the association. I would like to make this statement on behalf of the Augusta Lumber Co. They wired me as follows:

> Our and affiliated companies' production white pine last year was 8,000,000 feet and furnished employment to an average of 300 men. Practically all sold in New England and New York States. Profit margin was small. Any further price competition means drastic cut in our production.

The CHAIRMAN. Thank you very much.

A. A. D. RAHN (interrupting)

Mr. RAHN. Mr. Chairman, I happen to be vice president of the Shevlin, Carpenter & Clarke Co. The statement just made is very misleading in regard to the Shevlin, Carpenter & Clarke Co.

The CHAIRMAN. Well, I would suggest if you want to answer any of this statement that you will file a memorandum.

Mr. RAHN. I will be glad to do so.

(Subsequently Mr. Rahn submitted the following letter and memorandum.)

SHEVLIN, CARPENTER & CLARKE CO.,
Minneapolis, Minn.

Hon. PAT HARRISON,
United States Senate, Washington, D. C.

MY DEAR SENATOR: In accordance with your suggestion of filing a brief in answer to the statements presented to you at the hearing by Mr. John W. Maher, with respect to section 705 (C) of the tax bill, I attach hereto memoranda which I request to be printed in the record of the hearings.

I feel that the attached memoranda, together with the briefs and other data which have already been filed by Mr. R. C. Winton, as well as his testimony in connection therewith, support fully the position taken by the House Ways and Means Committee, and by the House, in their recommendation to exempt northern white pine, Norway pine, and western white spruce, from the excise tax, as now provided by section 705 (C).

Yours very truly,

A. A. D. RAHN, *Vice President.*

MEMORANDUM IN RE EXEMPTION OF NORTHERN WHITE PINE, NORWAY PINE, AND WESTERN WHITE SPRUCE FROM THE EXCISE TAX

1. Mr. Maher was misleading in his testimony in intimating that only two companies whose interests are mainly in Canada are interested in securing an exemption of these three species from the excise tax.

As a matter of fact, the following companies, among others, are interested in the removal of the excise tax from these three species:

The Shevlin-Hixon Co., Bend, Oreg.; Shevlin-Clarke Co., Ltd., Fort Frances, Ontario; Shevlin Pine Sales Co., Ltd., Minneapolis, Minn.; Shevlin, Carpenter &

Clarke Co., Minneapolis, Minn.; Monarch Lumber Co., Great Falls, Mont.; Winton Lumber Co., Gibbs, Idaho; The Pas Lumber Co., Ltd., The Pas, Manitoba; Winton Lumber Sales Co., Minneapolis, Minn.; Winton Oregon Timber Co., Minneapolis, Minn.; Siskiyou-Minnesota Timber Co., Wilmington, Del.

The investments in the United States of the affiliated companies operated by Shevlin, Carpenter & Clarke Co. amount to approximately $25 to every $1 invested in Canada.

Further, the lumber operations of these companies in the United States at Bend, Oreg., and at McCloud, Calif., will run for another 20 years.

2. It was stated by Mr. Maher that "Those concerns located in Canada when the excise tax on these woods was more than it is today."

Operations in Canada of Shevlin-Clarke Co., Ltd., at Fort Frances, Ontario, have been running since 1916, during a high protective era, and lumber from Canada was admitted free of duty until the Tariff Act of 1930 imposed a duty of $1 per thousand feet. The stands of old growth of northern white pine in Michigan, Wisconsin, and Minnesota were practically cut out as early as 1916, and with the depletion of such lumber we moved some of our operations across the border into Canada so that we could continue to supply our customers with the same type of lumber we had been supplying to them. We were unable to substitute for northern white pine the species of lumber grown in California, namely, California sugar pine and ponderosa pine. We began our operations in the west at Bend, Oreg., in 1916, and took over the operation of the McCloud River Lumber Co. about 12 years ago. As stated above, our principal business is in the United States.

3. Attached is a statement indicating that the Northeastern States produced only 20 percent of the lumber which they consumed in 1934, and therefore they had to ship in from other States and from Canada 80 percent of the lumber they required for their consumption. Apparently Mr. Maher is not familiar with the uses of lumber, and with the fact that the lumber produced in the Northeastern States does not, by any means, satisfy local consumption demands.

In this connection, it will be noted that only 6 percent of the consumption of the Northeastern States actually is imported from Canada, the remaining imports coming from other States.

Also, it should be noted that in 1934 Maine, while deriving 5,384,000 board feet of softwood lumber from Canada, exported to Canada 8,486,000 feet. In 1936, Maine imported 11,324,000 board feet from Canada, and at the same time exported to Canada 14,786,000 feet.

4. Depletion of these woods: As definitely corroborative of the fact that these species are depleted in the United States, which fact Mr. Maher and the northeastern association overlook and fail to take into consideration, there is also attached excerpts from investigation made by the Tariff Commission in 1936, when a thorough study was made by the very competent lumber section of the Commission. This investigation was unbiased and the results thereof definitely established the following facts:

(1) The forests have been depleted of these three species in the United States, and therefore imports must be made to supplement inadequate domestic supplies.

(2) In uses where highest quality is a primary consideration, imports are demanded in preference to other species of domestic woods.

(3) These high-grade imports do not compete with the low grades of the same species.

(4) If imports were greatly cut down, the consumers would have to substitute the other less desired woods.

5. Mr. Maher states that the average cut for the Northeastern States for 1934, 1935, and 1936 was 273,000,000 feet.

It should be borne in mind that a large percentage of this lumber is second growth and does not contain as much a percentage of building material as does old growth. In many places in New England, as in New Hampshire and Vermont, lumber is cut from 6-inch trees, barely making 2 inches by 4 inches, so that no opportunity is being given to replenish the United States supply when it is depleted before it can reach any appreciable size.

6. Imports of northern white pine: Over 40 percent of the northern white pine, which is cut in Canada, goes into the States of Illinois, Michigan, Ohio, Indiana, Iowa, Wisconsin, Minnesota, and Nebraska, and therefore does not compete at all with New England growth. This 40 percent is grown in Canada, in western Ontario, and does not even enter New England from Canada.

7. Stumpage costs: Attached hereto also is a memorandum showing stumpage costs in Ontario, to be $5.77 per thousand feet for northern white pine, as compared with $5.37 in the New England States.

And to this stumpage cost in Canada must always be added freight rates, as shown, running from $8.60 per thousand to $10.80 per thousand, to important consuming centers in the United States. These excessive freight rates practically exclude the Canadian imports from competition with the Northeastern States.

8. Selling prices of northern white pine: Attached is a further memorandum showing selling prices of northern white pine in the United States and Canada.

The northeastern representative has made no statement as to prices received in the Northeastern States for their lumber, nor that much of the lumber grown in the Northeastern States is of inferior grades, as shown by the excerpts from the Tariff Commission's findings referred to above, and also attached hereto.

The imports of white pine referred to by Mr. Maher include approximately 10 percent of low grades of jack pine and also includes Norway pine. There are no figures which break down the prices for all kinds of pine imported. The enactment of section 705 (C) will not remove the excise tax from jack pine.

It should be noted in connection with the selling price, that to the selling prices at Fort Frances must be added the excessive freight rates just referred to, which prevents Canadian imports of northern white pine from under-selling domestic production of such wood.

9. Summary: Finally is attached hereto summary of the reasons for the enactment by the Congress of section 705 (C) to provide for the exemption of the excise tax of northern white pine, Norway pine, and western white spruce.

NORTHEASTERN CONSUMPTION, PRODUCTION, AND IMPORTS, SOFTWOOD LUMBER—1934

According to official figures of the United States Census Bureau and the United States Forest Service, the New England States (including New York and Pennsylvania), consumed 2,135,275,000 board feet of softwood lumber in 1934.

In that same year, these Northeastern States produced only 436,894,000 feet, or but 20 percent of the lumber which they consumed.

Thus, the Northeastern States must import 80 percent of the lumber they require for consumption. However, it should be noted that only 6 percent of the Northeastern consumption comes from Canada, the remaining imports coming from other parts of the United States.

The following tables, computed from the official reports referred to, indicate in percentages:

(1) The insignificance of production in the Northeastern States to consumption.
(2) The large percentage of lumber which they must import.
(3) The small percentage of lumber imported from Canada.

States	Percentage of consumption State produces	Percentage of consumption State imports	Percentage of consumption imported from Canada
Total for Northeastern	20	80	6
Maine [1]			5
New Hampshire [1]			2
Vermont	78	22	16
Massachusetts	16	84	10
Rhode Island	6	94	4
Connecticut	5	95	3
New York	2	98	6
Pennsylvania	8	92	0.9

[1] Both these States produce more than they consume. It should be noted that Maine, while deriving 5,884,000 board feet of softwood lumber from Canada, exported to Canada, 8,486,000 feet. In 1936, Maine imported 11,324,000 board feet from Canada, and at the same time exported to Canada 14,786,000 feet.

[Excerpts from U. S. Tariff Commission, supplemental report, entitled "Concessions Granted by the United States in the Trade Agreement with Canada," published 1936]

TARIFF COMMISSION FINDINGS INDICATE NEED FOR REMOVING THE EXCISE TAX FROM NORTHERN WHITE PINE, NORWAY PINE, AND WESTERN WHITE SPRUCE

(1) DEPLETION OF NORTHERN WHITE PINE AND SPRUCE

There is definitely an exhaustion in supply of the better grades of this lumber in the United States, as is substantiated by conclusions of the Tariff Commission in a study made of United States growth, production, and imports of these species.

In its report[1] in 1936, the Commission, in discussing the production of lumber in the United States, made the following statement (at p. 91):

"The United States has extensive forest resources of softwood species. In the case of northern pine, however, the forests have been depleted to the extent that virgin stands are scarce, and the United States is behind Canada in timber from which a higher percentage of the better grade of lumber can be produced. The same is true in a smaller degree of eastern spruce. The condition with respect to these two species is connected with the fact that with the growth of population, the timber resources of the older regions have been depleted and production of lumber has moved southward and westward."

The report proceeds to point out that the largest producing areas—the North Pacific States and the Southern States—are far removed from the principal consuming area, the Northeastern region (which is composed of the Middle Atlantic and the New England States). And these large producing areas have no objection to the exemption of just these three species from the tariff and excise tax.

The larger lumber-consuming States produce only a small percentage of the lumber required in their industries, and necessary for local consumption. Their only recourse thus is to import lumber from other States. In the case of those species which are depleted in this country (such as northern white pine, Norway pine, and western white spruce) and which are necessary for local industries, imports must come from Canada.

(2) IMPORTS ARE SUPPLEMENTAL AND PREFERRED

In its discussion of the different species of wood now imported into the United States from Canada, the Tariff Commission, in the same report (at page 96) states:

"Grades of imported northern white pine are similar to northern white pine produced in the Lake States, but the New England product, cut from the remaining inferior stands, contains a much higher percent of the low grades. Because of the relative scarcity of domestic northern white pine through forest depletion, therefore, imports may be said to be largely supplemental. In uses where highest quality is a primary consideration, imported and Lake States white pine is demanded in preference to other species of domestic pines, such as Idaho white pine and sugar pine, which to some extent are used for similar purposes. Substantial quantities are dressed before importation, but more than half of the pine lumber imported is rough.

"Imported spruce is chiefly eastern spruce which enters the New England and New York markets. In New York it is chiefly used for scaffolding, furring, and industrial uses. In New England it has become established by long use as a wood for more general purposes. Much of the spruce from Canada is imported in the rough and is dressed or otherwise worked in domestic mills after importation."

In connection with the above statement with respect to imported spruce, it should be noted that western white spruce does not enter into the New York and New England markets.

(3) COMPETITIVE CONDITIONS

In its treatment of competitive conditions in the lumber markets of the world, the Tariff Commission (at p. 105) reported:

"*Spruce and white pine.*—Competitive conditions with respect to spruce and white pine, the principal species imported from eastern and central Canada, are quite different than for Douglas fir imported from British Columbia. High-grade white pine has special uses. The stand of white pine of such grade in the United States has been greatly depleted and imports are supplemental to inadequate domestic supplies. The imports do not compete with the low-grades of white pine.

"New England and New York formerly had large stands of spruce and local consumers have acquired a preference for that species, especially in New England. These stands are now inadequate to supply domestic requirements. If imports were greatly cut down, the consumers would have to substitute other less desired domestic woods."

[1] Concessions Granted by the United States in the Trade Agreement with Canada, Washington, 1936.

NORTHERN WHITE PINE STUMPAGE COSTS—UNITED STATES AND CANADA

Contention.—It is alleged, by the Northeastern Manufacturers Association, that the northern white pine stumpage prices average almost $6 per month in the Northeastern States; that they average only $2 to $3 in Ontario, Canada.

Facts.—According to figures of the United States Forest Service (Stumpage and Log Price for Calendar Year 1934), stumpage prices for northern white pine during that year averaged $5.37 in the New England States.

According to telegram (dated March 2, 1937), received from the Department of Lands and Forests, Toronto, Ontario, the average stumpage price for red and white pine in Ontario in 1934, was $5.57.

By further telegram the next day, the Department at Toronto wired:

"My wire yesterday gave averages of licenses including those old ones where Crown has only interests to extent of simple Crown dues. If limited to licenses involving bonus and dues, averages somewhat higher than those quoted."

Hence, if the Government bonus, as well as the Crown dues, are includes in the cost of Canadian stumpage of northern white pine, the price per thousand feet is about $5.77. In other words, in addition to Crown dues, the Canadian Provinces charge a bonus upon lumber when cut, which bonus is determined somewhat by the prevailing price of lumber. Such bonuses run from $2–$2.50–$3, sometimes even as high as $5 per thousand feet, depending upon the location of the timber—and this bonus must be paid the Provincial Government in addition to the Crown dues.

Thus, depending upon the location of the stands of timber, the prevailing price at the time it is cut, etc.. stumpage prices in Canada for northern white pine may be even higher than the $5.77 computed for 1934. And as stated, this figure is even higher than the average stumpage prices for the Northeastern States.

Finally, it must be remembered that in addition to the stumpage costs and to the cost of cutting the trees and converting the logs into lumber, the following freight must be paid on Canadian lumber imports of northern white pine:

From Fort Frances, Ontario—	Rate per 100 pounds	Rate per 1,000 feet
	Cents	
To Buffalo, N. Y.	43	$8.60
To Rochester, N. Y.	47½	9.50
To New York City	52	10.40
To Boston, Mass.	54	10.80
To Pittsburgh, Pa.	43	8.60

SELLING PRICE OF NORTHERN WHITE PINE—UNITED STATES AND CANADA

(1) *United States.*—The unit value of general imports of pine, according to the reports of the Tariff Commission, varies over recent years from $23 to $26 per 1,000 feet. (Generally, imports of "pine" include, in addition to northern white and Norway pine, a great deal of jack pine which is of a cheaper grade and which, therefore, brings down the average value of all pine imports.)

(2) *Canada.*—The average price realized by a representative mill at Fort Frances, Ontario, for northern white pine lumber was as follows:

Year:	Per 1,000 feet[1]
1924	$33.33
1926	31.13
1928	30.46
1930	31.83
1937	30.72

[1] Selling price, f. o. b. Fort Frances.

When there is added to these figures a freight of almost $11 per thousand feet on northern white pine from Fort Frances, Ontario, to New York City, it is obvious that the canadian imports of northern white pine do not undersell the domestic production of the specie.

In Re: Exemption of Northern White Pine, Norway Pine, and Western White Spruce from Import Excise Tax

REASONS IN SUPPORT OF SECTION 705 (C) H. R. 9682

Summary

(1) *United endorsement of the lumber industry.*—The exemption of these three species is recommended by:

(a) The National Lumber Manufacturers Association (1,000 sawmills and 300,000 to 500,000 employees throughout the United States), because these species are relatively scarce and commercially nonexistent in the United States; and by

(b) The National Retail Lumber Dealers Association (consisting of about 25,000 United States retail dealers), because of material benefit to consumers, dealers, and Government alike, in view of the new housing program and contemplated expansion in Navy building, where these special woods are largely used.

(2) *Favorable recommendations of the Government departments.*—Both the State and Treasury Departments have stated that they have no objection to the removal of the excise tax on these three species.

(3) *Tariff Commission investigations* (in 1936) found that:

(a) The forests have been depleted of these three species in the United States, and therefore imports must be made to supplement inadequate domestic supplies.

(b) In uses where highest quality is a primary consideration, imports are demanded in preference to other species of domestic woods.

(c) These high-grade imports do not compete with the low grades of the same species.

(d) If imports were greatly cut down, the consumers would have to substitute the other less desired woods.

(4) *Imports bear small ratio to United States production.*—The total imports of all kinds of spruce and pine from Canada in 1937 amounted to only 1.1 percent of the total United States lumber production in 1937.

(5) *Revenue involved is insignificant.*—It is estimated from Tariff Commission figures, that only about $145,000 in excise tax was collected on Canadian imports of these three species of lumber in 1936.

(6) *Opposition is negligible.*—The only opposition registered to removal of the excise tax on these three species is from the Northeastern Lumber Manufacturers Association, representing a region which produces but 1.2 percent of the total United States lumber production.

(a) The Northeastern States (New England, New York, and Pennsylvania) produce only 20 percent of the lumber they consume. Therefore, they must import 80 percent of the lumber they require for consumption.

(b) The total lumber imported from Canada by the New England States amounts to only 6 percent of the total New England consumption. Maine actually exports to Canada more lumber than she imports from Canada.

(7) *Answers to opposition's contentions.*—

(a) *Men employed.*—It is claimed that "50,000 men are employed in the Northeastern lumber operations."

Actually, in very efficient lumber operations in other States, only 5,000 to 7,000 men would be required to produce such an amount of lumber as the Northeast produces.

(b) *Wages paid, United States and Canada.*—It is alleged that sawmill wages in the New England States are 30 to 50 cents per hour, and 17 to 25 cents per hour in Canada.

Wage schedules filed with the Finance Committee show Canadian wages running from 35 cents to $2.15 per hour.

(c) *Stumpage costs.*—The Northeastern Association has contended that stumpage prices for northern white pine in the New England States are much higher than those in Canada.

According to United States Forest Service figures, stumpage prices for northern white pine in the New England States in 1934, averaged $5.35 per 1,000 feet.

According to the Department of Lands and Forests, Ontario, the cost of Canadian stumpage for the same year was about $5.77 per 1,000 feet—and to this must be added freight rates into the United States, running from $8.66 to $11 per 1,000 feet.

The CHAIRMAN. There are several witnesses here that want to talk about some hard drinks, but I think it is better to give no advantage there. So, I am going to ask them to wait a few minutes.

Mr. Loomis, have you a brief?

STATEMENT OF A. M. LOOMIS, WASHINGTON, D. C., REPRESENTING THE NATIONAL DAIRY UNION

Mr. LOOMIS. Mr. Chairman, my name is A. M. Loomis, representing the National Dairy Union, 945 Pennsylvania Avenue, Washington, D. C.

For the purposes of this hearing I also represent the Association of American Producers of Domestic Incedible Fats and several soybean oil producers.

I want to take up first, Mr. Chairman and gentlemen, a matter with reference to the section of the bill which you will find on page 337.

The CHAIRMAN. What is it in reference to?

Mr. LOOMIS. Whale oil.

The CHAIRMAN. What?

Mr. LOOMIS. Whale oil.

The CHAIRMAN. All right.

Mr. LOOMIS. I want to propose for the consideration of the committee an amendment which is to come at the end of subparagraph 8 (a) to begin on line 11, and which would read as follows:

Provided, That no whale oil, fish oil, or marine animal oil of any kind (whether or not refined, sulphonated, sulphated, hydrogenated or otherwise processed) or fatty acids derived therefrom, shall be admitted to entry free from payment of the tax provided in this subparagraph, unless such oil was produced by the citizens of the United States, on vessels of the United States, or in the United States or its possessions, from whales, fish, or marine animals or parts thereof taken or captured by citizens of the United States while employed on vessels of the United States.

Just a brief word of explanation and I may save the time of myself and the committee. This section here in the bill before you is an exact copy of the present law with reference to whale oil and certain fish oils, tallow and certain other oils. The whale-oil situation has not worked out as it was anticipated and as we understood it was the intent of Congress to make it work out. I will explain that in more detail. We believe this amendment will correct the whole situation and bring the provision back to the intent of Congress when it was passed in 1934.

Now it appears that the language which I have just read ought not to be required because that clearly was the intent of Congress that all whale oil produced by foreigners should pay a tax. However, in the rules and regulations of the Treasury Department the present situation is that if the whale oil is produced upon a ship of American registry, it does not make any difference what kind of ships or crews capture the whales. They are captured and killed and brought to the mother ship by Norwegian and English vessels employing Norwegian and English crews. Under the regulations of the Customs Bureau of the Treasury Department such oil is considered to be a product of American fisheries and comes in without payment of tax or duty.

The CHAIRMAN. How much comes in?

Mr. LOOMIS. We have just had a shipment of 12,000 tons. We have just had a shipment of 12,000 tons in the past 3 weeks.

Senator KING. Was that whale oil?

Mr. LOOMIS. Yes. Whale oil. During the past 2 years something over 90 million pounds of whale oil has come in without the payment of tax or duty under this ruling of the Treasury Department all of

which was made from whales caught and killed by foreign crews on foreign registered ships. Every statement I am making on this subject is of record in the Department of Commerce.

The CHAIRMAN. Mr. Loomis, did you ever present this matter to the Treasury Department?

Mr. LOOMIS. Continuously, for 18 months.

The CHAIRMAN. You got no sympathetic hearing?

Mr. LOOMIS. Had a letter from the Treasury Department in the last 8 or 9 days absolutely turning down any suggestions for a change in their rulings.

The CHAIRMAN. Did you present this to the subcommittee of the Ways and Means Committee?

Mr. LOOMIS. It was not presented to the subcommittee of the Ways and Means Committee because at that time it was before the Merchant Marine and Fisheries Committee of the House in a separate bill. Conditions have arisen in connection with that bill which make it almost impossible to get any relief this year. We hope by this proposal now before you to get immediate relief. This will prevent this 40, or 50, or 60 million pounds duty-free imports coming in this season.

Senator KING. Is it conceded that this amount to which you refer, that the whales were captured by foreign ships?

Mr. LOOMIS. Not only conceded, but the records show it. Because of the whaling treaty there is an American observer from the Department of Commerce on board these ships.

Senator KING. Were they brought into port under the flag of the Norwegian Government?

Mr. LOOMIS. The oil is brought into port in various vessels. Part of it has been brought in on board American tankers and part on foreign tankers. The whales themselves are brought to this mother ship out in the ocean and there processed, and the processing is all done on the high seas.

Senator KING. The mother ship is of what nationality?

Mr. LOOMIS. In my statement which I am going to put in the record, I am raising some question as to the legality of the documentation of the mother ship, but the Treasury Department rules they are——

Senator KING (interposing). Do you question the authenticity of the documentation?

Mr. LOOMIS. I do.

Senator KING. Your contention is the mother ship is owned by foreigners?

Mr. LOOMIS. Yes. One case of positive evidence was placed before the Merchant Marine and Fisheries Committee showing majority control of the corporation not held by citizens of the United States.

The CHAIRMAN. As I recall you reported this matter to the Joint Committee on Tax Evasion?

Mr. LOOMIS. I did.

The CHAIRMAN. We thought it was a matter the Treasury Department should take up.

Mr. LOOMIS. We thought so, too. But I want to observe that I do not want anything that I have said about the Treasury Department to indicate I think there is anything wrong about the Treasury Department ruling except the interpretation.

Senator CONNALLY. What domestic oil does this compete with?

Mr. LOOMIS. With the cottonseed, lard, butter, and soybeans. The lower grades of cottonseed, I should have said, and also with fish oil and the lower——

Senator KING (interposing). Do they export butter, lard, and various edible products that are the result of the utilization——

Mr. LOOMIS (interposing). We export cottonseed oil and lard and probably should export more than we do.

Senator KING. Export large amounts of edible products?

Mr. LOOMIS. Yes, sir.

Senator KING. So this is in part reciprocal trade. We ship to them and they ship to us?

Mr. LOOMIS. We do not ship to people producing this oil.

Senator KING. You ship to other countries?

Mr. LOOMIS. Yes.

Senator KING. Before you get through will you state how much whale oil is used for edible purposes?

Mr. LOOMIS. Not a great deal in this country.

Senator KING. In the United States?

Mr. LOOMIS. I cannot carry figures in my mind very well but I will furnish that for the committee. It is reported regularly by the Bureau of the Census.

(Subsequently Mr. Loomis furnished the following information:)

The use of fish and marine animal oils inedible and in edible products as shown by the reports of the Bureau of the Census, for the past 5 years (1937 not yet available) is as follows:

FISH OILS

	Total	Compounds and vegetable shortening	Soap	Paint and varnish	Linoleum and oilcloth	Printing ink	Miscellaneous	Loss, including foots
1932	93,685	11,520	49,291	7,565	11,988	63	12,723	735
1933	106,247	9,272	52,168	8,753	13,223	113	21,873	845
1934	126,480	10,775	64,584	11,654	13,282	103	25,235	883
1935	208,935	27,571	109,970	18,251	13,865	354	35,621	3,203
1936	248,432	40,278	128,044	23,166	16,235	235	36,914	3,160

MARINE ANIMAL OIL (PRINCIPALLY WHALE)[1]

	Total	Compounds and vegetable shortening	Soap	Paint and varnish	Linoleum and oilcloth	Printing ink	Miscellaneous	Loss, including foots
1932	51,974	2,185	48,944	38	....	2	766	49
1933	46,110	....	44,895	2	....	2	1,211	....
1934	35,207	304	33,906	37	....	5	838	27
1935	30,963	427	28,440	34	....	4	1,983	75
1936	35,388	....	32,630	17	....	11	2,747	10

[1] Words in parenthesis supplied for explanation, not found in Census report.

NOTE.—From "Animal and vegetable fats and oils—production, consumption, imports, exports, and stocks," U. S. Department of Commerce—Bureau of the Census. Washington, 1937. (Pp. 28 and 29.)

Senator KING. It is my understanding the greater part of whale oil is not used for edible purposes.

Mr. LOOMIS. Ten or twelve percent; I am not sure of that figure. It differs widely in various years.

The second matter I want to present is this: It has to do with the same section, 702. The item on top of page 339, where the rate of duty of hempseed, Perilla seed, rapeseed, kapok seed, and sesame seed have been criticized before this committee. I only want to comment briefly.

This matter was taken up briefly before the Ways and Means Subcommittee. It was given full consideration and the criticism was definitely rejected by the Ways and Means Committee. In other words, it has at least passed that scrutiny which is valuable therefore in any consideration this committee may give it.

The CHAIRMAN. We understand the situation thoroughly.

Mr. LOOMIS. The reason this rate was 2 cents was because they compete on soybeans. Perilla seed produces three times as much oil per pound of seed as do the soybeans.

Senator CONNALLY. What is the rate now on Perilla?

Mr. LOOMIS. Two cents; just what it is in the act.

Senator CONNALLY. I thought we had 3 cents.

Mr. LOOMIS. The 3-cent tax is on the oil. This item covers the seeds only. The rate is 3 cents on some oils, 4½ cents on others.

The CHAIRMAN. Mr. Loomis, are you through?

Senator CONNALLY. Two cents on the seeds and 3 cents on the oil?

Mr. LOOMIS. That is right.

Senator CONNALLY. Is that a proper relationship, 2 cents and 3 cents?

Mr. LOOMIS. No one has been able to figure the proper relationship, Senator.

Senator CONNALLY. I read in the paper they had reduced the rate.

Mr. LOOMIS. The subcommittee of the Senate Ways and Means Committee brought in a report for a very serious reduction, but the rate was left as it now appears on consideration by the full committee.

Senator BULKLEY. Is it a fact, if you want to buy Perilla oil that you buy it cheaper than the seeds?

Mr. LOOMIS. Yes.

Senator BULKLEY. It would be cheaper to buy the oil?

Mr. LOOMIS. Yes.

(The brief referred to by Mr. Loomis is as follows:)

Mr. Chairman and members of the Finance Committee, we are asking your attention to two matters both of which seriously affect our domestic interests.

The first one relates to the rate of taxation on imported oil seeds, presented here on Thursday by the representative of the Institute of Oil Seeds Products.

This is a statement in rebuttal of the view and in part of the facts presented at that time.

The law on this subject now is that a tax of 2 cents a pounds is levied on the importation of Perilla seed, hempseed, rapeseed kapok seed, and sesame seed. This is repeated in the bill which is now before you. It is a tax which has worked successfully, providing a modest amount of revenue, depriving no one of any oil which they needed, and harming only a very few small operations of oil mills on the Pacific coast who are by this tax limited in their operations to domestic-produced oil seeds.

You were not told that this matter was presented fully to the Way and Means Committee and there rejected and stricken out of the subcommittee report. That is a matter of record.

The presentation made to you failed also to present one other important factor to be considered. It is true that these seeds have widely varying oil content. That is sesame seed may produce more than half its weight in oil, and kapok seed produces less than 20 percent of its weight in oil, the others ranging between these extremes. But it is also a fact, which was not mentioned, that there is a second and valuable coproduct from these seeds, namely oil cake or oil meal, which is an important item in cattle-feeding materials. And the higher the content of oil, the less the content of meal or cake.

The lower the oil yield, the higher the content of oil cake. All the seed is used, is sold, and is converted into money so the variation in oil content in reference to the rate of taxation is by no means the whole story to be considered.

Nor is the exact mathematical computation of just what rate of taxation on the seed is exactly equal to the rate of tax or duty on both the oil and the oil

cake, the only or final factor to be used in determining what this rate should be. Because any one or all of these seeds are imported and made here into cake and oil this product in the domestic markets replaces the products of some domestic oilseed or other source of fat or of oil. Consequently the fair rate to be approved and supported by this committee should be the rate which makes it possible for the domestic producer of competing seeds to produce his product, sell it in the domestic market and at least break even, and make a small profit, if possible.

Perilla and hemp seeds produce an oil which can be used in paints and varnishes. They, therefore, compete directly with flaxseed, soybeans and their product with fish oil—these are the domestic sources of paint, varnish, and linoleum oils. The present import duty on soybeans is 2 cents a pound. Soybeans produce about 14 pounds of oil per hundred pounds. Perilla seeds produce about 37 pounds of oil per hundred pounds of seed. If the oil were the only basis for working out compensatory taxes, then in order to equalize the rates between Perilla seed and soybean seed, both imported from Manchuria and Japan, the rates should be between 6 and 7 cents a pound of Perilla seed producing 37 pounds of oil per hundred, to equalize the rate of 2 cents on soybean seed, producing 14 pounds of oil per hundred pounds.

The present rate of 2 cents a pound was placed in the law in the first place because the rate on soybean seed, with which every single one of these seeds directly competes, was already established by Congress in the Tariff Act of 1930 at 2 cents a pound. The implication presented here on Thursday that there was some lack of brains or of understanding in the heads of members of this committee in approving and putting into effect a flat rate of these different seeds was a reflection on the members of this committee which has no basis in fact.

With no more basis it would be possible to manufacture an attack on the members of the committee of the other house which only 3 weeks ago threw out this same demand for greatly reduced rates. But the facts are that such committee having before it the same documentary statements from the Tariff Commission that have been sent to this committee, and after giving the matter rather thorough consideration, did throw out this suggestion. In other words, there is a far greater problem presented here than a mere mathematical computation of second-grade arithmetic.

The facts are, also, that the Tariff Commission has not made any recommendation on this matter. What the Tariff Commission has done is to send here to you a mathematical statement of just what the exact compensatory rates would be based on a 3-cent duty on oil, and the existing three-tenths of a cent per pound duty on oil cake or oil meal. Then there is appended to that a statement of the result which would show if from these compensatory rates there should be contracted certain arbitrary figures.

No basis is given, or reason shown, for the use of any of these arbitrary subtractions. In fact, again, the Commission frankly states that it does not have the necessary data upon which to figure what deductions should be made. Nowhere does it state a case why any deductions should be made.

In other words, we come before you with the only tangible and factual statement which is being presented. Namely, that these seeds compete with soybeans, and soybeans carry a rate in the existing law of 2 cents a pound. Therefore, these seeds should carry a rate of 2 cents a pound, certainly not less than that amount. Every seed in this list produces more oil per hundred pounds than do soybeans. To be wholly fair about it the rates should be more than 2 cents a pound.

I wish to ask permission to file a brief for your consideration, and to urge the committee not to endanger any domestic producer of any oil or fat product by action on this matter which does not fully comprehend all the factors involved.

The second matter I desire to present is far less complicated and I think I can make it clear in much less time.

I am calling attention to and proposing an amendment to the first subparagraph on page 337. The amendment I am asking you to consider would be added after the semicolon after the word "pound" in line 11, and would read as follows:

"*Provided*, That no whale oil, fish oil, or marine animal oil of any kind (whether or not refined, sulphonated, sulphated, hydrogenated, or otherwise processed), or fatty acids derived therefrom, shall be admitted to entry free from payment of the tax provided in this subparagraph unless such oil was produced by citizens of the United States, on vessels of the United States, or in the United States or its possessions, from whales, fish, or marine animals, or parts thereof, taken or captured by citizens of the United States while employed on vessels of the United States."

This amendment should also end with a semicolon, so as not to interrupt the continuity of the entire paragraph.

We are asking for this amendment to correct the situation which has arisen in the whaling industry resulting in large quantities of whale oil being dumped into our markets under conditions which we are sure were never contemplated when the whale-oil tax was written into the law in 1936. This subparagraph numbered 8-a, says that whale oil when imported into the United States shall be taxed 3 cents a pound. But, only within the past 3 weeks, 12,526 tons of whale oil were admitted, landed from a foreign tanker ship in two of our ports, and our protest against permitting this to come in free of tax was answered by a letter from the Assistant Secretary of the Treasury stating that they find no reason for collecting the tax on this cargo.

This oil was produced on a ship which has received registration as an American ship, but every whale from which it was made was fished for, sighted, pursued, caught and killed by the crews of foreign vessels. This is of evidence in the Bureau of Marine Inspection and Navigation where the credentials of these vessels under the Whaling Treaty Act are issued and recorded. I am not here raising the very much disputed question of the character of the registration of the mother ships, or factory ships, as they are called. Whether or not these ships can legally engage in fishing and have it come under the rule of what constitutes an American fishery, I am raising here the fact that these 22 killer ships are frankly and admittedly foreign ships, and still the rule of the Customs Bureau permits the oil to be made from these whales to be admitted free from payment of this tax.

It may be perfectly legal under the law as it now stands. I do not admit it, but I say that under the remainder of the customs law it will be most difficult to do anything about it. But I further say that I am certain that it was not the intent of Congress in 1934, or again in 1936 when this was reenacted with additions, to permit this subterfuge by which foreign capital invested in factory ships, and in foreign killer ships could produce whale oil, and beat this tax.

This amendment will end this subterfuge and evasion of the intent of Congress. It is brief and clear. After it is enacted whale oil will fall into one of two classifications, that produced by the citizens of the United States, like the whaling companies now operating on the Pacific coast, and which will be free from this tax, and whale oil produced by foreigners in foreign ships, which will pay this tax to equalize the differences in the cost of reduction, the wages, and living conditions of the sailors, laborers, and fishermen employed in the operation.

I have been over this matter with officials of both the Bureau of Navigation and Customs, and with operators of vessels engaged in both the foreign-owned, pseudo-American-operated boats, and the all-American-operated boats. Unless and until the laws relating to whale fishing are changed as indicated in this amendment, this whale oil, produced as I indicate will continue to be offered here in such quantities as free from tax in such manner and at such prices as to ruin not only domestic whalers, but also the manufacturers and producers of competing products made by the citizens of the United States.

In the past few years these free-of-duty whale-oil cargoes admitted here free from tax have amounted to about 90,000,000 pounds. This amendment, had it been written into the act last year, when we first brought this to public attention, would have either retained the domestic market for domestic producers or collected a tax of 3 cents a pound, or about $2,700,000.

Every pound of this whale oil, of the better grades goes into manufacture of products usually made from cottonseed, soybean or corn oil, and competes with lard, while every pound of the low-grade whale oil competes with the low grades of cottonseed, soybean, corn oil, and tallow in soap and lubricants. It has a market here solely because of its low price, when coming in without tax payment. There is not, so far as I have been able to ascertain, any single use for this oil in the United States not as well or better served by one or more of our own products.

The CHAIRMAN. Miss Parker.

STATEMENT OF MISS MARY JANE PARKER, REPRESENTING THE BEAUTY INDUSTRY LEGISLATIVE COMMITTEE, NEW YORK CITY

Miss PARKER. My name is Mary Jane Parker, and I represent the Beauty Industry Legislative Committee, of which I am secretary. The address is 400 East Forty-ninth Street, New York City. This

committee was formed in 1935, composed of representatives of the American Cosmeticians' Association, the National Hairdressers' and Cosmetologists' Association, the All-American Beauty-Culture Schools, Associated, and the Beauty and Barber Supply Institute, Inc.

These two national organizations of beauty-shop owners include an active membership of around 16,000 and are fairly representative of the 64,000 beauty shops of the country.

These 64,000 beauty-shop owners and their employees as well as the manufacturers, distributors, jobbers of cosmetics and beauty schools, wish to enter a most vigorous protest against the proposal that the tax on their products be retained.

They accepted with good grace the fact that the tax of 10 percent put on these products 6 years ago because it was an emergency matter and included a long list of other products similarly taxed. They and the women of the country consider these products necessities and no more properly subject to tax than hundreds of other articles. The women of this country consider these products are absolutely essential and should not be taxed. There are numerous examples I could give you, but a specific one known is albolene. I know that numbers and numbers of women find such products as albolene absolutely essential and necessary for cleansing a skin that is abnormally oily or dry, or has some peculiarity which makes soap impossible, or impracticable, for them to use. I call that one particularly to your attention.

Since 1932, the tax on jewelry, obviously a luxury, has been abolished. The tax on furs, largely luxuries, reduced to 3 percent, and the present bill removes the tax on furs altogether, and on practically everything which was taxed along with cosmetics in 1932. It is estimated that at least 97 percent of the women of the country consider cosmetics necessities and they are certainly essential to women in industry, whom the census shows number more than ten million.

Now, the viewpoint held by the industry is that the tax seriously affects both the volume of business and conditions of labor. In this respect I call your attention to a statement made in the House of Representatives on March 10, by Congresswoman Mary T. Norton, of New Jersey, chairman of the House Labor Committee. Mrs. Norton said she had made a careful study prior to her introduction of an amendment asking the elimination of this discriminatory tax on cosmetics, and she estimated that indirectly or directly the tax affected employment and wages of some 500,000 people. Of this total between 250,000 and 300,000 fall within the beauty industry. And these people feel that it is most unjust and unfair to single out for taxation the industry in which they earn their livelihood, while furs, and jewelry, and other luxuries go scot-free.

Mrs. Norton also made reference to a letter which came from the President of district No. 50, of the United Mine Workers of America, attached to which were resolutions adopted by six of the local unions under his jurisdiction. She said, "This message points out the injustice of the tax to the members, all of whom are employes of cosmetic manufacturers. It states that the tax has increasingly reduced employment, has affected and is affecting adversely wage scales in the industry, and has prevented the expansion which would have been normal and increased employment. It also stresses that the tax has affected adversely the wages, hours, and employment of the hundreds of thousands of employees in the estimated 64,000 beauty

shops in the country * * *. They are vitally interested in removing this burden from the industry in which they gain their living."

I refer you to page 4268 of the Congressional Record for March 10, 1938.

Let me add that the Department of Labor and those interested in employment generally have taken up the matter of the increasing unemployment among people past 35. They have found it a major and distressing problem. On this subject a conference was held in the Department of Labor a few weeks ago and the conditions revealed were most unhappy. For women in this class, the retention of a job is in all cases difficult and originally impossible where the appearance begins to show signs of age. It is not too much to say that for practically all of these women the use of cosmetics is absolutely essential to the retention of employment. The difficulty, of course, is multiplied when she seeks not to retain a position but to obtain employment in competition with those who are younger. In modern industrial society, appearance of youth and efficiency must go along with efficiency itself. Cosmetics are not used by one class of women, but by all classes of women and, therefore, the tax falls heaviest on the women among working people, who are the most numerous.

Senator KING. May I ask you a question?

Miss PARKER. Yes, sir.

Senator KING. Do you have the thought that the charming ladies of this generation, by the use of cosmetics, are more beautiful than their grandmothers?

Miss PARKER. No; I would not say that, Senator King. Of course, I have only the benefit of the experience in my own generation, but I feel that modern industrial competition has made grooming an absolute essential to women more than ever before, especially among those women who have to meet the competition of those who are younger and better looking.

The CHAIRMAN. We thank you very much.

Miss PARKER. I would like to add, if I may, that on these grounds I have mentioned, the Woman's Trade Union League of Chicago, through its president, Agnes Nestor, has protested against the continuance of the tax and particularly as an injustice to working women who find the use of cosmetics essential.

All divisions of the beauty industry have from time to time during the past year voiced vigorous protests against this unjust taxation. In official conventions, trade shows, as organized national and local bodies, and as individuals, resolutions and various forms of protests have been adopted. The national trade journals which constantly reflect and direct the feeling of the industry, Modern Beauty Shop Magazine, with a circulation of 45,000 beauty shops, the American Hairdresser Magazine, Beauty Culture Magazine, and Beauty Trades Review, all with wide national circulation, have repeatedly encouraged the industry's action with regard to the tax and have forcefully urged that protests against it be made in terms loud and effective enough to be heard.

It stands to reason when organized bodies of beauty-shop owners, distributors of cosmetics and the schools, as well as the individual beauty-shop owner, protest to this committee against this tax, it is evident that they and their customers are vitally affected by the tax and are feeling the burden of it.

Mr. Eisner spoke for the members of the Toilet Goods Association, who furnish the 5- and 10- and 25- and 50-cent stores and the retailers in general, who, in many instances, are not able to pass on the tax, at least not directly, although it may be done by smaller packaging, etc. Those manufacturers do not supply the beauty shops. I, therefore, wish to quote a letter written last March by the executive director of the National Hairdressers' and Cosmetologists' Association, Inc.

> Every beauty shop in the United States is paying annually a substantial amount of money on account of the Federal excise tax on toilet preparations. This tax is of the "invisible" variety, and because it is commonly included in the price of merchandise bought, many shop owners do not know that they are paying it, but believe, erroneously, that the tax is levied on and paid by the manufacturer. The fact is, however, that every dollar of the tax levied against toilet preparations sold to and used by beauty shops is paid by the shops.
>
> According to the census figures, the average gross income of the 61,355 beauty shops in the United States for the year 1935 was approximately $2,800. Out of this amount the shop owner had to pay rent, wages, and the other operating costs of the business. It is evident that any enterprise of such limited income is not in position to continue to bear the burden of a tax of this character.
>
> This tax is discriminatory and places an unreasonable burden on the shops. Every shop owner, therefore, should be glad to join in a vigorous protest to Congress against the continuance of this levy, which is destructive to business, and has a serious adverse effect upon employment in the beauty-shop field.

I do not think, however, that the fact that the manufacturer may include the tax in his price negatives the contention made by women generally that the ultimate burden must be borne by them and that, as in the case of other excise taxes, it is included as a basic cost on which the jobber and beauty shop fix their prices as well, and that the ultimate amount paid by the consumer on account of the tax is, of necessity, much larger than the tax itself. The manufacturer, the shop owner, and the consumer each believes that he or she bears the full burden of the tax. What proportion each does bear is difficult to determine.

That the tax is, however, an unjust burden both on the industry and its women patrons is increasingly evident. I am quite sure that the members of this committee would not favor imposing such an inequitable tax on women, to the exclusion of taxes on things that are palpably luxuries, if the matter came to them as an original proposition.

Senator KING. Are any of them utilizing cosmetics, or do they just teach beautology, if you call it that, in the schools?

Miss PARKER. There are any number of universities that have included a course in grooming in their curriculum. New York University, and I think Kansas, or some Midwest university, and some of the public high schools, in New York for instance, are doing it.

My argument is not Beauty over Brains or Appearance over Ability or Artificiality over Naturalness; it is not that at all. My point is, and I think you will agree with me, that in merchandising anything, whether it is an article of merchandise or personal ability, appearance is important, and in this day of competition it is the attractive package that gets the attention. [Laughter.] But I am not concerned only with that fact; my plea is for the 300,000 people who earn and who are entitled to make their living doing that all-important packaging and repackaging job.

Senator KING. You look at the Senator from Texas when you speak about the handsome package. [Laughter.]

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Senator CONNALLY. I have not exhibited as much interest in the subject as the Senator from Utah. [Laughter.]

The CHAIRMAN. All right.

Judge Goodwin, you have 10 minutes. Have you a brief there?

STATEMENT OF CLARENCE N. GOODWIN, WASHINGTON, D. C., REPRESENTING SALES AFFILIATES

Mr. GOODWIN. Mr. Chairman, I will keep within the 10 minutes, I hope, and if I do not, you will keep me within it. You understand, however, how difficult it is to meet such competition as I have had just preceding me.

The CHAIRMAN. I do not think you can do that.

Mr. GOODWIN. I will not try.

I think perhaps everybody will wonder why, in view of the presentation made by the five Congressmen on the floor of the House, that the amendment was not passed. I think that the reason why it was not passed will be found in one sentence by the chairman of the committee, if I can locate that sentence. It was this, Mr. Chairman:

> This is one of the most prosperous industries in the country, and the adoption of such an amendment would simply mean taking $17,000,000 out of the Treasury of the United States to yield to a matter of sentiment, with the money going into the pockets of the manufacturers.

Now, that statement, Mr. Chairman—Mr. Eisner has shown that so far as the $17,000,000 is concerned, there was $17,500,000 spoken of by Mr. Cooper—the estimate was 112 percent too high because there is not more than $8,000,000 here involved, and he had inadvertently included the tax on toilet soaps and dentifrices, which are not in the bill and which had been taken out of the bill. So far as this tax going into the pockets of the manufacturers is concerned, he was about 90 percent wrong. The result of taking off this tax would be to the gradual benefit of those associations and organizations and other beauty parlors represented by the lady who just preceded me.

In view of the intensive competition which exists among manufacturers, it would be impossible for the manufacturers to retain that benefit. Their competition is directed to an increase in volume, and to obtaining volume from their competitors, and the first result of that lowering or elimination of the tax would be for the benefit of both the beauty parlors, of whom there are 64,000 and their employees of whom I think there are 300,000, and it would mean more work in the manufactures, a lower price, and consequently a benefit to the public generally.

There is, Mr. Chairman, a law of gravitation, and that law of gravitation works in business and industry just as it does in other things, and if there is a reduction in cost in a competitive industry there is a reduction in price, and ultimately the consumers get the benefit of it.

Now, Mr. Chairman, I happen to represent Sales Affiliate, which is a distributor of cosmetics. They stand between the manufacturer and the 1,500 jobbers and in turn they know the conditions affecting the manufacturers and affecting the jobbers and affecting the beauty shops and affecting the public. I notice in Mr. Eisner's presentation he suggested elimination of the tax on a number of things, and I am entirely in accord with him on that; for instance he suggested cleansing creams and hair tonic.

I am not so much sold on the idea of the efficiency of hair tonic, but we represent a large number of different brands of hair coloring—and I want to say a word about that. Now, who buys the hair coloring? Of course it is women whose hair has begun to gray and grizzle; but what women? Almost entirely women who are employed, whether they are executives, assistants, or whether they are stenographers or whether they are working in stores or in service or otherwise, they buy it, and they have to use it in order to keep their jobs.

I think Miss Parker referred to the conference in the Department of Labor that lasted nearly a week, on the subject of the people employed—the difficulties of people employed over 35 years of age. The women in industry could not keep their jobs overnight if they allowed their hair to become gray and grizzled. They must be not only efficient in industry, but the managers or superintendents demand that there be an appearance of efficiency as well as efficiency, and an appearance of youthfulness, and our customers, those to whom we sell, are people who have to use it in order to keep their jobs, and it is a tax, therefore, on the necessities of the working women.

The 10,000,000 women gainfully employed supply the bulk of the hair-coloring demand; the rest is hardly more than a fringe. This is illustrated by the fact that in New York the Third Avenue shops where the patrons are largely women employed the percentage who have their hair colored is high while in the Fifth Avenue shops where the percentage of patrons gainfully employed is low, the number who have their hair colored is proportionately small.

There is another thing I want to mention. It has been said cosmetics are in general use among all classes.

I am a witness here and I can testify first-hand in regard to that. In the summer of 1936 we drove from Blue Ridge Summit to Delaware Water Gap, where my people lived 200 years ago and we passed through all of those coal mining towns along the road. This happened to be a Saturday and the streets were full of the wives and daughters of the men who work in the mines. Thanks to the Congress they appeared to be in good circumstances, but all of them, apparently, so far as we could see, made use of cosmetics. So, it is a tax that does not fall on any particular class; it is a burden that the working classes bear their part of as well as others; they bear the larger part of it because there are more of them.

The CHAIRMAN. There is another witness on cosmetics and I am going to call him next. We will recess for 1 minute.

(Whereupon a short recess was taken after which the hearing continued.)

The CHAIRMAN. Mr. Goodwin, I understand you have something else to present.

I am advised that returning tourists bring in great quantities of tax-free foreign toilet articles under their customs exemption—often as high as 60 percent—which are sold in competition with our products paying 10 percent; this is an added burden to manufacturers.

Mr. GOODWIN. The bill removes the tax from toilet soaps and dentifrices but, while we approve of this because we are opposed to a tax on any toilet articles, there is no more reason for removing it from toilet soaps and dentrifices than from other toilet articles. The subcommittee recommended the removal of the tax from toilet soap and dentifrices, along with chewing gum and cameras, because, they said,

"they are imposed upon commodities in common use." These articles are not, however, in as common use as cosmetics, barring the fact that they are used by men and women alike while cosmetics are used principally by women alone.

While soap is universally used in this country for the toilet, the information gained during the years I represented one of our largest soap manufacturers indicated that at least 75 percent of the soap used for personal toilet purposes was general household soap and not toilet soap. Toilet soap is, therefore, in a sense a luxury, used by the comparatively well-to-do, but in a true sense I think that anything 25 percent of our people find necessary for their accustomed mode of living is not a luxury but a necessity; this applies with equal force to toilet articles, which the testimony shows are used by at least 90 percent of the women of the country. Neither toilet soap nor other toilet articles should be taxed, but if one is exempt the other should be exempt; if one is taxed the other should be taxed, and at the same rate. What is said about toilet soap applies equally to dentifrices, as the great mass of the people use salt, chalk, orrisroot, sodium perborate, powdered charcoal, and like material rather than taxable dentifrices.

I wish to submit a number of alternative proposals for amendments; (*a*) eliminating the tax altogether; (*b*) reducing it to 3 percent; (*c*) broadening the scope of this 3 percent tax to include proprietor brands in accordance with recommendation 63 of the House subcommittee; (*d*) making the 3 percent tax apply to all toilet articles, including toilet soap and dentifrices; and (*e*) applying the 3 percent to all toilet articles and broadening the scope in accordance with recommendation 63.

The CHAIRMAN. That may be placed in the record.

(The amendments proposed are as follows:)

(*a*) On page 299, lines 5 and 6, strike out the words "tooth and mouth washes, dentifrices, tooth pastes, or toilet soap" and insert the word "articles."

(*b*) On page 299, line 6, strike out the period after the figures "1938" and add "and the tax imposed by said section on other articles shall be 3 percent after that date." (Accepting Mr. Eisner's estimate that the bill would produce $8,000,000 in 1938, the yield under this amendment would be $2,400,000.)

(*c*) On page 299, line 6, strike out the period after the figures "1938" and add "and the tax imposed by said section on other articles shall be 3 percent after that date."

Add: "It is further provided that on and after said date the person, firm, corporation or association, owning or controlling, directly or indirectly, the trade-mark or marks, trade name or names, brand or brands (whether or not affixed to the article or its container or wrappings, or however otherwise the same may be indicated), shall be deemed the manufacturer, producer or importer of the article within the meaning of section 603 of the Revenue Act of 1932, regardless of who may perform its actual manufacturing and processing, in whole or in part.

"As used in this section, ownership or control of trade-mark, name, or brand, shall include the right to use or employ the same, whether conferred by license or permission, expressed or implied, agreement or agency relationship, or by any other manner or means.

"The tax shall be paid upon the sale of an article by the manufacturer, producer or importer as herein defined." (Mr. Eisner estimated that this change recommended by the subcommittee would increase the total amount of taxable sales by some 60 to 75 percent. On the basis of 60 percent, the yield under this amendment would be $3,840,000.)

(*d*) On page 299, lines 4, 5, and 6, strike out the words "not apply to tooth and mouth washes, dentifrices, tooth pastes or toilet soaps" and insert in place thereof "be 3 percent on all articles". (The yield on toilet soaps and dentifrices in 1937 was $6,642,000. Assuming that it would have been $6,000,000 for 1938 under the present law, at 3 percent the tax would be $4,800,000, making a total yield

on a straight 3-percent basis of $7,200,000 instead of the $8,000,000 suggested by Mr. Eisner's figures.)

(e) On page 299, lines 4, 5, and 6, strike out the words "not apply to tooth and mouth washes, dentifrices, tooth pastes or toilet soaps" and insert in place thereof "be 3 percent on all articles."

Add: "It is further provided that on and after said date the person, firm, corporation, or association, owning or controlling, directly or indirectly, the trade-mark or marks, trade name or names, brand or brands (whether or not affixed to the article or its container or wrappings, or however otherwise the same may be indicated), shall be deemed the manufacturer, producer or importer of the article within the meaning of section 603 of the Revenue Act of 1932, regardless of who may perform its actual manufacturing and processing, in whole or in part.

"As used in said section, ownership or control of trade-mark, name, or brand, shall include the right to use or employ the same, whether conferred by license or permission, expressed or implied, agreement or agency relationship, or by any other manner or means.

"The tax shall be paid upon the sale of an article by the manufacturer, producer or importer as herein defined." (On the basis stated above the tax under this amendment would be $11,700,000 or about $3,700,000 more than under the terms of the bill as it passed the House.)

Mr. GOODWIN. I thank you very much.

The CHAIRMAN. Mr. Mannes.

STATEMENT BY J. W. MANNES, NEW YORK CITY

Mr. MANNES. I am an employee of one of the largest cosmetic firms in New York City and also president of one of the local unions in that city. I want to stress a point that has not been stressed heretofore, I think, and that is the actual effect of the collection of this tax on the fellows and the girls who do the actual work in the plants. This cosmetic industry is one of the worst paid and hardest worked in the country. Wages of $8 a week are not uncommon in St. Louis and the Middle West, and $10 and $11 are far too common in New York City, which is not in the South, where living is supposed to be cheap and where workers do not need any wages at all, but is probably one of the most expensive parts of the country to live in.

Senator KING. Is that the women who work in the beauty shops that you refer to?

Mr. MANNES. No, sir; in the factories that produce the stuff.

When we ask for an increase in wages our answer is the company has not made money the previous year but has lost money, and in addition to that they have paid out over $200,000 in excise tax, and then we do not have any answer, naturally.

When the tax was first introduced in 1932 an emergency which has lasted 5 years and the tax has been taken off every other thing except cosmetics—we think we are a stepchild altogether. Through what process of reasoning golf balls, jewelry, furs, and chewing gum are considered to be necessities and cosmetics a luxury, I cannot say. If you gentlemen have any lingering doubts as to whether cosmetics are necessities or luxuries, I suggest you ask your wife or daughters and they will quickly dispel any doubt you may have on the subject. If cosmetics are luxuries, then shaving also is a luxury and you might as well put a tax on safety razors.

Senator KING. You want the tax removed?

Mr. MANNES. Entirely. It has been removed on everything else. The yield of the tax is so small in comparison with the damage it does to the industry in general and to the worker in particular, it is not warranted. The wages I have mentioned are not the exception but the rule rather than the exception.

Senator KING. Would the abolition of the tax on the manufacturing of these cosmetics seriously affect, or to what extent would the abolition of the tax on the manufacturers affect the workers in beauty parlors?

Mr. MANNES. As to the matter of increased production, it would affect them, but I am only talking about the people in the factories themselves. Some of the fellows have already gone on record saying they would be willing to turn part of it back in wages, and those who have not gone on record could probably be induced to do so.

The CHAIRMAN. We thank you very much. The cosmetics people have certainly presented their case strongly. We have heard about six of them, and I do not think there is any phase of this question which we do not understand. Of course we cannot say what the committee will do.

Senator BULKLEY. Several witnesses have discussed before the committee the tax on cosmetics. I would like to offer for the record a memorandum sent me by Mr. T. S. Strong, of Cleveland, Ohio, on this matter, in order that the committee may have as complete information as possible when the cosmetic tax is considered in executive session.

MEMORANDUM SUBMITTED BY T. S. STRONG, CLEVELAND, OHIO

Sections 603 and 619 of the Revenue Act of 1932 which impose and fix the basis of the manufacturers' excise tax on toilet preparations, should be amended and clarified so as to remove administrative uncertainties, difficulties, and disputes which are at present vitally and adversely affecting commercial and employment conditions in the toilet-goods industry. In support of this position we respectfully invite attention to the following matters:

(1) A manufacturers' excise tax is imposed on the privilege of manufacturing and should be based upon cost of manufacture, plus assembly and packing costs, plus a reasonable manufacturer's profit; in other words, a manufacturers' sale price.

(2) A sales tax is imposed on the privilege of selling goods and should be based on the cost of goods sold (whether manufactured or purchased) plus selling, promotional and distributional costs, plus selling profits; in other words, a merchant's sale price.

(3) It seems clear that Congress in enacting the Revenue Act of 1932 intended to impose a manufacturers' excise tax, not a sales tax, because,

(*a*) The 1932 Congress rejected Mr. Hoover's recommendation for a sales tax.

(*b*) Section 603 is a part of title 4, which specifically imposes manufacturers' excise taxes on various articles.

(*c*) Section 619 (*a*) specifically includes manufacturing and packaging charges but specifically excludes from the tax base selling expenses such as transportation, delivery, insurance, installation, "or other charge," not specifically required to be included in the price.

(*d*) The construction which Congress intended to be placed upon the phrase "or other charge" is clearly indicated by the uncontradicted and unambiguous statement made by Congressman Crisp on the floor of the House of Representatives, "* * * the selling cost is not intended to be added."

(4) Notwithstanding the clear intent of Congress to impose a manufacturers' excise tax based upon the manufacturers sale price at the factory, excluding delivery, selling and advertising costs and expenses, the Bureau of Internal Revenue is assessing the tax as if it were a sales tax computed on the price paid by a retailer for an article, including all the selling costs and expenses.

(5) The Bureau started to administer this law as Congress intended, as witness the first regulations issued by them. However, by an evolutionary process of modifying old regulations and issuing others more stringent, they by 1936 had arrived at their objective of including in the tax base all sales, advertising, and other promotional costs. By 1936 they were assessing this tax throughout the industry on this basis.

(6) This is done in violation of congressional intent by a bureaucratic finding that a cosmetic distributor who buys cosmetics from a cosmetic factory and sells

to a retailer is a manufacturer himself. Such finding is frequently a fiction. It is as reasonable to hold that an owner who orders a general contractor to build a house according to blue prints is himself the general contractor.

(7) It is done, secondly, by a bureaucratic and arbitrary denial of deductions of selling-cost items, bureaucratic because the law itself specifies the deductions; arbitrary because some taxpayers are favored over others, and when a taxpayer cites another's treatment as a precedent, the Treasury authorities refuse to discuss the more favored treatment accorded to others. This cannot be in accord with congressional intent.

(8) Such executive action violating the congressional intent has already turned some modest profits into substantial losses, and raised the question of winding up many companies with consequential increased unemployment and complete loss of revenue for the Government.

(9) It is true that the Bureau of Internal Revenue, in the settlement of certain isolated cases, has allowed deductions for certain specific types of sales and distributional costs, thereby effecting substantial reductions in the assessments in such instances. But the Bureau does not grant the same deductions to all manufacturers generally, nor will they give assurance even in these isolated cases that similar deductions will be allowed in the future. And if the future can be foreseen from the past it seems clear that the Bureau will continue to disallow selling, advertising, and similar costs in the average run of cases both large and small. The result is gross discrimination and unfair competitive conditions in an industry which should be competing upon an equal basis. Moreover, there is such uncertainty in the industry that business cannot be transacted without assuming unreasonable and prohibitive risks of being subjected to ruinous deficiency assessments because of a change of front by the Bureau.

(10) One of the largest companies in the industry paid as excise tax over 250 percent of their remaining net profit, which means that 71 percent of their profit was paid out as excise tax; and this is only a start in the taxation competition, for the balance of 29 percent may be subject to corporation income tax, undistributed profits tax, closely held corporation tax, and, finally, individual income tax on dividends paid, if any.

(11) In addition to the present doubts as to the proper basis and computation of the tax, the even more important question of "Who is the manufacturer" is cloaked with uncertainty due to the vacillating executive administration of the statute.

At the inception of its administration of the manufacturers excise tax imposed by the 1932 Revenue Act the Bureau of Internal Revenue held in accordance with the intent of Congress as expressed in section 619 (a), that—

(*a*) Where a manufacturer makes a packaged cosmetic for a wholesaler who furnishes labels, metal containers, etc., to the manufacturer, the wholesaler is taxable as the manufacturer.

(*b*) Where a manufacturer makes a packaged cosmetic for a wholesaler, furnishing all necessary labels, containers, and supplies to complete the package, the manufacturer is subject to the tax and the wholesaler is not liable.

(*c*) Where a manufacturer sells a bulk cosmetic to a wholesaler who separates the bulk and places it in retail-size packages, the wholesaler is taxable as the manufacturer.

Under these varying conditions the result was to consistently fix the manufacturer or taxpayer as the one who placed the article in containers ready for sale at retail, thus in all instances including the retail container in the tax base.

Later the Bureau held that the container need not be included in the price where its cost was disproportionate to the value of the cosmetic placed therein. This was the first breach of the will of Congress (sec. S. T. 559).

Next the Bureau reversed its former ruling and held that (see G. C. M. 11522)—

(*a*) Where a manufacturer makes a packaged cosmetic for a wholesaler who furnishes labels, containers, etc., to the manufacturer, the one subject to tax is the manufacturer and he is subject to tax only on the sale price of the bulk cosmetic. Here the containers are excluded from the tax base.

(*b*) Where a manufacturer sells a bulk cosmetic to a wholesaler who separates the bulk and places it in retail size packages, the manufacturer is subject to tax on the bulk sale price only. The wholesaler is not subject to tax. Here the containers are also excluded from the tax base.

(*c*) Where a manufacturer makes a packaged cosmetic for a wholesaler who furnishes not only the labels and containers but also ingredients which become a component part of the bulk cosmetic, the wholesaler is the manufacturer and subject to tax on his resale price. Here the containers are included in the tax base.

More recently the Bureau has held that a wholesaler who purchases a completely packaged cosmetic from a manufacturer is taxable as the manufacturer because—

(a) He specifies that the cosmetic shall have a certain odor, shape, size, or color.
(b) He advertises that he is the manufacturer.
(c) He owns the trade-mark or label under which the product is sold.

At present the definite tendency of the Bureau is to hold that the one who owns the label under which a cosmetic is marketed is taxable as the manufacturer even though he does not manufacture or produce the cosmetic and does not furnish any of the ingredients or packaging materials.

(12) Recently, the Treasury submitted to the House Committee on Ways and Means their recommendation No. 63 to H. R. 9682, which was intended to clarify the law, but presumably after further consideration the Bureau of Internal Revenue felt it would embarrass it in disposing of cases now pending before it, so this recommendation was withdrawn. This is typical of the uncertainty in the Bureau with which the cosmetic trade has had to do business.

We therefore both from the past record of old regulations modified and new, more stringent regulations adopted, and from the withdrawal of this recommendation No. 63, have every reason to believe that the industry cannot hope for nondiscriminatory and reasonably consistent treatment, rulings, and decisions from the Bureau unless Congress clears the way by removing all possible opportunity for executive misconstruction of the law. This can be done, we believe, by means of the following amendments to sections 603 and 619 (a) of the 1932 Revenue Act. We further believe that the suggested amendments are not only in strict accordance with the original intent of Congress in enacting these sections of the presently existing law, but that if enacted they will remove existing inconsistencies in Bureau rulings and compel the Bureau to administer the statute equitably and without discrimination throughout the industry.

T. S. STRONG,
2654 Lisbon Road Cleveland, Ohio.

Senator KING. Mr. Frederic Brenckman.

STATEMENT OF FREDERIC BRENCKMAN, WASHINGTON, D. C., REPRESENTING THE NATIONAL GRANGE

Senator KING. If you have a written statement we will be glad to take it.

Mr. BRENCKMAN. Mr. Chairman and gentlemen of the Committee, my name is Fred Brenckman and I am Washington representative of the National Grange. I will try to be as brief as possible so as to conserve the time of the committee.

In appearing before the committee, I wish to say that the National Grange favors that provision of the revenue bill which places an excise tax of 6 cents per pound on pork and pork products.

Official figures of the Department of Commerce show that our imports of pork and pork products have gone up by leaps and bounds during the past 3 years. The statistics in this connection are as follows:

Pork imports for consumption during the past 3 years

Item	1935	1936	1937
	Pounds	*Pounds*	*Pounds*
Live swine	3,414,317	17,445,457	16,555,218
Fresh pork	3,703,375	12,886,150	20,876,569
Hams, shoulders, and bacon	5,230,766	26,009,700	47,422,022
Pickled, salted, and other	1,288,529	2,806,787	6,531,889

Adding these figures together gives us total pork imports of 91,385,698 pounds for the year 1937, as compared with 13,576,987 pounds for 1935.

Senator KING. Do those figures show the exports of lard and canned goods, such as canned fruits?

Mr. BRENCKMAN. No; but I would like to place them in the record if it is the wish of the committee.

Senator KING. They will be placed in the record.

Mr. BRENCKMAN. I am speaking of imports.

Senator KING. You may do so.

Mr. BRENCKMAN. According to the Department of Agriculture on January 1, 1936, there were 42,837,000 hogs on the farms of the United States, having a farm value of $544,911,000. On January 1, 1938, the number of hogs on farms had increased to 44,418,000. Their value as given by the Department of Agriculture was $498,025,000. It will be seen, therefore, that while the number of hogs on our farms had increased by more than a million and a half during the past 2 years, their value has decreased to the extent of nearly $47,000,000.

The latest index of the Department of Agriculture shows that the average price level of all farm commodities now stands at 102 percent of pre-war. Prices paid by farmers for commodities bought averaged 126 percent of pre-war, giving the farm dollar the purchasing power of 81 cents.

During the calendar year ending December 31, 1937, our imports of canned beef amounted to more than 88,000,000 pounds. According to our information, for every pound of canned beef produced domestically, we imported 12 pounds. In fairness to domestic producers, we advocate the imposition of an excise tax of 3 cents per pound on imported preserved beef and veal products contained in air-tight containers.

During the last calendar year, we imported the equivalent of more than a million cases of eggs in various forms. This amounts to 31,933,000 dozens. While these eggs were being imported, the Surplus Commodities Corporation was buying eggs in the domestic market in an effort to stabilize prices.

The price index of the Department of Agriculture shows that the average farm price of eggs in our local markets throughout the United States on February 15 was 16.4 cents per dozen. Such a price for eggs during the winter months is ruinously low.

Many people do not realize that poultry and poultry products account for approximately 1 billion dollars of our farm income annually. Thus far, our poultrymen have received no benefit from any of the adjustment programs carried out by the Government. On the contrary, the poultrymen have been penalized by the higher prices they have been compelled to pay for feed by virtue of the control programs carried out for the benefit of other agricultural producers.

Under the circumstances, we are persuaded that reasonable excise taxes on imported eggs should be included in the pending revenue bill.

Under the Tariff Act of 1930, tapioca, cassava, and sago were placed on the free list on the theory that these were noncompetitive food products.

In reality, however, these starches, for such they are, come into competition with domestic starch made from corn, Irish and sweet potatoes, rice, and other farm products. The United States has become the dumping ground of the world for these starches. In 1932 our imports of duty-free tapioca and sago amounted to 139,000,000 pounds. By 1935 this figure had jumped to 227,000,000, and during 1937, our total imports were more than 460,000,000 pounds.

With more than a million and half pounds of duty-free starch entering the country every working day in the year, we respectfully

submit that it is the duty of Congress to take proper steps for the protection of domestic producers of starch-bearing commodities. I have some facts pertinent to the matter under discussion that I should like to file for the record.

We are asking that an excise tax of 1¾ cents per pound be placed upon the first domestic processing or use of sago, sago crude, and sago flour, tapioca, tapioca crude, tapioca flour, and cassava, whether or not such products or any of them have been refined, modified, or otherwise processed, and in whatever combination or mixtures containing a substantial quantity of any one or more of such products, the tax to be paid by the processor or user thereof in manufacturing or processing.

For the purposes of this section the term "first domestic processing" shall mean the first use in the United States, in the manufacture or production of an article intended for sale, of the articles with respect to which the tax is imposed. The tax on the article described in this paragraph shall apply only with respect to such articles imported after the date of the enactment of this paragraph and shall not be subject to the provisions of subsection (b) (4) of section 601 of the Revenue Act of 1932, as amended (prohibiting drawback), or section 629 of such act (relating to expiration of taxes).

We assume that this amendment should follow section 712 of the 1938 Revenue Bill now being considered by your honorable committee.

These products are of the Orient, produced mostly on the Islands of Java and Madura with coolie labor on fertile soil. An acre planted to tapioca bushes will yield approximately 1,550 pounds of competing product. Sago palms will yield around 10,000 pounds per acre. In this country, about 865 pounds would be the yield per acre of domestic starch. These imported products compete directly with the American-produced starches—corn, wheat, sweet- and white potatoes, and rice. The products, tapioca and sago, come into this country prepared so there is no American labor involved, whereas in the corn-refining industry, for instance, between 7,000 and 8,000 men are employed. There is practically no expenditure for supplies or processing of the imported products whereas in the corn-refining industry, the purchases of supplies and fuel for processing are very heavy. You would probably be surprised to know it takes 16 tons of coal to process a thousand bushels of corn. In a normal year, the industry buys about 1,500,000 tons of coal. There is a great deal of freight transportation necessary in the receipt, processing, and delivering of these products from corn. The corn-refining industry has to freight the corn in, freight its finished products out to the market, freight the feed out to the various districts, freight the coal and supplies in, and so forth.

The ever-increasing imports of these starches have been the source of a great dislocation to the domestic industry. The menace of these imports has been mentioned by the agricultural interests for some time. In 1900 there were about 16,000,000 pounds imported. This amount was doubled in every 10-year period, and when the Netherlands treaty was first being considered, the imports were around 180,000,000 pounds. The year the treaty was consummated the imports were 226,000,000 pounds. The first year under the treaty they were 306,000,000 pounds, and last year a 50-percent increase over that to 466,000,000 pounds. All of this at the expense of the American starch producers. The imports of these Asiatic starches today amount to two-fifths of the total starch sales in this country;

in other words, for every 5 pounds of starch sold, 2 are of Asiatic origin and 3 domestic. The 466,000,000 pounds of Asiatic starches which were brought into this country last year were equal to the domestic starch produced from 13,700,000 bushels of corn. I want to read to you the dislocation that caused:

IMPORTANT DISLOCATIONS RESULTING FROM DUTY-FREE STARCH IMPORTS REVENUE TO THE FARMER

The 466,327,683 pounds of duty-free starches imported in 1937 are equivalent to the cornstarch produced from about 13,700,000 bushels of corn. One bushel of corn yields approximately 34 pounds of cornstarch. Weighting the average monthly price of corn at Corn Belt farms by each month's corn grind, the weighted average price for 1937 was 93.5 cents per bushel.

Value of 13,700,000 bushels, at 93.5 cents per bushel	$12, 810, 000
Revenue to the railroads:	
(a) Freight revenue on the corn-grain equivalent of the duty-free starch imports	1, 370, 000
(The average freight from the farm to the processing plant is placed at 10 cents per bushel.)	
(b) Freight revenue on cornstarch	700, 000
(It is assumed that the freight revenue on cornstarch from the corn-processing plants to the points of consumption would be at least 15 cents per 100 pounds greater than the revenue obtained from the transportation of the duty-free starches from the Atlantic coast ports to the points of consumption.)	
(c) Freight revenue on the byproducts obtained from the processing of the corn-grain equivalent of the duty-free starch imports	330, 000
(It is assumed that in the processing of a bushel of corn, from 14 to 16 pounds of byproduct feeds are produced; also, the average freight rate on the byproduct feeds from the point of production to that of consumption is $3 to $3.50 per ton.)	
In addition, the processing of a bushel of corn yields about 1½ pounds of corn oil; the average freight on corn oil is estimated at ½ cent per pound	100, 000
(d) Freight revenue to railroads on coal which would have been consumed to process corn-grain equivalent of the duty-free starch imports	226, 000
(The average freight per ton is placed at $1.)	
(e) Freight revenue from other fuel, chemicals, bags and containers, supplies, etc., estimated at	1, 250, 000
Revenue to labor:	
(a) Wages of men at corn plants to process the corn equivalent of the duty-free starch imports	1, 680, 000
(About 7,000 men are employed at the corn processing plants. The daily average capacity of the corn processing plants is 365,320 bushels. Assuming the plants could operate at about 90 percent of their capacity, it would take a little more than 8 5-day weeks to process 13,700,000 bushels, the corn-grain equivalent of the imports. The average wage per week is $30).	
(b) Wages to bituminous-coal miners	250, 000
(It would take about 226,000 tons of bituminous coal to process 13,700,000 bushels of corn. The average output per man per day is 4.5 tons, and the average wage is about $5.)	
(c) Revenue to additional railroad labor	
(The freight revenue listed above would cover a large portion of dislocation in railroad labor. However, the processing of an additional 13,700,000 bushels would probably require more locomotives, cars, other equipment and crews. The amount involved is not known.)	
(d) Revenue to farm labor	
(The price of corn under "Revenue to the farmer" would include practically all of this item. It would not cover additional costs, if any, necessary to provide a larger supply of corn-grain, such as shelling charges, storage, etc)	

Miscellaneous:

Elevator charges	$250,000
Fuel, excluding coal, chemicals, cotton bags and other containers, and miscellaneous supplies necessary to process the additional 13,700,000 bushels of corn (excluding freight costs included under "Revenue to railroads")	2,500,000
Total	21,460,000

I want to call your attention to section 202, on page 17 of the recently enacted Farm Act, which provides for setting up laboratories and the expenditure of money to investigate and find newer and greater uses for the products of American agriculture. How strange it is that we do things of this kind and then fail to avail ourselves of the opportunity to further increase the use of our American products by permitting competing products produced under slave labor, at costs this country cannot meet, to come in duty-free. In this connection, a study shows that whereas 15 years ago practically half of the exports of these starches was taken on the continent and half here, now the continental countries have enacted duties to protect their domestic starches so that now 82 percent of the Asiatic starches are coming to this country duty-free. It is interesting to note that while the Netherlands asked Secretary Hull to bind tapioca on the free list in this country, they have an import fee on these products from their own islands when it comes into the mother country, Holland. Holland sees fit to protect her domestic starch supply and asks the American farmer "to take it on the nose" by letting these products come in here duty-free, rather than come to Holland and menace her domestic starch supply. We claim that the American farmer should not be asked to do any such thing. Therefore, we ask that you place an excise tax of 1¾ cents per pound upon the first domestic processing of these products. One and three-fourths cents is the rate the President of the United States fixed for imported potato starch at the time the Netherlands Treaty was consummated. Potato starch up to that time had an import rate of 2½ cents per pound. The President, under the authority he has, reduced it to 1¾ cents.

The thought may come to some of you that because these products were bound on the free list in the Netherlands Treaty, you are violating an international agreement when you place an excise tax on the first domestic processing of these products. Such is not the case. Section 5 of the Netherlands Treaty provides—and mind you, that was there when both Nations approved the treaty:

> Articles the growth, produce, or manufacture of the United States of America or the Kingdom of the Netherlands, shall, after importation into the other country, be exempt from all internal taxes, fees, charges, or exactions other or higher than those payable on like articles of national origin or any other foreign origin.

This definitely says that if this country wants to place an excise tax on these articles, it has a right to do so, as long as the tax is not higher than is placed on like articles of national origin or any other foreign origin. Now, that means you can place a 1¾-cent excise tax on these products and the 1¾-cent excise tax will apply, of course, to sago flour and tapioca flour coming from other countries as well as Netherland possessions—and some is produced in Brazil). If tapioca and sago were produced in this country, they would bear the same rate of tax: Please keep that in mind, because we have heard it stated that an excise tax on these products would be in violation of an international agreement.

Senator CAPPER. Mr. Brenckman, do you know of any things where these trade agreements have opened up the foreign markets for the product for the American farmers?

Mr. BRENCKMAN. In answer to that question, Senator Capper, it may be true that we have gained certain foreign outlets for specified commodities; but on the whole, the figures show that agriculture's share of our total of exports during the year 1937 dropped to 24.1 percent, which is the lowest on record—that is 24.1 percent of the total. Our total exports of agricultural commodities amounted to $700,000,000 plus, during the calendar year 1937, while competitive agricultural imports were valued at $868,000,000. That was the fiscal year 1937.

Senator KING. You remember when you were shipping agricultural commodities, and cotton was an important part, which was perhaps three-fourths of our exports.

Mr. BRENCKMAN. Yes.

Senator KING. Do you not believe that the high tariff rates which we have imposed have interfered with our agricultural exports as well as other exports?

Mr. BRENCKMAN. Senator, when the Hawley-Smoot tariff bill was pending, the National Grange made a fight against the excessively high rates imposed on industrial commodities on the theory they were not needed, in any legitimate sense, for the protection of industry and labor, and that the imposition of those rates would react unfavorably on agricultural exports, and I think that was the case.

Senator KING. I remember your organization was very vociferous and very logical and very fair in the presentation of your views in respect to that matter, and I shared those views which you entertained.

Mr. BRENCKMAN. Now, speaking further of cotton, if I may have another minute.

Senator KING. You may have 1 minute.

Mr. BRENCKMAN. I think the record will show our exports on cotton have very seriously declined as a result of the control program of the Government itself. I recall very definitely being at a meeting of the southern agricultural people in Memphis when the Bankhead Act was pending; an effort was made to sell the Bankhead Act to the southern cotton producers; they were told the only thing we needed to do was restrict, reduce, and control world price.

Senator KING. Kill the pigs and destroy the farm products and we would be happy.

Mr. BRENCKMAN. With that assurance, the domestic producers reduced the production of cotton. At that time the foreign production of cotton amounted to ten and a half million bales, and while we were restricting and reducing, foreign production went up year after year, until last year foreign countries produced approximately 20,000,000 bales of cotton. At the present time foreign consumption of cotton amounts to only about 19,000,000 bales, and you can see what that did to the American export market for cotton.

Senator CAPPER. You do not know of any tariff on farm products that ought to be reduced?

Mr. BRENCKMAN. No. [Laughter.]

Senator KING. I suppose the manufacturers of various other commodities do not know of any, either; so we will have a stalemate; maintain the status quo.

The CHAIRMAN. Mr. Frazier.

STATEMENT OF T. McCALL FRAZIER, RICHMOND, VA., CHAIRMAN OF THE VIRGINIA ALCOHOLIC BEVERAGE CONTROL BOARD

Mr. FRAZIER. I appear in opposition to the 25-cent tax increase on each gallon of whisky. For the past 4 years in Virginia a very positive, a very definite, and very sincere effort has been made to combat illicit liquor traffic. We believe we can report progress, but the problem of bootlegging and illicit traffic is still with us, and evidence of that fact is that last year, with the assistance of Federal agents, we destroyed 1,707 stills in Virginia and 175,503 gallons of illicit whisky.

Senator KING. You are not prohibition men down there, are you?

Mr. FRAZIER. Not yet. Had that whisky gotten into bootleg channels it would have represented a loss in revenue to the Federal Government of $351,000 under the present tax law. On each pint you would lose 22½ cents.

On the tax that is proposed there is no hope, and I do not believe there is anyone who has made any study of the matter who can believe or hope that the distillers can absorb the tax. Of course, the State could have, but we are not operating our system for profit, although we have made a considerable profit each year, the reason being we have lowered the price to where it competes with the bootlegger and therefore encourages consumption of legal whisky.

This increase, added to increased cost of transportation from warehouse to stores, will increase the cost of whisky in Virginia by 10 cents a pint, as a conservative estimate. If the State should absorb it it would throw our budget out of balance by $600,000, and Virginia is operating under a balanced budget. We cannot absorb it and it means reduced revenue to the Federal Government and the State.

I cannot speak for other States, but I am advised that Iowa, Ohio, New Hampshire, and Utah have expressed their opposition to this tax; how many others will, I do not know. We know this, only: If this tax is put on, our experiment in liquor control will be definitely retarded and possibly the efforts of the past 4 years will be brought to naught. Certainly in the long run we cannot with an increased tax compete with the situation I have described, when 1,707 stills are found in 1 year.

Senator CAPPER. How much revenue does Virginia obtain from this source?

Mr. FRAZIER. $17,000,000 last year, a net profit of $4,600,000.

Senator KING. $4,600,000?

Mr. FRAZIER. Yes, sir.

Senator BROWN. You have the State store system like we have in Michigan?

Mr. FRAZIER. Yes, sir.

The CHAIRMAN. We thank you very much.

Mr. Matthew G. Patterson. Mr. Patterson is from Boston, Mass., and represents the National Retail Liquor Package Stores Association.

STATEMENT OF MATTHEW G. PATTERSON, BOSTON, MASS., REPRESENTING NATIONAL RETAIL LIQUOR PACKAGE STORES ASSOCIATION

Mr. PATTERSON. Mr. Chairman and gentlemen, I have a statement I would like to read.

I appear as the proprietor of a small liquor store in Boston and also on behalf of the National Retail Liquor Stores Association, a group of 32,000 stores throughout the United States. We have been complimented by the various State liquor administrators where our type of outlet exists on our businesss methods.

The Alcohol Tax Unit of the Treasury Department made a survey last year from coast to coast and in one of the most careful checks failed to find a single non-tax-paid bottle in any of our stores. Not only have we observed the letter and spirit of the law but we have campaigned for stricter law enforcement.

The reason for that is simple. The average dealer is satisfied to go along and make an honest living. If you add this additional tax we fear the temptation for those whose business is jeopardized will be too great. Faced with the propsect of going out of business, they might listen to the bootlegger and be tempted to sell spurious non-tax-paid products.

Few of the stores are today in a position to raise any additional capital, neither are the small wholesaler nor the small distiller.

Warehouses are at the present time loaded to capacity with liquor stocks. The small distiller in order to raise capital for the additional tax will have to dump stocks on the market. The only ones in a position to avail themselves of this type of merchandise will be the very large wholesalers, those that are financed by Wall Street capital, thus forcing the small jobber out of business. The same holds good with the retail stores. Surplus stocks can only be picked up by the very large dealers, such as department stores and chain store outlets, who in turn by their ruthless work will squeeze the small independent merchant out of the picture. Although they may offer a bargain to the purchaser for a short time, in the end you will have created a monopoly which will have the consumer at its mercy when independent competition has been eliminated.

There are, as I said at the outset, about 32,000 units in our national retail association employing on the average of three men per store. A tax of this type will force out of business about half of the stores which now are hanging on the ropes, resulting in unemployment for about 48,000 people. The increase in the relief rolls will create more problems for Federal and local governments than the amount of the proposed tax could overcome.

The above evils of the proposed tax are sufficient arguments against it.

However, if you take into consideration the next move, the levy on floor stocks, then the danger is beyond doubt very grave and very serious.

The average retail liquor-package store carries about $6,000 worth of stock. To be conservative, let us say $5,000. That means that a storekeeper at a time when he is having difficulty in meeting his fixed overhead and paying his current bills have will to dig up more capital. Where will he get money? The banks won't lend it. If he is overdue

on his bills with the wholesalers, various State and Federal laws prohibit him from accepting help from those in the industry.

What happens? He will go out of business and those retailers remaining will have to stop buying and work off their present stock, thus forcing the small wholesaler into bankruptcy.

Gentlemen, the little man, whether he be distiller, rectifier, wholesaler, or retailer, is the one that keeps the business on an even keel. It is for them that I make this plea. Please don't place any more tax on our business. It is already overburdened by Federal and State taxes, to say nothing of high Federal, State, and local license fees. Fixed overhead now threatens our existence.

We have employed thousands of men in a period when that has been the most vital problem in our country and we do not believe you gentlemen are willing to send those men back to the relief rolls who have gained employment as the result of repeal.

These are the facts and on behalf of the 96,000 families involved in the package-store group, I ask you to void this additional tax.

The CHAIRMAN. Thank you very much.

Mr. Barker, I understood, filed his brief.

Mr. SWITZER. Mr. Barker has to leave for St. Louis and I would appreciate reading his statement to the committee.

The CHAIRMAN. What is that?

Mr. SWITZER. It will only take about 2 minutes.

The CHAIRMAN. I was looking at that large sheaf of papers you have. All right.

Mr. Switzer.

STATEMENT OF FOREST SWITZER, ST. LOUIS, MO., REPRESENTING WHOLESALE LIQUOR DEALERS ASSOCIATION

Mr. SWITZER. My name is Forest Switzer and I represent the Wholesale Liquor Dealers Association. Mr. Barker is a member of the firm of Simpson & Barker, a wholesale firm in the city of St. Louis.

His statement is as follows:

STATEMENT OF E. D. BARKER, OF SIMPSON & BARKER, ST. LOUIS, MO., AND REPRESENTATIVE OF THE MISSOURI WHOLESALE LIQUOR DEALERS ASSOCIATION, BEFORE THE SENATE FINANCE COMMITTEE IN OPPOSITION TO THE DISTILLED SPIRITS TAX INCREASE OF 25 CENTS A GALLON

I have been appointed by the president of the Missouri Wholesale Liquor Dealers Association to appear before this committee to state the case of the wholesalers in Missouri. We have been attempting to establish ourselves in the wholesale liquor business since repeal. Despite the fact that before prohibition there were approximately twice as many wholesalers engaged in business in Missouri as we have today, the wholesaling of liquors since repeal has not proved to be a profitable business in Missouri. I am well acquainted with the situation, particularly in St. Louis, and can state that none of the wholesalers realizes anything like a just profit on the distilled spirits which he handles. Right at this particular time, business is, relatively speaking, at a standstill. The credit situation is bad. Instead of a 30-day credit situation, a very substantial number of accounts on the books of every wholesaler runs up to 60 and even 90 days. The wholesalers in Missouri are simply struggling along hoping for better days.

Taxes which are levied all along the line today and finally lodge on the wholesaler require far more capital than was the case before prohibition. The wholesaler's investment now needed is about three times as great as was formerly the case, and the profits are nowhere near as great.

We are verging on a situation which would make it impossible for any but the big houses to stay in business. The little fellow would be driven to the wall. I think it would be bad for us and for the country to bring about any such result.

The proposed gallonage tax increase on distilled spirits though seemingly small, will be a severe strain on a considerable number of the wholesalers working with small capital. It will undoubtedly result in the elimination of some of the weaker ones. If the bill is amended to provide for a floor tax, I am positive that the credit and competitive situation is such that the wholesalers will be unable to realize the tax increase from an increase in price, making the situation worse than it is now. If there is no floor tax, the stronger wholesalers will be able to secure a 25-cent-a-gallon advantage over the wholesalers who are not in a position to load up before the tax goes into effect.

In Missouri, the bootlegger has not been eliminated. An additional advantage of 25 to 50 cents a gallon will enable the bootlegger, in my opinion, to conduct a more thriving business. Frankly, I fear anything which will give the bootlegger an additional advantage. As a matter of fact, there has been considerable sentiment looking to a reduction of the 80 cent State gallonage tax to prevent the bootlegger from getting a stronger hold of Missouri. The increase would create further problems and decrease the Federal revenue from sales in Missouri.

From my rather considerable experience, I am convinced that this measure will not add to the revenue of the Federal Government and I am positive that it will make our present difficult situation even worse.

Senator KING. What is the reason for the necessity for such a large increase of capital; you say three times as much.

Mr. SWITZER. Mostly because of taxes. Where we had $1.10 we now have $2 Federal excise and 80 cents occupational tax.

Senator KING. It is largely an increase in Federal and State taxes?

Mr. SWITZER. All of the charges amount to three times as much as we needed before prohibition.

Senator KING. We may learn after a while to cut down our bureaucracy.

The CHAIRMAN. At this point I wish to place in the record numerous letters, briefs, and statements submitted on the matter of increasing the distilled-spirits tax. These documents are submitted by the following: Distilled Spirits Institute, Inc., and the League of Distilled Spirits Rectifiers, Inc., Mr. Neil F. Dieghan, president, and William G. Wellhofer, chairman, public relations committee, New Jersey Licensed Beverage Association, Pennsauken, N. J.; Mr. A. Smith Bowman, Sunset Hills, Fairfax County, Va.; James F. Hoge, counsel of the Proprietary Association; the National Association of Retail Druggists; the National Drug Trade Conference; the Repeal Associates, Washington, D. C.; Mr. Emil Nathan, executive secretary, Wholesale Liquor Dealers of Missouri; and Mr. J. Zimmerman, editor-in-chief, Daily Metal Reporter, published by the Atlas Publishing Co., New York City.

BRIEF SUBMITTED BY THE DISTILLED SPIRITS INSTITUTE, INC., AND THE LEAGUE OF DISTILLED SPIRITS RECTIFIERS, INC.

This brief is filed on behalf of the Distilled Spirits Institute, Inc., and the League of Distilled Spirits Rectifiers, Inc., representing the manufacturing end of the distilled spirits industry. On distillers and rectifiers fall the burdens of the initial payment of the Federal tax on distilled spirits. The present heavy tax gives ample warrant in our opinion for the placing before your committee of our opposition to the increase as proposed in the bill which was passed by the House and is now under consideration by your committee.

The Federal tax on distilled spirits is now $2 per gallon, which rate has been in force since the passage of the Revenue Act of 1934. H. R. 9682 would increase the rate, effective July 1, 1938, to $2.25 per gallon except as to brandy. This increase, small as it may seem, must be added to the already heavily taxed commodity and when pyramided, as it must be in passing through the channels of trade to the ultimate consumer, will be at least twice that amount at the retail outlet. It will provide a still greater spread between the price at which the consumer can secure

a legal tax-paid product and the illegal beverage which the bootlegger dispenses, and will make more difficult the elimination of the illicit distiller whom the Treasury Department has been struggling with some success to suppress. It will create a capital investment burden on the manufacturers of distilled spirits which will be extremely difficult to carry at this time with capital investment funds at a low ebb. As a source of revenue it will not meet the expectations of those who propose it and it will have a tendency to disorganize and unsettle a new industry before it has an opportunity to really level itself out and stabilize its activities.

With the coming of repeal, Congress imposed on distilled spirits the highest tax it has borne since 1868 with the exception of the punitive taxes levied during wartime and prohibition period. Tax history in the United States demonstrates that revenue goes down and not up when the rate of taxation on distilled spirits is increased. The Federal tax rate on liquor was changed six times between 1863 and 1917, the longest unbroken period for which comparable figures are available. Each time the rate was raised there was a decrease in consumption of tax-paid liquor and each time it was lowered there was an increase. The biggest increase in receipts was shown in 1869 when the Federal tax was cut from $2 to 50 cents a gallon. The previous income of $14,000,000 was boosted to $33,000,000. Previously, in 1864, when the Government had raised the tax rate from 31 cents to $1.22 a gallon, the Commissioner of Internal Revenue had expected to raise $40,000,000 from distilled spirits during the last 7 months of the fiscal year, but the actual revenues for the period were only $16,000,000, which was $24,000,000 below that expected.

An increase in tax comparable to that proposed now occurred between the years 1894 and 1895. In the former year the tax on distilled spirits was 90 cents. In 1895 it was increased to $1.10—a jump of 20 cents per gallon. The immediate effect was an 11,886,000-gallon decrease in legitimate liquor consumption and a $5,074,000 decrease in revenue. In 1894 the internal revenue collections from distilled spirits were $79,913,000. The following year collections dropped to $74,839,000. This is in marked contrast to the increase in revenue as shown above when the tax was reduced from $2 to 50 cents a gallon.

Serious consideration was given before the imposition of the $2 rate in the Revenue Act of 1934 to the possibility that this rate might be so high as to enable the bootlegger to continue in business at a profit, and the fact that the figures of the Treasury Department show that over 12,000 stills were seized during the calendar year 1937 proved that the fears of the opponents of this high rate were well founded. The distilled-spirits industry does not object to taxation; it recognizes its responsibility as a luxury item to carry a proportionately greater burden than other commodities, even those falling in the luxury class, but it contends that there is a point beyond which the tax cannot go without creating an illicit industry which will at once defeat the tax returns to the Government and destroy the market for the legitimate vendors of tax-paid goods. From its earliest days the Federal Government has found the taxation of distilled spirits a fruitful source of revenue and we can well understand that Congress, with the coming of repeal, by the imposition of the tax of $2 per gallon, intended to secure as great a financial return from the legalization of liquor as was thought to be possible. In addition to the $2 tax there is in many instances a 30-cent rectifying tax to pay and also the cost of the strip stamps which are affixed to the bottles. We find, therefore, that on a pint of whisky which retails at a dollar or less, and it is estimated that more than 70 percent of the whisky sold falls into that class, that about 30 cents is paid by the manufacturer in direct tax to the Federal Government before the product leaves his premises. And this does not take into consideration the occupational taxes imposed by the Federal Government nor the innumerable license fees and occupational taxes laid by municipalities. In addition, there are State gallonage taxes which run as high as $2.20 per gallon. Add to these exactions the taxes which all business bears and we have an industry and a product laboring under a tax burden far beyond that imposed upon any other industry or commodity.

The distilled spirits tax is laid on the article as soon as it comes into existence and therefore it is necessary for the manufacturer to finance the tax before it leaves his plant. In many instances, when a case of whisky leaves the bottling plant of the producer it carries over $7 in direct Federal taxes which the producer has been compelled to pay in advance to the Government on an article the bare cost of which is about $2.75. Literally, figuring the bare cost of the spirits at about 50 cents a gallon, the smallest item of cost in a bottle which the consumer purchases at retail is the cost of the whisky itself. It may be readily seen, therefore, that the necessity of financing the tax outlay which the producer is required to make is one of the serious problems of the industry. With the average State

rate of taxation being about $1, there is about $90,000,000 of capital tied up by the industry in the nearly 30,000,000 gallons which are constantly in the channels of distribution between the bonded warehouse and the ultimate consumer.

To this already heavy tax burden the proponents of this tax would add 25 cents per gallon. And it is said that since to add this sum amounts to only 6¼ cents per quart it would be absorbed by the distiller. This is a wholly erroneous deduction. In the lower price goods, and this amounts to more than 70 percent of the sales, the 6¼ cents is considerably more than the producer makes on a quart bottle. Any such increase as is proposed in this bill must of necessity be passed along to the consumer and when it reaches him it will be much more than the original 6¼ cents. To this amount must be added the mark-up of the wholesaler and the mark-up of the retailer, not to speak of the carrying charges of increased capital investment of the producer. When the wholesaler receives the goods the 6¼ cents will be added to the present price of the manufacturer and in arriving at his sales figures the wholesaler will add approximately 20 percent for his mark-up. This will be 1¼ cents, thus adding 7½ cents to the sales prices of the wholesaler. In the hands of the retailer a mark-up of approximately 40 percent will be placed on the price fixed by the wholesaler. And approximately 3 cents will thus be added on account of this tax and thus we find that in the normal course of trade by the time the 6¼ cents tax reaches the consumer it will have increased to 10½ cents. Probably 70 percent of whisky sold today is in the class of $2 or less per quart, and to add 10½ cents to that figure, as would inevitably result from the proposed tax, would intensify consumer resistance and undoubtedly drive some purchasers to the bootlegger, with a consequent loss to the legitimate industry and a drop in tax returns to the Government.

As further proof that this increase if imposed would be passed on to the consumer, attention may be directed to the amount of revenue which the proponents of this measure estimate it would produce, to wit, $35,000,000. While full figures are not available for all units in the industry the earnings of the major companies are readily available in financial circles, and authoritative estimates are that the earnings for the entire distilling industry in 1937 is in the neighborhood of $35,000,000. Experience has shown that an increase in tax reduced legal consumption and together with the impaired buying power from which we are now suffering, leads to the certain conclusion that the profits from 1938 will be less than those of 1937 and therefore, without facing certain bankruptcy, it would be impossible for the manufacturing industry to absorb this $35,000,000 additional levy or any substantial part of it. Conceding as we must, that this tax will be passed on to the consumer, yet it must be financed in the first instance by the distiller and the rectifier who withdraws the product from the bonded warehouses and who pays the Federal tax at the time of withdrawal. This burden will then be transferred to the wholesaler and on through to the retailer. It is estimated that there is at all times a floating stock of 40,000,000 gallons between the bonded warehouse and the ultimate consumer. This includes the tax-paid goods which the distiller and the rectifier has in process of bottling and in transit to the wholesaler, as well as the stock which the wholesaler carries and the goods on the shelf of the retailer. An increase of 25 cents in the tax rate on 40,000,000 gallons of whisky means that the industry must secure additional financing to the extent of $10,000,000. In the present condition of the capital investment markets this would create a very serious problem for the industry While money may be readily available to purchase grain in barrels, to build warehouses, and add to plant equipment, it is a much more difficult problem to secure funds for the payment of taxes on a commodity on which the Government already has a lien before it has even started into the channels of trade. It is estimated that there is now outstanding in excess of $80,000,000 in bank loans to distillers and the necessity of financing any additional amount in the depressed condition of the money market might seriously affect and unsettle existing loans.

The distilled spirits industry is admittedly under-capitalized and is even now facing a curtailment in the collateral value of stocks held in bonded warehouses for aging purposes. Financing for tax payment creates no additional collateral value in the whisky. Faced with a certain reduction in consumption in 1938 due to economic conditions, a situation which is already apparent in tax payments during the past months, a reduction which will be accentuated and made greater by the proposed tax, if adopted, the distilled spirits industry will find great difficulty in securing the extra $10,000,000 to finance the proposed tax over and above the normal borrowing in which the industry has to indulge. Add to declining consumption and consequent slowing up in business the fact that invest-

ment funds are at a very low ebb and we have a condition in the industry which will be very serious and may result in the liquidation of the smaller and weaker units.

To expect that an increase in liquor taxes is going to result in a corresponding increase in the revenue which such taxes produce is to ignore the past experience following tax increases and to disregard entirely the bootleg factor which was developed and brought to full growth during the prohibition period. The high rate of taxation on distilled spirits in England is referred to as indicating the burden which this commodity can bear but an examination of the consumption figures of that country will show that in the past 20 years while the tax has been increased from $2.62 to $12.88 per United States proof gallon consumption figures have fallen from 35,000,000 gallons to about 8,000,000 gallons. This in England, a country which is traditionally law-abiding and where the problem of illicit liquor has never developed to any extent. There can be no denying the fact that our country still has a tremendous illicit industry and as it thrives on the competitive advantage which a high tax burden gives to the bootlegger, even a small additional tax increases to that extent the difficulty of suppressing illegal activities.

To fail to consider the bootleg factor in any consideration of the tax problem is to overlook the fact that Congress is called on each year to appropriate millions of dollars for the enforcement branch of the Alcohol Tax Unit. While the Treasury Department, even under the $2 Federal tax rate, to which must be added the heavy taxes imposed in many States, has been making inroads on the illicit traffic, within the calendar year 1937 a total of 12,355 stills and nearly 9,000,000 gallons of mash were seized. While it is a considerable reduction from the 16,000 stills seized in 1936 it gives no indication that the illicit traffic which flourished so vigorously prior to 1933 has yet been brought under control. Until the time comes when illicit production is no longer a real factor in supplying the demand for beverage spirits it is our contention that an increase in taxation is highly unwise and will tend to increase lawlessness and to perpetuate the bootlegger.

In addition to the grave Federal problem which would result from the increased activities of the bootlegger as the result of the proposed increase in the distilled spirits tax there would be an equally serious situation so far as concerns the several States. State revenues derived from the taxation of distilled spirits suffer a corresponding decrease when sales are made by the bootlegger. Furthermore, the States of Pennsylvania, Ohio, West Virginia, Michigan, Idaho, Maryland, North Carolina, Maine, Vermont, New Hampshire, Iowa, Virginia, Alabama, Washington, Oregon, and Utah have State monopoly systems under which sales of distilled spirits are conducted exclusively by the State and afford an enormous source of revenue to these States. The loss of revenue suffered by these States as the result of decreased consumption will deprive the States of moneys which are urgently needed for relief funds, education, and the many other necessary activities of the State governments.

For the reason that the proposed increase will not porduce the revenue desired, that it will depress an industry not yet stabilized after an experiment in prohibition, that it will increase consumer cost in an already declining market, and that it will provide the bootlegger with an additional margin of profit and thus tend to divert the demand for distilled spirits into illicit channels, we ask your committee to eliminate section 712 of H. R. 9682.

Respectfully submitted.

DISTILLED SPIRITS INSTITUTE, INC.,
LEAGUE OF DISTILLED SPIRITS RECTIFIERS, INC.

STATEMENT OF NEIL F. DEIGHAN, PRESIDENT, AND WILLIAM G. WELLHOFER, CHAIRMAN, PUBLIC RELATIONS COMMITTEE, NEW JERSEY LICENSED BEVERAGE ASSOCIATION, PENNSAUKEN, N. J., REPRESENTING 9,000 RETAIL CONSUMPTION OUTLETS FOR ALCOHOLIC BEVERAGES IN NEW JERSEY, TO THE FINANCE COMMITTEE OF THE UNITED STATES SENATE

Who will be the ultimate payer of the 25-cent additional liquor tax? Will it be the distiller? The wholesaler? The consumer? No, it will be the tavern owner.

The distiller will pass it on but only after he has placed a surcharge on it for the use of the money that he has laid out for the tax. It will rest with his good graces whether that will be an additional 5, 10 or 25 cents per gallon. The package store owner will pass it on to the consumer on the price per bottle. We, the tavern keepers, cannot pass it on on the price per drink. It will not only be impractical to pass it on to the consumer, but unfair, for there is no such thing as a penny increase per drink. It must be 5 cents or nothing.

Now, those who sell the better-grade liquors at a price around 25 cents per drink, if they have proper volume, may be able to absorb this additional tax but only by giving up some of their proper profit. But, those who sell the cheaper merchandise, the workingman's tavern, the neighborhood place, with small volume, will be utterly unable to stand the strain. The competition of the speakeasy with its moonshine liquor selling at $7 for a 5-gallon can will make it impossible for the legitimate dealer, paying $12 to $14 a case of 3-gallon liquor to compete. It will only create a market for the moonshiner and the bootlegger. Prohibition was not voted out by the people primarily to get revenue or even to get a drink, but it was a mandate from the people to get rid of the disrespect for law—the bootlegger and resulting gangster and general lawlessness engendered by the "noble experiment." A heeding of this method, to our minds, is much more important than an attempt to get additional revenue where a popular protest is least likely to come. Let us heed the experiences of the past which have shown the overburdened liquor industry means less revenue instead of an increase.

On November 6, 1933, the people passed their opinion in favor of repeal of the eighteenth amendment by majority of 9,000,000. Crime and corruption, then existing, was encouraged because of disrespect for an improper law. Repeal of the eighteenth amendment was the beginning of the end of racketeering that had shaken the confidence of the people. Promises were made that the twenty-first amendment would play an important factor in starting American industries, beginning with a market for the farmer's grain, up to and including the rental of approximately 400,000 properties for retail outlets in the United States and taxes and revenues were considered. But the major thought at the time was to reflect the profits from the sale of illicit liquors to the Treasury of the United States and the various States who voted for repeal. Since repeal in 1933, $300,000,000 a year in liquor taxes have reached the Treasury and, while opinions differ, it is estimated that approximately 25 percent of the liquor consumed today is bootleg, drunk in speakeasies, and any new or additional taxes will not reflect themselves in increased revenue but will decrease Federal receipts for many reasons, chiefly, the Federal Government does not have an enforcement bureau for speakeasies or unlicensed premises.

Federal wholesale stamps required by the municipal licenses can be obtained by anyone who applies for them. As a result, approximately 1,800 Federal stamps were issued in New Jersey above the number issued to municipal and State licensees. The lack of sufficient men on enforcement work makes possible the operation of speakeasies, and the experience in New Jersey in 1935, when an additional appropriation of $50,000 permitted the employment of 25 additional men on enforcement work in Commissioner Burnett's office provided a weapon to strike at the source of bootleg liquor as well as speakeasy outlets. This appropriation resulted in an increase of $1,600,000 in liquor taxes to the State of New Jersey as well as an increase of $3,200,000 to the Federal Government. If an appropriation of money sufficient to employ the necessary men in the various States were provided, one does not have to use his imagination to draw the conclusion that consumption of bootleg liquor would be reduced by at least 10 percent. It would not necessarily mean increased consumption of liquor but rather increased consumption of tax-paid liquor.

On the other hand, if the proposed additional tax of $0.25 per gallon were reversed and a decrease of $0.25 per gallon instituted and a sufficient appropriation was made to employ additional men for enforcement work, it is my personal opinion and the opinion of those I represent, that even with the reduction of $0.25 per gallon, Federal receipts were to tbe increased by a sum of money equal to 10 percent of all taxes received during 1937. And, at the same time, employment would be provided for many who are now receiving relief. In presenting this, we ask that your honorable committee give serious consideration to the recommendation contained in this last paragraph.

SENATE FINANCE COMMITTEE,
Washington, D. C.

GENTLEMEN: On behalf of the National Association of Retail Druggists, comprising approximately 25,000 members residing in every State in the Union, begs leave to bring to the attention of the committee its views in regard to the 10 percent excise tax on cosmetics and toilet preparations.

We submit that a tax of this size is a tremendous burden upon this branch of industry, in which about 60 percent of the total retail business is conducted in the retail drug stores of the United States. We are informed that only in the case of distilled spirits and tobaccos is the tax comparable in size. We further submit that cosmetics and toilet preparations are no longer in the luxury class;

that they are purchased and consumed by all classes of our people; and that not being luxuries, a tax as great as 10 percent is enormous and insupportable. The committee of the House, in its wisdom, has seen fit to repeal entirely the excise taxes on jewelry, furs, sporting goods, photographic supplies, chewing gum, matches, and other products. With this action we have no quarrel, but we do submit that it is unfair to relieve such products entirely of taxation and allow the large excise tax of 10 percent to remain unchanged on cosmetics and toilet preparations.

We submit that, as a matter of justice, these excise taxes should be lowered proportionately on all classes of products so covered, and that no single class of products should be singled out for a continuing heavy tax when 100 percent relief is afforded to a number of classes of products, many of which are definitely in the luxury classification. Therefore, we ask that the committee in its deliberation, give attention to this situation. We specifically ask that the excise tax of 10 percent on cosmetics and toilet preparations be reduced by 50 percent. If it becomes necessary for revenue purposes to make up any deficiency, we suggest that the committee consider similar reductions on the present taxes on other products mentioned in lieu of complete repeal.

The drug industry has always borne its share of the tax burden, State, and national, cheerfully but it is unanimous in its opinion that the bill, as approved by the House of Representatives is unfair and inequitable in these respects.

Respectfully,

ROWLAND JONES, Jr.,
Washington Representative, National Association of Retail Druggists.

MARCH 18, 1938.

SENATE FINANCE COMMITTEE,
Washington, D. C.

GENTLEMEN: On behalf of the National Association of Retail Druggists, comprising approximately 25,000 members residing in every State in the Union, begs leave to bring to the attention of the committee our views in regard to the tax bill now under consideration by the committee. This statement is concurred in and supported by the National Drug Trade Conference which is composed of associations representing all branches of the drug industry. The component organizations of the conference are:

American Pharmaceutical Association.
National Association of Retail Druggists.
American Drug Manufacturers' Association.
American Association of Colleges of Pharmacy.
National Wholesale Druggists' Association.
The Proprietary Association.
American Pharmaceutical Manufacturers' Association.
National Association Boards of Pharmacy.
Federal Wholesale Druggists' Association.

The 1938 tax bill, as passed by the House of Representatives, now before the committee, increased the excise tax on distilled spirits in the amount of 25 cents per gallon.

The above-mentioned organizations respectfully call to the attention of the committee that this increase in the excise tax represents an approximate increase of 47 cents a gallon on ethyl alcohol, which has widespread use in the manufacture and preparation of drugs and medicines. We believe that the House committee and the House of Representatives as a whole, did not contemplate and did not realize that this increased tax on distilled spirits would also increase the tax on ethyl alcohol, thus increasing the cost of drugs and medicines to the sick.

Therefore, it is respectfully urged that the Senate Finance Committee, in their wisdom, make provisions for the exemption of ethyl alcohol used for nonbeverage purposes from this increased tax.

It is further pointed out that such an excise would have a very small effect upon the total revenue collected under this provision.

The drug industry has always borne its share of the tax burden, State and national, cheerfully; but it is unanimous in its opinion that the bill, if approved by the House of Representatives, is unfair and inequitable in this respect.

Respectfully,

ROWLAND JONES, Jr.,
Washington Representative, National Association of Retail Druggists;
Secretary, National Drug Trade Conference.

STATEMENT BY JAMES F. HOGE, COUNSEL ON BEHALF OF THE PROPRIETARY ASSOCIATION

To: The Committee on Finance, United States Senate.
In re: The Revenue bill, section 712, tax on distilled spirits.

This is a request to exempt alcohol intended for use in the preparation of medicines from the increased tax proposed by section 712.

The Proprietary Association is an unincorporated body. Its membership consists of manufacturers of proprietary medicines. It is estimated that the membership represents approximately 80 percent in volume of proprietary medicines manufactured in this country. The association has been in existence for over 50 years, and maintains its principal office at 810 Eighteenth Street NW., Washington, D. C. Practically all of the well-known proprietary medicines are included in its membership. These medicines are advertised for direct sale to the public, although some of the products are sold only on physicians' prescriptions.

Section 712 of the bill, as adopted by the House of Representatives, increases the tax on distilled spirits from $2 to $2.25 on each proof gallon, or wine gallon when below proof. It also increases proportionately the tax at a like rate on all fractional parts of such proof or wine gallon. This is, in effect, (commercially and practically), an increase of 47½ cents per wine gallon.

Presumably, the motivating idea was that this was an increase in the tax on whisky or alcohol used for beverage purposes. There are certain arguments usually and generally advanced for high taxes on beverage alcohol. However, the term "distilled spirits" includes alcohol used for medicinal purposes. Of course the arguments which pertain to high taxes on alcohol for beverage purposes do not pertain to high taxes on alcohol used in the preparation of medicines.

This statement does not contemplate the use of whisky for medicinal purposes. Whisky is at times used medicinally. This statement, however, contemplates only the use of alcohol as one of the materials in the manufacture of medicines.

Every vegetable plant and other collateral growth contains to a very great extent what we term in medicine ingredients which cannot be extracted by water but must be extracted by the use of alcohol. When a solution is made of these preparations it is medicine which is utilized to allay sickness and human sufferings, and all symptoms that flow from pathological conditions.

Alcohol, therefore, is a usual and important ingredient in the manufacture of medicines. To increase the tax on it is to increase the cost on the raw materials which go into the manufacture of medicines. And that, in turn, is to increase the price of medicines. It is particularly objectionable in connection with proprietary medicines because they are the medicines sold to, and purchased by, people who frequently do not have the financial means to obtain medicine on medical prescription. Proprietary medicines frequently are referred to as the "poor man's medicine."

It is now the policy of the Government to permit the withdrawal of denatured alcohol tax-free. The reason given is that it is unfit for use for beverage purposes. When alcohol is used in the manufacture of medicine and the product is capable of being used as a beverage, and contains a sufficient amount of alcohol to be intoxicating, it is, in law, an intoxicating liquor. It is only when it is so medicated that it is not capable of being used as a beverage that it is in law treated as a medicine. In other words, the alcohol which legally enters into the manufacture of medicinals, which are not capable of being used as a beverage, is a medicine, and not an intoxicating liquor. When medicine and not intoxicating liquor, there is just as good reason why it should not be taxed as there is why denatured alcohol should not be taxed.

Section 712 of this bill makes an exemption as to brandy. It therefore cannot be successfully argued that it is administratively impossible, or difficult, to make exceptions. If exception can be made for brandy, exception can be made for alcohol used in the manufacture of medicines.

In the past, revenue laws have provided for drawbacks in the case of alcohol withdrawn for use in the manufacture of medicine. For instance, section 600 (a) of the Revenue Act of February 24, 1919, imposed a tax on distilled spirits of $2.20, or "if withdrawn for beverage purposes, $6.40." This and other similar enactments in the past show clearly that a distinction can be made between alcohol used for beverage purposes and alcohol used for the manufacture of medicines.

So much for the administrative purposes.

As for the legislative purposes, it is not believed that there was any intention to increase the tax on alcohol used in the manufacture of medicines. As stated earlier, it is believed that the motivating idea was to increase the tax on alcohol used in the manufacture of beverages.

However, the tax as contained in this bill enters into the cost of medicines which are used alike by the rich and the poor. They are necessaries, and as such should be kept within the reach of all. In the last analysis, the truth is that this tax is generally paid by those who are sick, and by far the greater portion of it is paid by the poor who are sick and can ill afford to pay it.

We request that in subsection (e) of section 712, an exemption be made for alcohol used in the manufacture of medicines. This could be done by rewriting subsection (e) to read as follows:

"(e) The amendments made by this section shall not apply to brandy or to alcohol used in the manufacture of medicinal preparations and the rates of tax applicable to such brandy and to such alcohol withdrawn for use in the manufacture of medicinal preparations shall be the rates applicable without regard to such amendments."

Respectfully submitted.

THE PROPRIETARY ASSOCIATION,
By JAMES F. HOGE, *Counsel.*

WASHINGTON, D. C.,
March 19, 1938.

REPEAL ASSOCIATES,
Washington, D. C., March 16, 1938.

Hon. PAT HARRISON,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR HARRISON: The officers of Repeal Associates, whose names appear on this letterhead, request that you lay before the Senate Finance Committee the information contained in the attached statement.

In order not to add to the pressure on the committee in its consideration of the revenue bill, we are asking for no part of the time allowed for public hearings, but should the committee desire fuller information, I shall be glad to send a representative to appear, at the convenience of the committee, to answer questions.

Very truly yours,

W. H. STAYTON, *Executive Director.*

STATEMENT FROM REPEAL ASSOCIATES, OTIS BUILDING, WASHINGTON, D. C.

To accompany letter from W. H. Stayton, executive director, to the chairman, Senate Finance Committee, March 16, 1938.

SUBJECT

That section of the bill H. R. 9682 which provides that "section 4 of the Liquor Taxing Act of 1934 is amended by striking out '$2' and inserting in lieu thereof '$2.25'."

WHO REPEAL ASSOCIATES REPRESENT

Repeal Associates is a nonpartisan, nonpolitical, Nation-wide membership organization of American citizens who are interested in establishing and maintaining proper control of the liquor traffic.

In presenting this statement to the Senate Finance Committee, Repeal Associates speaks in behalf of citizens having no financial interest in the liquor traffic, but who are keenly interested in matters affecting proper State control of the traffic.

STATEMENT

We believe that to lay this increased tax upon distilled spirits at this time—when State control bodies are endeavoring to establish satisfactory control and to eliminate the scourge of bootlegging and tax evasion which still exists—would increase the difficulties of State liquor-law enforcement and result in evil conditions adversely affecting the welfare of the country as a whole.

We, therefore, request that the Senate Finance Committee give due thought to the following considerations:

1. Revenue to the Federal Government from taxes on distilled spirits has increased each year as the States have been able to reduce the amount of illicit manufacture and sale, through the establishment and enforcement of local control measures.

2. When the increased rate of tax was proposed it was offered as a means of adding an estimated $30,000,000 to Federal receipts, without bringing dissatisfaction to the consumers.

There is no basis for the belief that an increase of 12½ percent in this tax would be absorbed wholly by the manufacturers and not passed on, at least in part, to the consumers.

An increase in taxation on a commodity which is in great demand, which lends itself so readily to smuggling and bootlegging, and which so recently has been supplied entirely through illegal but well-organized channels, would increase tax evasion and the cost of law enforcement.

Therefore, any increase in the rate of taxation would not produce a proportionate increase in the amount of revenue.

3. The people of the United States have decreed that the liquor traffic shall be a legal traffic, controlled by the States in accordance with the wishes and judgment of the people of the respective States.

Any action taken by the Federal Government which increases the difficulties of State and local control, tends to prevent the fulfillment of the expressed wishes of the great majority of the American voters.

4. The conclusion that the proposed increased liquor tax would materially add to the difficulties of State control of the liquor traffic is confirmed by the following testimony from State liquor administrators:

CALIFORNIA

"Any increase in Federal or State taxes on liquor would, in my opinion, increase the problems of enforcement in California. Everyone knows illicit liquor operations are engaged in for profit only, and increasing the taxes on the legally manufactured and distributed product proportionately increases the profits to the bootlegger."—George M. Stout, State liquor administrator.

COLORADO

"Colorado tax of 20 cents per pint, plus 25 cents per pint Federal Government tax, plus license fee and property tax, is severe penalty. Further penalty might encourage illicit trade."—George E. Saunders, Secretary of State.

FLORIDA

"The higher the tax on liquor the more it encourages the manufacture and sale of moonshine whisky, and this illegal manufacture and sale of moonshine whisky is now our greatest problem, as it pays neither a license or excise tax."—State beverage department.

ILLINOIS

"High taxes make bootleggers. Bootleggers make enforcement difficult."—Arthur S. Smith, chairman, Illinois Liquor Control Commission.

IOWA

"Increased taxes make higher consumer costs. This encourages illicit stills, thus interfering with State control."—Bernard E. Manley, Iowa Liquor Control Commission.

MAINE

"In our opinion, proposed increased Federal liquor tax in this State would not reach consumer, but would result in the State absorbing the tax. Impossible for us to increase liquor prices as they are already at the peak. Further increases would result in bootlegging and real protest from the citizens of the State."—H. F. Boardman, chairman of the commission.

MARYLAND

"Increased Federal liquor tax would encourage sale of illegal liquor and add to local enforcement problem."—Wm. S. Gordy, Jr., State comptroller.

MASSACHUSETTS

"This commission believes that increased Federal tax 25 cents per gallon on distilled spirits is very apt to increase the difficulties surrounding the proper enforcement of the provisions of our liquor-control act. Our excise tax rate on all distilled spirits sold in this Commonwealth is at the reasonable rate of 40 cents per gallon. This rates was decided upon by the legislature with a view to minimizing the possibility of bootlegging, by endeavoring to keep down consumer

prices to such levels as would remove opportunities for large bootlegging profits. We sincerely trust that no action will be taken by the Congress which will tend to invite such activity."—Alcoholic beverages control commission, William P. Hayes, chairman.

MINNESOTA

"Every increase in liquor tax enlarges the margin of profit for the illicit manufacturer and seller and encourages violation of the State and Federal liquor laws. Increased activity of illicit liquor traffickers necessitates an increase in enforcement agents and in the cost of enforcement."—William Mahoney, Minnesota State Liquor Commissioner.

NEW JERSEY

"Proposed increase in liquor tax means more work and less revenue for State. Present Federal tax of $2 per gallon, to which State adds $1, makes a $3 tax on alcohol which costs less than 20 cents a gallon to produce. That is why we have bootleggers in spite of repeal. The additional tax of 25 cents a gallon (proposed) is thus a tax of 125 percent on the cost of production. Adding this to the present 1,500 percent makes a total of 1,625 percent. No wonder we have bootleggers. The more the illicit alcohol the less the revenue. Why add fat to the prize already so tempting to the bootlegger?"—D. Frederick Burnett, commissioner.

NEVADA

"Increased Federal or State tax on alcoholic beverages will mean additional cost of enforcement of liquor laws."—Wm. Kelly Klaus, supervisor, Liquor Tax Department, Nevada Tax Commission.

NORTH CAROLINA

"Proposed increase in Federal liquor tax will necessitate increase in retail prices in North Carolina, which will force us to increase prices on cheap whisky, heretofore used to combat the illicit liquor traffic in rural counties and industrial towns. We are now selling some whisky for 50 cents per pint. With increase in tax it will be impossible to use this method of combating the bootlegger."—North Carolina Board of Alcoholic Control, Cutlar Moore, chairman.

OHIO

"As chairman of taxation committee of the National Conference of Liquor Administrators during 1935 and 1936, will say that we took action recommending that the Federal Government reduce the gallonage tax. The Ohio Board feels that increasing taxation encourages the bootleggers and makes enforcement more difficult."—Wellington T. Leonard, member, Ohio Board of Liquor Control.

SOUTH CAROLINA

"Increased Federal liquor tax will have tendency to encourage the manufacture of illicit liquor, especially in States imposing high rates of tax."—W. G. Query, chairman, South Carolina Tax Commission.

UTAH

"Any measure increasing cost of legal liquor to consumer would make illicit traffic more profitable and thereby increase enforcement problem."—J. W. Funk, chairman, Utah Liquor Control Commission.

VIRGINIA

"Virginia Board has notified our Senators we are opposed to this increase."—R. McC. Bullington, chairman, Alcoholic Beverage Control Board.

WASHINGTON

"Proposed increase of Federal liquor tax will certainly be passed on to consumer. Previous experience shows that increasing tax is followed by increasing activity of illicit trade. In this State moonshining has been almost entirely eliminated because of moderate mark-up and close cooperation of Federal and State enforcement officers. Impossible to forecast effect of the increased tax now contemplated."—Washington State Liquor Control Board.

WEST VIRGINIA

"We have wired West Virginia Senators urging them to oppose increased Federal liquor tax. Such an increase by causing higher prices to consumer undoubtedly would lend encouragement to bootleggers and thus would render enforcement more difficult."—R. E. Kelly, chairman, West Virginia Liquor Control Commission.

WYOMING

"Difficulty in enforcement of local liquor control would be increased more than 25 percent by proposed increase Federal liquor tax."—O. O. Natwick, director, Wyoming Liquor Commission.

SUNSET HILLS FARM,
SUNSET HILLS, FAIRFAX COUNTY, VA.,
March 18, 1938.

Hon. PAT HARRISON,
Chairman of Senate Finance Committee,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR HARRISON: Several days ago I requested the privilege of appearing before your committee in regard to the increase of the revenue on distilled spirits of 25 cents a gallon. I visited your committee room yesterday but understand there are so many witnesses to be heard and so many other schedules before your committee that there would probably be no time available to hear me. I am, therefore, submitting these thoughts to your committee for such consideration as you may think advisable.

While I manufacture distilled spirits, I am writing this letter to your committee as a citizen and taxpayer with interests far larger along other lines than my distillery. Therefore, I trust that you may take my remarks as coming from an unbiased source.

My distillery is a small one making approximately 1,300 gallons a day and is located on my farm of 4,000 acres in the blue grass hills of Virginia. I am situated so that I raise a large amount of grain for my distillery and feed the by-product to my dairy cattle, beef cattle, horses, hogs, etc. Operating my distillery in conjunction with my farm as I do, I could sell my whisky at cost and still make a reasonable profit.

The tax probably would not affect me very much for the reason that I am making a very high grade bourbon whisky such as was made in the old days when bourbon whisky became famous and my trade is rather exclusive and of high grade and as my production is small, the increase in tax may not materially affect me or my product, but on the other hand, as my distillery is probably the only one in America down on the farm with no stocks, bonds or mortgages to contend with, and a high grade trade developed, I am probably the only one so situated who could absorb this increase in taxation.

Being rather familiar with the industry before prohibition, during prohibition, and since prohibition, it is my firm conviction that the increase in tax, such as proposed by you, would not bring increased revenue but a diminishing revenue for the reason that the tax you propose together with the tax already imposed would be more than 300 percent of the average cost of manufacture, and such a tax would be prohibitory and would open the door for the bootlegger as in the days of prohibition. In fact, is it not problematical that if this tax was imposed and the bootlegger again became active that the cost of enforcement might be greater than the income received? It might be comparable to pouring water into a bung with the spigot open.

The American Encyclopaedia of 1879—volume XVI, page 598—states that in 1868 when the tax of $2 a gallon was imposed that $19,000,000 was collected in revenue. In 1869 when the tax was reduced to 50 cents a gallon, the Government revenue increased to $45,000,000. The following year it increased to $55,000,000.

Thus showing that in that period the total revenue tax diminished with the increase of revenue and increased with the decreased revenue.

A tax of 25 cents per gallon may seem small to the Congress but when it is added to an already back-breaking revenue it is my opinion that it will bring results very different than those contemplated by your honorable body. Of course, it must be remembered also that back in the days of which I speak, the revenue from distilled spirits largely paid the running expenses of the Government, but in the present day with not only this particular tax but the other immense and burdensome taxes that are imposed, they are really getting beyond

the possibility of the taxpayer to pay them and in the last analysis it will be passed on to the ultimate consumer and in reality will not be a tax on the distillery but the public at large. This, in my opinion, will drive the ultimate consumer to the bootlegger which, as we all know, before the end of prohibition made a quality of whisky better than some of the legal liquor immediately after prohibition.

In conclusion I desire to state that my experience of rather an active business life extending from the panic of the early nineties down to the present time makes it my belief that if the Congress and the administration were as alert in putting forth economies, curtailing expenses and stopping the unnecessary outflow of the taxpayers' money as they are in digging up new and increased taxes, business might take a turn for the better.

It seems to me that the major things that are confronting us are:

Fear, fear, more fear, and then some.
Taxes, taxes, more taxes, and then some.
Politics, politics, more politics, and then some.

All of which are fast getting on the nerves of the businessman whether he be farmer, merchant, stock breeder, distiller, or what not.

Yours very truly.

A. SMITH BOWMAN.

STATEMENT OF EMIL NATHAN, EXECUTIVE SECRETARY, WHOLESALE LIQUOR DEALERS OF MISSOURI, TO SENATE FINANCE COMMITTEE AT PUBLIC HEARING HELD AT WASHINGTON, D. C., MARCH 19, 1938

Representing the responsible wholesale liquor dealers of the State of Missouri, I beg to submit the following facts in connection with the proposal to raise the excise tax from $2 per gallon to $2.25 per gallon on distilled spirits.

My activity of more than 50 years in the distilled-spirits industry affords the opportunity of expressing to you the experience of a half century devoted entirely and continuously to this line of service.

There is no question that if 100,000,000 gallons are tax-paid in a given year that the raise of 25 cents per gallon would produce $25,000,000 additional revenue, but the experience of the past half century has proved that when the rate is raised the withdrawal and tax payment from bond is correspondingly reduced, and the calculation so simply arrived at with a pencil is not in fact realized.

The reasons for this are obvious, as it has been the unfailing experience that every increase in the tax rate has increased the production of illicit whisky, which pays no tax but takes its place in the realm of consumption to the detriment of the industry and the loss to the Federal Treasury.

The present tax on a case of 100-proof whisky is $8.88, which includes Federal tax, Missouri State tax, and Federal strip-stamp tax, while the tax bill on preprohibition whisky of the same strength and gallons was $3.30 per case.

Preprohibition times recorded no State taxes, no strip-stamp taxes, and only a Federal tax of $1.10 per gallon.

The effect of this difference alone on the industry is terrific, as it requires an investment by the wholesaler of three times the amount that he needed in his business prior to the prohibition era. The profit on sales is far less and the expense of doing business more, which has brought about a very serious condition and is showing losses instead of profits and practically making the wholesale liquor dealer a responsible collector of taxes for Federal and State authority without pay.

It cannot be said this condition is due to too many firms in the business of wholesaling liquors, as there were over 6,000 wholesalers actively engaged in business prior to 1920, while today there are less than one-half that number so engaged, and these, generally speaking, operating without profit.

The business is in such a desperate condition that the present form of distribution at wholesale can be completely upset by some such apparently small and simple act as this proposed raise in tax which might be likened to the "straw that broke the camel's back."

MARCH 18, 1938.

Senator PAT HARRISON,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SIR: As the editor in chief of the Daily Metal Reporter, which caters to the ferrous and nonferrous metal industries, and of several other trade papers catering to basic industries, I desire to voice my objection to the proposed increase in the excise tax on liquor.

The steel and metal industries have benefited materially by the business that has come to them in one form or another from the liquor industry. Any increase in the internal revenue tax on liquor, is bound to have a two-fold influence. It is bound to result in a lessened consumption of liquor and it most certainly will divert a good portion of the remaining liquor business from the legitimate trade to the bootleggers. In turn, these results will have their bearing on the steel and metal industries. If the liquor industry is deprived of a good portion of its revenue it will mean that the industry will spend less for equipment, for machinery, for supplies, and for the hundred and one other commodities that it uses. I am not only referring to the purchase of new equipment but also to replacement and repairs.

In times like these when basic industries like steel and metal are operating at a low rate, when every channel is being fine-combed in an effort to dig up new business to keep plants going and to give employment to men who want to keep off the relief rolls, it would seem to me to be poor economics to say the least, to place greater burdens on a legitimate industry which, in my opinion, is already heavily taxed. The proposed increase in the excise tax would be akin to killing the hen that laid the golden egg.

Respectfully yours,

JOSEPH ZIMMERMAN,
Editor in Chief.

Mr. W. B. Holton, Jr., New York City, representing the Walworth Co., is the next witness.

STATEMENT OF W. B. HOLTON, JR., NEW YORK CITY, PRESIDENT THE WALWORTH CO.

Mr. HOLTON. My name is W. B. Holton and I am president of the Walworth Co. I have come here to talk to you through your courtesy this afternoon on matters pertaining to the effect of the undistributed-profits tax on the so-called heavy industries, the capital-goods industries.

The Walworth Co. is part of and largely serves the capital-goods industry. To my mind, and after a careful review of the underlying facts of the business trend in the heavy industries over the past 6 months, there is no question but that the undistributed-profits tax was one of the major factors which caused the precipitate decline in the latter part of the second half of the year.

Before going into that general question I shall be quite brief, but I should like to call attention to two points in respect to the provisions of the House bill in matters pertaining to the undistributed-profits tax if it is to be retained, and I sincerely hope that proves not to be true. The first is on page 17 of the House report, subsection E of section 13, and has to do with the exemption of companies which emerged or are emerging from reorganization proceedings. If I have read the section correctly, and I think I have, it means that the "breather" provided for companies having undergone a reorganization depends upon the date of the final decree; in other words, if the company emerges from a reorganization in the last of the taxable year, on the last day, there is no breather; they would have one day of exemption; if, on the other hand, they emerged from reorganization proceedings in the early part of the taxable year, there would be the remainder of the year. It seems to me it would only be equitable if a uniform period were provided for those companies which have gone through reorganization.

The second point has to do with the recording of the dividend position and the annual statement. At the present time all of us have been required to guess as to what our net profits would be, with an audit 2½ to 3 months off, and to take dividend action in respect to

the provision of the undistributed-profits tax, with no knowledge of what the precise earnings were.

Both of those points could be readily corrected.

Senator BROWN. On the last one you mentioned, if a flat rate of 17 or 18 percent corporation tax is levied, the problem would not arise, would it?

Mr. HOLTON. It would not; sir.

The CHAIRMAN. We took care of that difficulty in the personal holding company provision, but not in the undistributed-profits tax.

Mr. HOLTON. That is right.

The CHAIRMAN. You want it to apply the same as to holding companies so far as notice of distribution is concerned, if it should be retained?

Mr. HOLTON. Yes; and I hope it will not be retained.

I should like to take just a minute of your time on the question of what has happened to the buying power of the heavy industries.

The heavy industries gain their sales volume both from maintenance and from reconstruction, and we in our industry, which is the valve and fittings industry, providing valves and fittings which are used for the control of pipe-line transmission of all types—oil, water, gas, liquids, and what not, from a vacuum to 10,000 pounds per square inch pressure—have a rough rule of thumb measure as to whether the volume is coming from maintenance or whether from construction, and that turns on a particular type of fitting known in the trade as a union. Unions are used very much more extensively in repair work than they are in new construction. When you have to replace a worn-out fitting or a worn-out valve it is necessary to cut the line and in order to bring it together again a union of the two is required.

Whenever we find in the analysis of the sales volume in our industry the demand for unions is going up in the air, we can be pretty sure there has been considerable stimulation in the maintenance field. That happened last spring, and the last precipitous decline in volume was most noticeable in that same field. In other words, the necessary repairs were being deferred by customers of the heavy industries because they were unable to see into the future just what the threat against their working capital would be in the event they had to pay as high as 27 percent undistributed-profits tax.

Now, the arithmetic is very simple, Senator. Take, for example, a company, or an individual, who has one-third of his net worth invested in an inventory which has been manufactured in his own plant. Consider further that the heavy industries granted to labor, from the period June 30, 1936, until June 30, 1937, or a little later, very substantial increases in wages. These increased labor rates reached as high as a 25 to 30 percent increase. Any company which is a customer of the heavy industries and which had one-third of its total net worth invested in fabricated products of its own manufacture and having as little as a 15 percent increase in labor and materials in the total loading of costs as carried on their books for inventory purposes, when taken together with the normal tax of 15 percent would have absorbed in these two items alone a full 6 percent earning power on the total net worth of its investment. At the time when the business man began to see that his working capital, although increasing from profits, would all be required to finance additional inventory, he stopped buying. Company after company on June 30, or thereabouts, of

last year realized that although they were having a profitable year, a very large part of those profits would be required to finance an increased cost of the same number of units in their inventory, whether pounds, tons, barrels, bags, or what not.

Now, the result was that there was an immediate stopping in major repair work. The further result was that there was an effort to get money out of their own inventories, whether of their own manufacture or raw material. And what happened? We had a flattening down of the demand for raw materials, semi-finished, and all other products of the heavy industries almost immediately. When it was understood that a large portion of their cash would be required for operating purposes the heavy industries took a nose dive. Volume went off as though you had cut it with a knife, and although at the end of the year there were substantial profits in many lines, those earnings and current accruals to surplus were not represented by cash, and they are not represented by cash today.

The earnings and the current accruals to surplus were looked upon by a great many people as a surplus in the nature of working capital beyond the needs of that particular company, but that is not true; working capital was represented by higher inventory cost of the same number of units, and the cash was not available with which to pay a dividend, and, furthermore, in order not to pay a weighted average of a profits tax on undistributed profits of 20½ percent, five times that amount had to be paid out to stockholders. The stockholders generally would have preferred to have the money remain in the business, save for the penalty taxes.

I have been quite disturbed of late, Senator Harrison, about the questioning of the importance of the undistributed-profits tax of last year in its effect on business, and if I may leave one thought with this committee it is, insofar as the heavy industries are concerned, an examination of the record of last year will undoubtedly bring you to the conclusion that the most important contributing factor in the decline and precipitous decline of volume in the heavy industries was due to the undistributed-profits tax.

I thank you very much.

The CHAIRMAN. Thank you very much.

Mr. Percy Phillips, representing the Baltimore Transit Co.

Have you a brief, Mr. Phillips?

Mr. PHILLIPS. I have left copies with the clerk for distribution. I also have a brief statement that should not take more than 7 minutes, to summarize this matter, which has not previously been brought to the attention of the committee.

STATEMENT OF PERCY W. PHILLIPS, WASHINGTON, D. C., REPRESENTING THE BALTIMORE TRANSIT CO.

Mr. PHILLIPS. My name is Percy W. Phillips and I am a member of the law firm of Ivins, Phillips, Graves & Barker, of Washington, D. C. For several years I had the privilege of being a member of the United States Board of Tax Appeals.

I appear here on behalf of the Baltimore Transit Co., which operates the transportation system in the city of Baltimore.

In 1934 that company went into receivership. In 1935 it was reorganized under section 77 (b) of the Bankruptcy Act. Indebted-

ness of some $64,000,000 was reduced to $23,000,000, a cut of more than 50 percent, and the annual interest charges of that company were reduced from some $3,000,000 to less than $1,000,000.

That company has not earned its interest requirements since it came out of the receivership, and its bonds today are selling at about 20 percent of their par value.

Senator KING. The stock, I suppose, is wiped out entirely?

Mr. PHILLIPS. So far as value is concerned; yes. In the reorganization the common stock, I believe, was practically wiped out. The stockholders were given a very small percentage of the common stock in the resulting capitalization under 77 (b), but it was very small.

That company has certain capital assets which could normally be used in the purchase and retirement of these bonds, but has no income which it could use for that purpose and the only securities are these bonds which, as I say, are selling at 20 percent of their par.

However, under a decision of the Supreme Court in the *Kirby Lumber case*, handed down in 1931, the Treasury Department would attempt to collect a tax upon the difference between the par value of these bonds and the price paid to purchase them—it would attempt to collect from the company an income tax on the difference between the par value of those bonds and the price at which the company went in the market and bought them, or a tax as income upon 80 percent of the par value of those bonds if they were purchased and retired at 20. The net result of that is that the company is not in a position to go out and buy and retire its bonds.

Senator KING. Were those bonds purchased and retired by officers or capitalists who got the benefit?

Mr. PHILLIPS. They have not been retired, Senator King, and that is the point I am making. The company would normally use some of these capital assets for the purchase and retirement of its bonds, but the income-tax burden is such the company cannot do so. It is not a question of the officers or some outside financiers retiring the bonds; it is a case of the company itself being able to retire parts of its indebtedness except for the provision of the Income Tax Act.

Senator KING. It is not in the position of the land banks, where they speculated and made enormous profits and got away with it?

Mr. PHILLIPS. I think not, sir.

We have a situation in the income-tax laws by which a corporation which is in a strong financial position may retire or call its bonds—and usually the call provision is at a premium; they call them to refinance at a lower rate of interest. If, for example, those bonds are called at 110, the company is entitled to take as a deduction on its income-tax return the premium over par at which they retire those bonds, or 10 percent. For the purpose of my illustration, I am assuming the bonds are sold at par. If, on the other hand, a corporation which is in a weak financial position finds itself in a position to retire its mortgage bonds at a percentage of their par value, that corporation must pay a tax upon an income computed by including in that income the difference between the price at which those bonds were marketed, or perhaps the amortized price, and the price at which retired.

So we have a situation in the income-tax law which gives a premium to the strong company, which allows it to retire its bonds at a premium, and take the resulting loss, and which puts a burden upon the weak financial corporation which finds itself in a position where it can retire its bonds at less than par.

Now, it seems a rather strange situation and we made inquiry to learn whether it was general; that is, whether corporations generally were in a position where they were not able to retire their bonds because of tax burden, and we found we were not alone in that situation, and it is a situation which is fairly general among transit companies and railroads. That same situation is true in the case of the individual who finds an opportunity to compromise his indebtedness with one or more creditors. The compromise is regarded as income to the extent the indebtedness is wiped out. There are a number of cases which have been tried in the Board of Tax Appeals and the courts in which conflict has developed as to the extent of that liability and there are decisions which say that the individual or company which effects a compromise with its creditors is taxable only to the extent it makes the individual solvent, because no one would contend, and so far as I know no one has yet contended that a man who goes through bankruptcy and whose debts are wiped out has received income to the extent they are wiped out, although the logic of the situation would carry the rule that far.

Senator WALSH. Is there not a provision in the new bill that a corporation can go bankrupt and yet not take a loss?

Mr. PHILLIPS. None that would correct the situation I have in mind, sir.

Senator WALSH. I would like to ask Mr. Stam about that.

Mr. STAM. That is not the same proposition.

Mr. PHILLIPS. We do not believe that a policy which so hampers the weak corporation which is trying to reestablish its credit or put itself on its feet, or the individual, or any other business which is in such a situation, can be regarded as a sound public policy. It was not the rule prior to the decision in the *Kirby Lumber Co. case*, and when I say it was not the rule, I mean it was not the rule laid down by the Board of Tax Appeals and the courts, although there may be some doubt as to what the Treasury Department's ruling on that situation was, prior to that time. There may be some question as to the situation which has developed in the decisions of the courts and the Board of Tax Appeals as to whether the *Kirby Lumber case* and the *Kerbaugh Empire case* are in conflict with each other; there is a no man's land in there, and the individual taxpayer who finds himself in that no man's land, also finds himself in the position of being in litigation to determine what his tax liability is.

We believe such a policy tends to injure business and also tends to reduce taxes. I say it tends to reduce taxes because the strong corporation which will get the benefit of a reduction has all of the advantage of carrying out the transaction which would produce that reduction in its tax return.

The CHAIRMAN. Did you bring this to the attention of the House subcommittee?

Mr. PHILLIPS. It was not brought to the attention of the House subcommittee in any way except in a brief filed by the Railroad Security Owners' Association; a mere mention of that situation was made as one of the recommendations of that association, but it was not discussed.

The CHAIRMAN. Do you know whether it has recently been brought to the attention of the Treasury officials?

Mr. PHILLIPS. Not as far as I know.

The CHAIRMAN. We will ask Mr. Stam and others of our advisers to give us their reaction to this, and the Committee will consider the points you make.

Mr. PHILLIPS. I doubt if the Treasury Depratment could take any position other than it has under the decisions as they stand at the present time.

I would like to make a point elaborated on in the brief. I believe there will be no decrease in revenue as a result of the change, but ultimately an increase because of the retirement of the bonds and the reduction of the annual interest deductions of the corporations whose bonds are retired. I believe it would improve the bond market because there are practically no buyers for bonds of that sort, selling around 20. The natural buyers are the corporations themselves, and they are unable to go into the market because of the tax situation.

I believe it is in the interest of public policy these debts be retired, and that is enlarged on in the brief. The present tendency in all refinancing operations is to require a provision for the refinancing of new indebtedness floated at the present time. I think that is the policy of the Interstate Commerce Commission and other such Federal and State organizations generally. I think it will accord with good accounting and sound business.

I doubt whether under any proper definition of income, this is income.

I will ask the committee to give consideration to my brief.

Senator KING. Is that memorandum you have there supplemental to the printed brief?

Mr. PHILLIPS. No, sir.

(The brief referred to is as follows:)

MEMORANDUM ON BEHALF OF THE BALTIMORE TRANSIT COMPANY WITH REFERENCE TO RECOMMENDATION FOR AMENDMENT OF THE INCOME TAX LAW TO PROVIDE THAT NEITHER LOSS NOR GAIN SHALL BE RECOGNIZED UPON RETIREMENT OR COMPOSITION OF INDEBTEDNESS

The Baltimore Transit Co. requests that the Senate Finance Committee consider an amendment to the proposed Revenue Act of 1938 (H. R. 9682) in the following respects:

By adding to section 22 (b), which provides for exclusions from gross income, an additional paragraph to read substantially as follows (p. 25):

"(9) DISCOUNT.—The discount under the face value thereof (or amortized value if issued at some value other than face value), at which a taxpayer may redeem, compromise or otherwise satisfy his bonds, notes or other indebtedness."

By adding to section 24 (a), which enumerates items not allowable in computing net income, an additional paragraph to read substantially as follows (p. 38):

"(6) PREMIUM.—The premium over the face value thereof (or amortized value if issued at some value other than face value), at which a taxpayer may redeem, compromise or otherwise satisfy his bonds, notes or other indebtedness."

Under present Treasury rulings a taxpayer realizes taxable gain or deductible loss from the retirement or satisfaction of indebtedness at other than the amount borrowed. This position of the Treasury seriously hampers the taxpayer who is financially weak but who has an opportunity to strengthen his position by a composition with one or more creditors or the purchase of bonds or notes at a discount.

At the same time it places the financially strong business in a favored position. Such a taxpayer who retires or satisfies its indebtedness at a premium, for the purpose of refinancing the indebtedness at a lower interest rate, is allowed to deduct the premium.

The purpose of the change requested is to provide that neither gain nor loss shall be realized by a taxpayer for purposes of computing taxable income by reason of the discharge or retirement of indebtedness, without, however, dis-

turbing the present rulings requiring that the premium or discount at which bonds are issued be amortized over the life of the bonds.

The changes proposed will effect the following results:

(1) An ultimate increase in the revenue, with no immediate loss therein.

(2) It will be consistent with a sound public policy which requires the reduction of indebtedness, especially by transit companies and railroads, the accomplishment of which policy is now hampered, if not prohibited by the resulting liability.

(3) It will be of substantial assistance to those corporations and businesses which are weak financially and most in need of assistance.

(4) It will bring the taxing statute into accord with good accounting and sound business practice.

(5) It will simplify the administration of the tax law by removing the doubt and uncertainty with respect to the tax liability resulting from the discharge of indebtedness caused by the great confusion now existing in the decisions of the United States Board of Tax Appeals and the courts.

THE EVIL TO BE CURED

The situation of the Baltimore Transit Co. is typical of that of many other corporations. It found itself unable to meet its obligations and was forced to seek relief in section 77 (b) of the Bankruptcy Act. In July 1935 it was reorganized. A total funded debt of $64,000,000, which bore interest of $3,000,000, was reduced to $23,000,000, represented by cumulative income bonds. The annual interest requirement is now $988,000, payable if earned; otherwise cumulative. The bonds issued in the reorganizations are now selling at about 20 percent of their par value. It would be greatly to the advantage of the company to use such capital funds as may be available in the purchase and retirement of some of these bonds. Under the present rulings of the Bureau of Internal Revenue, the company would realize a gain of 80 percent of the par value of these bonds, if it should purchase and retire them at 20. It would have to pay taxes upon an income so computed. This tax obligation is so onerous that the company cannot afford to use its funds in this manner. As a consequence, the company suffers, the bondholders suffer, the securities market suffers, and the Government realizes no taxes. In fact, as we shall show, the Government suffers a loss from the continuance of the bonded indebtedness, unreduced.

This situation is not peculiar to this company alone. As shown later, this situation could not have existed under the decisions of the Board of Tax Appeals and the courts, prior to the decision of the Supreme Court in Kirby Lumber Co.,[1] and it is proposed to restore the rule which existed prior to that decision and which apparently was satisfactory to Congress.

The present position of the Treasury is that whenever a taxpayer retires his bonds or other business indebtedness at a premium, he is entitled to a deduction upon his income-tax return, while if he redeems or discharges his obligations at a discount, a gain is realized which is subject to income tax. It is obvious that such a rule benefits financially strong corporations whose obligations are selling above par, or which are in a position to refinance bonds bearing a high rate of interest with bonds bearing a lower rate of interest. It is equally obvious that this rule works to the disadvantage of those corporations which are in a weak condition and whose bonds consequently sell below their par value and to the disadvantage of the individual or corporation which must seek a compromise with creditors.

Such transactions are in the nature of adjustments to capital and, under generally accepted principles of accounting, do not represent either income or loss of the year. The transaction does not bring to the taxpayer any cash which it can use to pay taxes. It does not represent any true income but is, in reality the recognition of the fact that there has been a diminution in the value of assets, which is reflected in the reduced value of the debt.

THE IMMEDIATE EFFECT WOULD NOT BE ANY LOSS OF REVENUE

As the law now stands, a deduction is allowed to a corporation which retires its bonds at a premium. Many corporation bonds, particularly those bearing a high rate of interest, contain provisions permitting the bonds to be called at a premium. The result has been that in periods of low interest rates, such as exist at the present time, strong corporations find it beneficial to exercise this privilege.

[1] 284 U. S.

In addition to a lower interest rate, these corporations also receive a deduction upon their income-tax returns substantially equal to the premium. There is, therefore, every incentive for such corporations to take advantage of this deduction. The Government loses revenue from this source which it would otherwise receive from such corporations.

On the other hand, the business which is in a weak financial condition, but which finds it possible to retire a part of its bonded indebtedness at a discount, finds that it will have to account for the discount as income and pay taxes thereon. Such a business is already struggling for its very existence; otherwise, the discount situation would not exist. The tax burden, when added to its other financial problems, makes the situation so difficult that the management hesitates to do that which sound business judgment would dictate.

In the case of the Baltimore Transit Co. the burden is so great that it cannot afford to acquire any substantial amount of its bonds, and the same situation is unquestionably true of many other concerns in a like condition. In other words, those who are in a position to show a loss upon their tax returns will carry out the transactions bringing about such a loss, while those who would have a profit under the Treasury rulings do not undertake such transactions. While statistics are not available, it seems reasonable to assume that the net result to the Government is a loss. It is inconceivable that there could be any substantial taxable profits in excess of deductible losses.

The situation is comparable to that which existed prior to 1921 with respect to the computation of gain or loss on the sale of property given by one person to another. Under the law prior to 1921, the donee reported profit only on the difference between the selling price of property and its value when it was received by him. The result was that if an individual owned property which had risen substantially in value and which he wished to sell, a gift might be made to a wife, son, or daughter, or to a trust, and the sale would be made by the donee. There would then be no taxable gain to the donee on which the Government could collect tax. If, on the other hand, the property had deepreciated in the hands of the owner, the sale would be made by the owner so that the loss could be taken for income tax purposes. Congress saw fit to correct that situation by providing that the donee should take the cost basis of the donor.

If the law could be restored to the condition existing before the decision in the case of Kirby Lumber Co., there would be no tax premium to the strong corporation, which would retire its bonds in any event, and no prohibitive tax on the financially weak taxpayer who would like to reduce his debt but cannot do so.

THE ULTIMATE EFFECT OF THE PROPOSAL WOULD BE TO INCREASE THE REVENUES

The Government revenues are benefited whenever indebtedness is reduced, because the interest deduction allowed by law is decreased and taxable income is increased correspondingly. For purposes of illustration we assume the following facts:

Assume annual income before interest of $1,200,000
Assume indebtedness of 25,000,000
Assume interest of 4 percent 1,000,000

Assume annual reduction of debt of $500,000 by purchasing own bonds at a discount, either from income or from capital funds, such as depletion or depreciation reserve.

The following would result:

	Income	Interest deduction	Taxable income	Tax at 16 percent
First year	$1,200,000	$1,000,000	$200,000	$32,000
Second year	1,200,000	980,000	220,000	35,200
Third year	1,200,000	960,000	240,000	38,400
Fourth year	1,200,000	940,000	260,000	41,600

If on the other hand, the indebtedness is not retired, the tax remains at $32,000 in each of the years.

The benefit to the Government in revenues from encouraging debt retirement is obvious.

THE RETIREMENT OF DEBT IS IN THE PUBLIC INTEREST

The railroads and public utilities have been severely criticized on the ground that in the past their provisions for the retirement of their debts have been inadequate. Today many of the regulatory commissions require that sinking funds be established. Provision for the retirement of debt is sound public policy.

Today the tax constitutes a burden which makes it difficult or impossible for a taxpayer to effect a compromise with creditors or to retire indebtedness at less than par without the aid of the bankruptcy courts.

Any taxpayer effecting a compromise with creditors which leaves him solvent, is subjected to tax. A tax in such circumstances defeats the very purpose of any such compromise. Voluntary settlements with creditors on the basis of ability to pay are made difficult or impossible. Businesses are thrown into bankruptcy or receivership proceedings which might have been avoided.

This situation should be corrected. It is submitted that the amendments suggested, or something of the same effect, will make the law more just and more consistent with the public interest.

THERE IS NO TRUE INCOME IN A COMPROMISE WITH CREDITORS OR IN THE RETIREMENT OF DEBT

The Treasury Department has never attempted to collect tax from one who is discharged from his debts in the bankruptcy courts on the ground that he has received income equal to his unpaid debts. But if strict logic were to be applied, the Treasury rulings should go to that extent.

What then of the debtor who, in the bankruptcy courts, effects a compromise with his creditors? Or of the debtor who effects such a compromise without the intervention of a court? What if the compromise is with only a part of the creditors, or with one principal creditor? Is there any distinction in principle between the latter situation and the purchase and retirement by a corporation of its own bonds at a price below par? Should voluntary compromises with creditors, or retirement of indebtedness, be encouraged, or should the debtor be forced into the courts in order to avoid the tax?

When indebtedness is reduced by reason of the doubtful ability of the debtor to pay, there is no true income; nothing is realized which the debtor may use to pay his tax. True, there has been a reduction in liabilities, and an improvement in the balance sheet, but no improvement in the income statement. There has been, in effect, a limited recapitalization or reorganization, but one which does not come within the definition of reorganization in the revenue act.

If a discharge of indebtedness in a reorganization or bankruptcy is not income, is it sound to rule that a partial discharge is income? Is a policy sound which so penalizes voluntary retirement of debt that taxpayers are forced into the court for reorganization? Is a policy sound which leaves taxpayers in grave doubt whether the compromise, retirement, or payment of debt will impose a tax which they cannot pay?

BONDS SOLD AT PREMIUM OR DISCOUNT

The suggested amendment would not change the existing rulings with respect to bonds which are issued at a premium or a discount. These rulings now provide that the amount of such premium or discount shall be amortized over the life of the bonds. When bonds are originally issued, the premium or discount at which they are sold can be controlled by the rate of interest to be paid—assuming the bonds to be otherwise acceptable as an investment—and it seems proper that amortization of such premium or discount should be used as an offset to the interest deduction. Consequently, no change in the present rule is contemplated in the amendment suggested.

The situation is different, however, when the financial condition of the debtor becomes such that he must seek a compromise with his creditor, or can retire part of his debt at less than par. As pointed out above, the very fact that the debt can be retired at less than par usually indicates that the condition of the debtor is worse than at the time the indebtedness was incurred.

THE LAW IS NOW IN CONFUSION AND AMENDMENT OF THE STATUTE IS NECESSARY TO AVOID MUCH LITIGATION BETWEEN TAXPAYERS AND THE TREASURY

The Treasury Department, at least since 1919, has consistently contended that the release or forgiveness of indebtedness, or reduction of debt by composition of creditors, or by acquisition of obligations at less than their face, constituted income to the debtor. The Treasury never attempted to assert taxes on this basis against

debtors who were discharged in bankruptcy, for the practical reason that such taxes would almost always be uncollectible.

The first reported litigation was in 1924 when the District court decided *Kerbaugh Empire Co.* v. *Bowers*.[2] The taxpayer had borrowed German marks before the war and was able to discharge its obligation in greatly depreciated marks. The Treasury determined a profit and asserted a tax. The District court held that there was no income and that the mere fact that after the transaction the plaintiff's balance sheet had improved was not sufficient to constitute "a gain derived from capital." This decision was relied on by the Board of Tax Appeals in April 1926,[3] in holding that where a debtor made a composition with creditors who wrote down their claims and settled them for less than face, no income was realized by the debtor.

The *Kerbaugh Empire case* was affirmed by the Supreme Court in May 1926,[4] in an opinion which analyzed the definitions of income in previous opinions, indicated that the reduction of indebtedness could not be said to be income derived from capital or labor, overruled the Treasury's theory that the situation was analogous to that of a short sale of stock, but went on to say that in the particular case the borrowed money had been lost in a certain venture, and so the whole transaction taken together resulted in a loss rather than a gain. The opinion of the Supreme Court was so couched that it was universally accepted by all tribunals confronted with similar problems as authority for the broad proposition that one who liquidates a debt for less than the amount borrowed does not derive income thereby. The Board of Tax Appeals in at least 15 cases, the circuit courts of appeals for several circuits, the Court of Appeals of the District of Columbia, and the Court of Claims all held that the reduction of indebtedness, whether by voluntary release on the part of creditors or by the purchase on the part of its debtor of its bonds or notes at a discount, did not constitute income.

In November 1931 the Supreme Court decided the *Kirby Lumber Co. case*.[5] There a corporation issued bonds at par and later in the same year repurchased some of them in the market for less than par. The company was not insolvent nor in financial difficulty. The Supreme Court in a very brief opinion quoted the Treasury Regulations to the effect that taxable gain resulted from the retirements of bonds at less than the issuing price and said:

"We see no reason why the regulations should not be accepted as a correct statement of the law."

It then distinguished the *Kerbaugh Empire Co. case* on the ground that in the latter the transaction as a whole was a loss and said of the case before it—

"Here there was no shrinkage of assets and the taxpayer made a clear gain."

Since the Kirby decision numerous cases have been litigated with respect to transactions which occurred before its rendition. The Board of Tax Appeals held [6] that a corporation which bought some of its bonds at a discount realized taxable income. The case differed from the *Kirby case* in that the sale and repurchase were not in the same year and that here there was evidence of shrinkage in value of assets absent in the *Kirby case*. The Board regarded neither of these elements as controlling.

Shortly afterward, however, the Board of Tax Appeals held [7] that where a taxpayer was in receivership and the creditors forgave part of the indebtedness and their claims wre liquidated at a discount, no taxable income was derived. The Board distinguished the *Kirby case* and said that here—

"The parties contemplated no profit from the transactions which merely relieved the taxpayer from a part of its liabilities."

This decision was followed in several other cases, and the *Consolidated Gas Co. case* was also followed, so that the test seemed to be whether the taxpayer agreed with its creditors to reduce their claims or whether it went into the market and purchased its bonds below par, with no income resulting in the first instance and taxable income resulting in the second.

The Board presently realized that this distinction was unsound and held that where a solvent purchaser gave notes for machinery and in a later year some of the machinery proved defective and the creditor canceled some of the notes, the amount of the canceled notes represented income. The Board said that the cases—subsequent to Kirby Lumber Co.—where the reduction of indebtedness had not been treated as income were all cases of insolvent debtors. And in

[2] 300 F. 938.
[3] Meyer Jewelry Co., 3 B. T. A. 1319.
[4] 271 U. S. 170.
[5] 284 U. S. 1.
[6] Consolidated Gas Co. of Pittsburgh, 25 B. T. A. 901.
[7] E. B. Higley & Co., 25 B. T. A. 127.

Dalls Transfer & Terminal Warehouse Co.[8] where real estate worth $42,507.20 was transferred to the creditor and the balance of an indebtedness of $110,101.90 was canceled, the Board held that the debtor had realized taxable income to the extent of the debt canceled. The circuit court of appeals,[9] however, reversed the Board, saying that the cancelation of the balance of debt did not have the effect of making taxpayers' assets any greater. In Coastwise Transportation Co. the Board's first decision had preceded the Kirby Lumber Co. decision of the Supreme Court. The circuit court of appeals reversed [10] on the authority of the *Kirby case* and remanded the case to the Board to make further findings as to losses so that it could be determined whether the case fell within the reasoning of the Kirby Lumber Co. or the *Kerbaugh Empire case.* The Board decided that the assets acquired with the borrowed money had so shrunk that the gain by reduction of debt did not offset the loss in value, and held that there was no income, but the circuit court of appeals again reversed the Board [11] in an opinion which practically limits the Kerbaugh Empire decision to cases where the entire transaction entered into with the borrowed money has been finally closed—a very unusual situation.

Other decisions of the Board of Tax Appeals hold that if the taxpayer is solvent both before and after the reduction of its debt, gain will be recognized on that reduction; if the taxpayer is insolvent both before and after, no gain will be recognized; and if the taxpayer is insolvent before but solvent after the reduction of its debt, gain will be recognized, not to the extent of the difference between the face of the debt and the amounts paid in discharge thereof, but to the extent of the net worth of the debtor after the transaction.[12]

Of course, it may be possible after a taxpayer has made a composition with creditors to determine its net worth—although this could be done in the case of a transit company, a railroad, or a public utility only at prohibitive expense and the net worth could probably not be decided except by litigation. A taxpayer, with assets of indefinite value, confronted with the problem of whether or not to buy in its securities at a discount would find it practically impossible to determine in advance of the transaction whether or not it would result in taxable income. The risk of (1) the probable expense of litigation in deciding the question and (2) the risk of losing in such litigation, would make it extremely unwise for any taxpayer to undertake such a step, involving any substantial amount, unless it knew itself to be so insolvent that by no possibility could the reduction of its debt render it solvent.

On the converse of the question, the Board of Tax Appeals has held that where a taxpayer retires bonds at a premium it sustains no deductible loss,[13] and has held exactly the opposite.[14]

Another rather fine-spun distinction is made by the Board in holding that if a debtor's obligation is reduced taxable income results, but, if the debtor is under no personal obligation but the composition has the effect of reducing liens upon his property, for example, where he has bought land subject to a mortgage which he does not assume, no income results.[15]

The decision of the Supreme Court in the *Kirby Lumber Co. case* is very difficult to reconcile in logic with its decision in *General Utilities & Operating Co.* v. *Helvering,*[16] wherein the Government unsuccessfully relied upon the Kirby Lumber Co. decision. The Court held that no taxable income resulted to the taxpayer corporation.

With the confusion in the authorities, we are sure to have much litigation between taxpayers and the Treasury for some time to come, unless Congress will eliminate the source of controversy.

Respectfully submitted.

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[8] 27 B. T. A. 651.
[9] 70 F. (2d) 95.
[10] 62 F. (2d) 332.
[11] 71 F. (2d) 104.
[12] Lakeland Grocery Co., 36 B. T. A. 289; Madison Railways Co., 36 B. T. A. 1106.
[13] Coast Counties Gas & Electric Co., 33 B. T. A. 1199.
[14] Metropolitan Edison Co., 35 B. T. A. 1110.
[15] Fulton Gold Corporation, 31 B. T. A. 519; P. J. Hiatt, 35 B. T. A. 292.
[16] 296 U. S. 200.

The CHAIRMAN. Mr. Joseph France, Baltimore, Md.

STATEMENT OF JOSEPH FRANCE, BALTIMORE, MD.

Mr. FRANCE. I am going to give a few illustrations in support of the brief just filed. My name is Joseph France. I am a lawyer in Baltimore, and during the last 5 years I have done a great deal of corporation work, reorganizing corporations.

I am particularly concerned with the remnants of about 20 corporations now being liquidated for the benefit of bondholders. I have not formed a new corporation in the last 3 years, except for reorganizations. I have to advise clients not to incorporate, particularly small partnerships, because they were leading themselves into the hazard of being attacked and penalized on what would really be an innocent undistributed profit, as anyone who has studied the returns of small companies can easily see.

Senator KING. Your view is the influence of the undistributed-profits tax is to do violence to the small businessman?

Mr. FRANCE. Absolutely; and force him to dissolve his corporations. We have made dissolutions in Maryland easier and quicker, and I have been dissolving many more corporations than I have formed.

Senator KING. That is because of the undistributed-profits tax?

Mr. FRANCE. Of the hazards of it.

Senator KING. I think you verify my prediction made in 1936.

Mr. FRANCE. First, my three illustrations will show how important it is to entirely eliminate the tax on undistributed profits.

Second, I believe it will help to simplify the tax on capital gains. It is bad enough to work out percentages from 100 to 30 and then find you can only take a $2,000 loss, but if you go through all of the arithmetic on a monthly basis or a daily basis, it really justifies resentment on the part of the person making out the return.

Third, I hope you are not going to create another artificial distinction; in substance saying: If I own a corporate mortgage I cannot take a loss, but if I own an individual mortgage, I can. That distinction is in the House bill.

Now as to my three illustrations. First, a company that came to me after it had begun its bond purchasing. It is a company that came out of 77B with a plan that said it should set aside in a depreciation fund earnings to the extent of depreciation before paying interest on its bonds. It bought $90,000 of bonds at an approximate cost of $20,000. It is faced with a $20,000 tax and has not a nickel to pay it with; literally, not a nickel. It bought its bonds out of its depreciation fund and apparently there is a profit of $70,000 which cannot be distributed—in the first place because it hasn't got it, and in the second place, it of course should not do so when it has so much debt.

Senator KING. That is, when it expended the money they treated it as an income gain?

Mr. FRANCE. Yes; but it is not income nor capital gain. They extinguished a $90,000 debt with $20,000 and there is $70,000 of alleged income for which they are penalized with taxes, not only income taxes, but also both the capital stock excess profits tax and the undistributed profits tax; as there was nothing in that indenture (legally—within the meaning of the Treasury Department regulations) which prevented distribution of income.

Senator KING. That is, the Treasury Department held that was income and subject to the undistributed profits tax.

Mr. FRANCE. The return has been filed stating the facts and I have every reason, as my next illustration will show you, to believe that the Commissioner will so hold.

Postal Service Building Corporation went into 77B in 1935. I participated in the reorganization plan. The Government refused to permit its attorney in Baltimore to consent to our plan because there were $6,000 of unpaid income taxes. The $6,000 of unpaid income taxes represented a tax assessed by the Government at this time on income—alleged income—which was solely the difference between the par value of the bonds and the price paid for them. In other words, here was a tax of the kind Senator King was talking about, actually placed or assessed on bond discount, and a refusal to consent to confirmation. I took the position, as counsel for the committee, that the corporation was insolvent now, that it had been insolvent in 1934, that it had decreased its liabilities, that it had not increased its assets, and that I could not see where there was any income.

We could not get anywhere in negotiations with the Government, set the case for a hearing, and settled it for $500. We paid that $500 because it would have been more expensive for us to pay appraisers and lawyers.

My third illustration shows the way I think we can start the wheels of business turning a little bit, if these small corporations can use their funds to buy their bonds without being taxed on what is really a reduction of debt. It is a mortgage company that had a lot of real estate and mortgages and by foreclosing and taking over properties, established worthless deficiencies and had losses. We felt that these losses could be offset against discount on bonds purchased so that we would be able each year to buy bonds to the extent of such losses. We could liquidate and have a $50,000 loss and then buy bonds at a discount even if the Government's contention that such discount is a profit is continued. We raised the price of these bonds from 1935 to date from 33 to 85, but if present taxes continue we will have to stop because we are pretty well liquidated and cannot get many more losses out of our real estate. As a matter of fact we had them up to 87, but when we stopped buying at this price they dropped and if our losses stop we cannot afford to have any more discounts.

The CHAIRMAN. You will stop buying when you have to pay a tax.

Mr. FRANCE. Yes.

The CHAIRMAN. Mr. Carroll, I understood you wanted to get away.

STATEMENT OF MITCHELL B. CARROLL, NEW YORK CITY, REPRESENTING THE AMERICAN CHAMBER OF COMMERE IN LONDON

Mr. CARROLL. Mr. Chairman, I am Mitchell B. Carroll, a lawyer, representing the American Chamber of Commerce in London. I wish to speak to you about various limitations that inadvertently or extra-legislatively, if I may use that word, have been placed upon the foreign tax credit, the provision to protect American enterprises from international double taxation. As you recall, the late Dr. T. S. Adams, back in 1918, proposed that this provision be inserted in our revenue act, and it was enacted. It has been reenacted in all

subsequent revenue acts, and relying thereon corporations have extended their commerce into the British Isles and overseas possessions, and also in many other foreign countries.

The maintenance of the full credit for relief from international double taxation is of vital importance to our foreign commerce. It should be regarded as a supplementary policy to that of promoting trade through reciprocal-trade agreements. Obviously, the purpose of reciprocal-trade agreements is to remove the barriers to the importation of goods within a foreign country. Much of these goods is sold through foreign sales branches and subsidiaries and if the profits of these sales branches and subsidiaries are subjected to taxation in the foreign countries, and again to taxation at home, the resulting burden under existing rates of taxation would be too crushing for the commerce to be carried on.

Senator KING. Just give us a complete example of how that operates.

Mr. CARROLL. Take for example an American corporation that is producing shoes, for example, in New England, and selling them in London. The profits realized through a branch in London are subject there to a profits tax of 5 percent and then to a standard rate of income tax of 25 percent.

Senator KING. Do you mean by the British Government?

Mr. CARROLL. Yes. When these profits are brought home to the United States a credit is granted against the United States tax which cannot exceed what the American tax would have been on that foreign income. In other words, the credit does not in any way operate to reduce the tax on the balance of the income realized exclusively in the United States.

The importance of this credit is to save those particular profits from being fully taxed twice for if on top of the 5- and 25-percent taxes you pile a corporation tax and undistributed-profits tax, or if the profits were distributed, the normal tax and surtax of the individual, the total rates might well exceed half the income.

If the income goes into the higher brackets of the surtaxes, the rate is almost confiscatory. Recently there has been a tendency to encroach more and more upon this credit for foreign taxes and, in behalf of American enterprises engaged in foreign trade, I wish to call this to your attention in the hope that measures may be taken to remove these encroachments and prevent future encroachments.

In the first place, in the Revenue Act of 1936, in formulating the undistributed-profits tax, the deduction for intercorporate dividends was converted into a credit against net income. It is rather complicated to explain it all here, but it resulted in arithmetically padding the denominator of the limiting fraction which protects the revenues of the United States.

As you know, the credit cannot be greater than the proportion of the foreign income over total net income. By including in total net income all the dividends received by one domestic corporation from another domestic corporation, even though only 15 percent of the intercorporate dividends were subjected to tax, it automatically padded the denominator of the fraction, and made the fraction smaller, and thereby reduced the credit that could be allowed.

That could be simply rectified and I have ventured in all humility to submit in and annexed to my brief a draft of amendment which I think would cure it, although I think it could be greatly improved upon by the draftsmen of your committee. It reads as follows:

PROPOSED AMENDMENT TO REVENUE BILL OF 1938, AS SECTION 131 (h)

Section 131 (h), definition of "entire net income": For the purposes of this section the term "entire net income" means net income as defined by section 21 after deduction of the credit for dividends received which is allowed in section 26 (b).

The other limitation results from a decision recently handed down by the Supreme Court, in the case of *Mary Duke Biddle* v. *The Commissioner of Internal Revenue* involving a minority shareholder in a British corporation. The Supreme Court in examining the British system of collecting at the source said it is the will of Congress which controls the application of the provisions of the credit, but expression of its will in legislation must be taken to conform to its own criteria, unless the statute by express language or necessary implication makes the meaning of the phrase "paid or accrued" and hence the operation of the statute in which it occurs, dependent upon its characterization by the foreign statutes and by the decisions under them.

In other words, here is a case involving British law, and when you read the rules of the British law, it is quite clear, and when you talk to officials of the British Board of Inland Revenue, it is explained that under the British system of collection at the source, that tax is first collected from the corporation and then recouped from the shareholder.

However, the court held that the corporation was the taxpayer although in fact the tax was borne by the American shareholder, and it is the American minority shareholder who by virtue of this decision is deprived of the credit for foreign taxes, even though the American enterprise which sells directly in England, through a sales branch and an American corporation which has a sales subsidiary in England can still get the foreign-tax credit. In other words, by virtue of this decision, one category of taxpayers, the minority shareholder in a British corporation, is discriminated against.

Furthermore, because of a difference in interpretation of what constitutes taxes withheld at source, shareholders in French corporations can get the credit although shareholders in British corporations are denied the credit. As you will recall, the purpose of this credit was to encourage our foreign commerce after the war, when taxes were high, and when the elimination of all barriers that could possibly be eliminated was necessary in order to retrieve our foreign markets.

We are in a similar situation today. It is even harder today to do business abroad than it was then. Furthermore, in the field of international double taxation for the period since 1918, other countries have in their laws or in bilateral treaties, of which there are more than 40, granted even more liberal treatment to their enterprises than we are granting to ours. For example, France and Italy exempt outright the profits of a domestic enterprise which are allocable to a sales branch in another country. The same principle of exempting from profits tax the income allocable to an establishment in another country is found in the treaties mentioned above. In other words, the corporations of those countries selling in a given country have an advantage over ours because they are exempted from their home tax on the profits they realize abroad, whereas our corporations have to compute this complicated credit, and if the foreign tax is by any chance lower than the American tax, they have to pay to the American Government the difference between the foreign tax and the American tax.

The CHAIRMAN. You have elaborated on your views in your brief?

Mr. CARROLL. Yes; and I have also ventured to draft a clarifying amendment, which is as follows:

SEC. 1001. Definitions: (c) The term "income, war-profits, and excess-profits taxes paid or accrued" as used in Section 131 of this act, and the same or similar term in the corresponding provisions of prior revenue acts, includes any taxes treated as income taxes by the laws of a foreign country or of a possession of the United States, and any taxes withheld or deducted upon payment of income, or recovered from, charged to, or otherwise borne by the recipient of the income, under any such laws.

(Subsequently Mr. Carroll submitted the following brief:)

STATEMENT OF MITCHELL B. CARROLL, REPRESENTING THE AMERICAN CHAMBER OF COMMERCE IN LONDON, BEFORE THE SENATE FINANCE COMMITTEE, MARCH 21, 1938, CONCERNING H. R. 9642

In behalf of the American Chamber of Commerce in London, which represents the numerous American citizens and corporations engaged in trade with Great Britain, I beg to call your attention to certain obstacles to that trade which result from limitations indirectly or extralegislatively placed upon the provisions in the United States revenue act which are intended to protect our members from the crushing burden that would result if they had to pay the full income taxes of both the United Kingdom and the United States. Relying upon provisions to prevent such double taxation (known as the credit for foreign taxes), which were first introduced by Congress in the Revenue Act of 1918 (secs. 222 and 238), Americans have extended their activities to the British Isles and overseas possessions. The importance of this question is evidenced by the fact that Great Britain is not only the best customer of the United States, but also buys more than three times as much from us as we buy from her people. The credit is correspondingly important to American enterprises which are marketing American products in all other countries with income taxes.

These provisions were introduced to help our enterprises regain foreign markets just after the World War when the accumulation of taxes in two countries on the same income often consumed more than one-half the gain from producing in the United States and selling abroad, and in the case of individuals subject to high progressive surtax in both countries, the combined liabilities to the two Governments even exceeded the income involved. Due to the high rate of taxes of the present time, the situation is much the same, and in view of the many other obstacles to trading abroad the maintenance of the full credit for foreign taxes is absolutely essential to the fulfillment of the administration's policy of encouraging foreign trade through concluding reciprocal tariff agreements and other measures.

It is more necessary than ever to maintain these provisions because during the last two decades practically all other commercial countries have in their national legislation or treaties, adopted measures for preventing international double taxation, which in many instances are more liberal than the foreign-tax credit. Thus, some countries, such as France and Italy, by virtue of their own laws, exempt the profit of a domestic enterprise which is allocable to a permanent establishment in another state, and a similar provision has been incorporated in more than 40 bilateral treaties between the principal European governments.

In order to encourage trade within the Empire, the United Kingdom grants a credit against its tax which, in conjunction with corresponding provisions in the tax laws of the various dominions, is intended to relieve the British enterprise trading therein from double taxation. In view of the brevity of time allotted, I shall not discuss these provisions further, but I am annexing a reprint of a report submitted at the last meeting of the American Bar Association, which describes more fully the provisions in foreign laws and treaties which grant to foreign enterprises a treatment more liberal than our own enjoy. (See annexed reprint in the Tax Magazine, February 1938, p. 75 et seq., Developments in International Tax Law in 1937.)

Obviously, to compete with these enterprises under the extremely difficult conditions of foreign trade at the present time, it is essential that our enterprises should not be subjected to a greater burden of taxation. Furthermore, it is essential to domestic recovery and to preventing further unemployment, that no artificial restrictions be placed on foreign trade by our own Government that will diminish the volume thereof and, hence, cause unemployment among the estimated 10 percent of our population depending directly upon our foreign trade as well as those which are indirectly dependent thereon.

Moreover, it is essential to our economic welfare that no obstructions be placed in the way of bringing back from abroad the income derived from foreign activities, in order that such income may be paid out as salaries to employees, dividends to shareholders, and for the purchase of raw materials and supplies from the very interior of our country. It is needless to point out that practically every time this income changes hands it becomes subject to our Federal income tax and, consequently, the Government should collect tenfold whatever amount is involved in granting the credit for foreign taxes. In fact, the revenues of the United States are protected by certain justifiable limitations that have specifically been placed upon the foreign tax credit in the successive revenue acts since 1918, but I wish to point out that in the last few years indirect limitations have been placed upon it which were never intended by Congress.

It may recalled that the amount of credit allowed against the United States tax in respect of the tax paid or accrued to any foreign country shall not exceed the same proportion of the United States tax which the taxpayers' net income from sources within such foreign country bears to his entire net income for the same taxable year.

When the undistributed-profits tax was introduced in the Revenue Act of 1936, no direct amendment was made to section 31 which grants the foreign-tax credit, and to section 131, which defines it, but an indirect limitation resulted from converting the allowance for intercorporate dividends, which was in the form of a deduction under section 23 (p) of the 1934 Revenue Act into a credit against net income under section 26 (b) of the 1936 act. The phrase "entire net income" in section 131 (b) was, therefore, construed to mean the taxpayer's entire net income including dividends from domestic corporations with the consequence that the denominator of the limiting fraction is arithmetically padded which causes a reduction in the allowable credit. The foreign-tax credit provisions of the law were intended (1) to eliminate the United States tax on income from foreign sources to the extent such income was taxed at its source, but (2) to do this without reducing the tax on income actually earned in the United States. Nothing we suggest would be in violation of those principles. We merely point out the incidental effect of a technicality which has made the arithmetical formula work out in a different manner than was the intention of this provision. (A restriction on the credit would also inadvertently result if Congress should enact the present sec. 13 (c) (2) (A) of H. R. 9642.)

It is respectfully urged that this indirect limitation be removed. If the undistributed profits tax is repealed, it can be done merely by restoring the allowance for intercorporate dividends to its previous position in section 23 as a deduction in arriving at net income. If the undistributed-profits tax is maintained, it is respectfully urged that an appropriate provision be inserted to assure the granting of the full credit clearly intended by Congress. (See annex I.)

Another restriction on the foreign tax credit results from a decision rendered by the United States Supreme Court on January 10, 1938, in the case of *Mary Duke Biddle* v. *Commissioner of Internal Revenue.* In the carrying on of trade with the United Kingdom, it is often unavoidable because of local restrictions and requirements to form companies under the British laws and under this decision American taxpayers owning minority interests in such corporations are denied the relief from double taxation which they had enjoyed since 1918 and is still granted to others, including taxpayers with direct branches and corporations with sales subsidiaries. The decision involved a very technical interpretation of the British system of collection of tax at source, whereunder the standard rate of income tax is collected from the corporation which in turn recovers it from the shareholder. The Court held the Corporation to be the "taxpayer," although under British law the shareholder bears the tax. Furthermore, taxpayers have been informed by officials of the Bureau of Internal Revenue that they feel this decision makes it necessary for them to question the credit in the case of Americans receiving interest and royalties from British corporations, as well as certain classes of income from other countries, such as dividends from Belgian corporations and interest from Italian corporations.

It results in discrimination not only as between different American taxpayers deriving dividends from British sources but also in discrimination in favor of those deriving dividends from French and other foreign corporations in the case of which the tax withheld at source is allowed as a credit. Thus the United States citizen is denied the credit for the British tax of 25 percent withheld at source whereas another would be allowed a credit for the French 18 percent withheld at source. In other words, through judicial and administrative interpretation of terms used in the law, the credit is not being given the full scope which we believe was intended by Congress.

We believe that these and any other indirect limitations are contrary to the intention of Congress in that to use language employed by the Senate Finance Committee in its report on the 1934 revenue bill, they place "an undue burden upon income from foreign sources." And under them "an exporter or trader is at a serious disadvantage by reason of the necessity to pay taxes to two governments on the same income, the total amount of which taxes may be greatly in excess of the taxes paid by his foreign competitor."

We, therefore, urge that a clarifying definition be inserted under section 1001, or under some other appropriate section of the act, along the lines of the one contained in annex II, which would remove some of the restrictions that have been imposed by judicial or administrative interpretation and permit of the application of the full credit as a measure to encourage international commerce. Such action is essential at the present time in order to maintain the current volume of our foreign commerce and not to preclude some of the advantages that might be derived from trade agreements, including the contemplated trade agreement with Great Britain.

I also wish to submit for the record a report made at the last meeting of the American Bar Association entitled "Developments in International Tax Law in 1937, Reprinted from the Tax Magazine February 1938."

Developments in International Tax Law in 1937[1]—and Suggestions to Protect American Foreign Trade

By Mitchell B. Carroll[2]

[Reprinted from the Tax Magazine, February 1938]

A trend toward the more active participation of the United States Government in the development of international tax law may be found in the exchange of ratifications of the tax treaty with Canada on August 13, 1937, and the announcement of Under Secretary of the Treasury, Roswell Magill, that the State Department with the cooperation of the Treasury is entering into discussions with representatives of Canada and other countries with a view to making treaty arrangements for the exchange of information by the respective tax administrations.[3]

The treaty with Canada follows the provisions contained in sections 211 (a) and 231 (a) of the Revenue Act of 1936 to reduce from 10 percent to 5 percent the withholding rate applicable to dividends, interest, and other recurring classes of income in the case of individuals residing in Canada, and only to dividends in the case of Canadian corporations. The primary purpose of the above-mentioned provisions in the 1936 act and the treaty was to meet the 5 percent withholding rate applied by Canada to dividends and interest flowing to residents of other countries including the United States. This treaty does not "freeze" the 5-percent rate, however, as either country is free to modify its rate at any time and thereby terminate the treaty.

The proposal to arrange with other countries for an exchange of information was made during the hearings before the Committee on Ways and Means in connection with the bill to reduce certain forms of tax avoidance and evasion. It is significant in this connection, that out of 44 general arrangements, by treaty or reciprocal legislation, between European States for the prevention of double taxation in the field of income taxes (most of which are in effect), only 27 have made some reference to mutual assistance and only 19 go into the question in some detail in the same or in supplementary agreements. In only three instances of minor importance do mutual assistance agreements stand alone. It is therefore to be hoped that if the United States is to enter into such arrangements it will do so only in connection with broad treaties to prevent unfair and excessive taxation of American citizens and corporations with investments and business enterprises abroad, and in furtherance of the administration's program for encouraging foreign trade.

Incidentally the amendment to section 211 (a) or the 1936 act in section 501 of the 1937 revenue act which subjects to normal tax and surtax nonresident alien individuals not engaged in business in the United States, derive more than $21,600

[1] Report to the meeting of the American Bar Association, Kansas City, Mo., Sept. 28, 1937.
[2] Attorney at law, New York; chairman, committee on international double taxation, section of international and comparative law, American Bar Association.
[3] Hearings before the Committee on Ways and Means, Aug. 9 and 10, 1937, p. 31.

in dividends, interest, and other recurring types of income from American sources, may give rise to various complications (especially in connection with foreign corporations owned by aliens), which can be solved by treaties.

It is opportune first to consider the steps taken by other countries to protect their citizens and corporations from international double taxation, in order to determine to what extent they are more advantageous than the credit allowed American enterprises in section 131 of the Revenue Act of 1936. This involves consideration of the underlying theory of this measure to prevent the excessive tax burden that would otherwise fall on Americans engaging in foreign commerce, the scope of the credit, the similar provisions in the laws of other countries, and the provisions in laws and treaties which are essentially the same nature, and afford foreign enterprises a competitive handicap over our own.

PURPOSE OF THE CREDIT AND EQUIVALENT PROVISIONS

The most frequent case of international double taxation occurs when one country taxes income from sources in its territory and a second country taxes the recipient on the basis of his entire income by reason of his being a citizen, or a resident within its territory. Corporations are likewise subject to this overlapping of fiscal jurisdiction of the country of source of the income and of the country of the corporate fiscal domicile.

During the years immediately following the World War, the rates of income tax were so high that the total taxes and surtaxes by two countries on income flowing from sources in the one to persons resident in the other often amounted to more than the income involved, and the cumulation of taxes on corporations was paralyzing trade.

With the realization that relief from such double taxation was needed to permit American enterprises to recapture markets lost during the World War, and, at the same time, remove tax obstacles to the bringing home of the profits earned abroad, Congress, upon the recommendation of Dr. T. S. Adams, then economic adviser to the Treasury Department, incorporated the foreign tax credit in sections 222 and 238 of the Revenue Act of 1918. Relying upon this protection which has been reenacted with ever more limiting amendments in subsequent revenue acts, American citizens and corporations have expanded our commercial frontiers through establishing branches and subsidiaries or making other investments abroad.

Concurrently, by legislation or by an ever-growing recourse to treaties, other countries have also protected their enterprises from multiple taxation. The movement has been aided by work carried on since 1921 under the auspices of the League of Nations, primarily by governmental experts and representatives of the International Chamber of Commerce. This work has resulted in the formulation of model conventions which have conducted to a large degree of uniformity in the numerous bilateral treaties.

The situation is again almost as bad as when the need for relief from double taxation was recognized in the Wilson administration. If an American corporation has a subsidiary in Great Britain, its profits will be subject there, under the Finance Act of 1937, first to a profits tax of 5 percent and then to a standard rate of income tax of 25 percent. If the American corporation has a branch in France, it is subject to a profits tax of 12 percent, and to a dividend tax of 24 percent which, under article V of the Franco-American treaty, is imposed on the basis of three-fourths of the profits earned by the branch, making a total rate of about 30 percent. Should the American corporation receive dividends from a Belgian subsidiary, it would suffer deduction of tax at the rate of 22 percent. Aggregate tax rates in other countries, such as Japan, run much higher.

If the income derived in any one of these countries has also to bear in the United States the corporation normal tax progressing from 8 to 15 percent, and the surtax progressing from 7 to 27 percent on undistributed income, the cumulation of taxes would obviously consume the greater portion of the profits, without taking into account the normal tax and surtax paid by individuals on whatever amount is distributed. Most governments recognize that the imposition of taxes by two or more countries on the same income may so reduce the net profit of an enterprise remaining after deduction of all other costs incident to trading that its owner may be forced to give up foreign business. As an alternative, the owner might feel constrained to keep the foreign profits in the country where they were earned and use them for the development of an industry abroad which would soon compete with enterprises at home.

In the face of such tax burdens, new enterprises hesitate to venture into foreign commerce. Double taxation is often the direct cause of tax avoidance or evasion, and more revenues may be lost through the depression of trade or measures to

escape taxes than would have been given up through the granting of relief. Considering the various consequences of double taxation, whatever is foregone through granting relief should be more than retrieved when the profits from abroad are distributed as dividends or paid for services or supplies, and the Government collects increased taxes from the recipients.

In short, such measures of relief from double taxation as the foreign-tax credit conform to the administration's policy of encouraging foreign trade through reciprocal tariff agreements and also tend to increase revenues through adding to the national income the earnings from abroad.

GENERAL NATURE OF RELIEF MEASURES

To prevent double taxation it is obviously necessary for either the country of a source of income or the country of the recipient's fiscal domicile (whether on ground of residence or nationality) to give up all of its tax on the income involved, or for each to forego a part of its levy. Whereas the principle of reciprocal exemption at source and full taxation at fiscal domicile is almost universally applied through bilateral arrangements by the United States and other countries with regard to shipping profits, and is also prescribed in treaties for certain other items of income, the only case where it is applicable to all classes of income derived from sources in one country by persons resident in the other is in the British-Irish Free State agreement mentioned further on.

In the great majority of cases the country of fiscal domicile renounces all or a part of its tax in favor of the country of source. In other words, the country where the recipient resides generally exempts from its levy the income attributable to another state which has already been taxed there. At least 10 treaties exempt such foreign income but require that the progressive home tax be levied on the domestic income at the rate which would have been applicable if the foreign income were included, or require the computation of the home tax and then allow a reduction in respect of the foreign income of an amount equal to tax at its own rates exclusively on the foreign income.

The fundamental principle underlying these provisions, that of the country of fiscal domicile foregoing its tax in favor of the country of source, yet without lowering the tax on domestic income, is likewise inherent in the United States credit for foreign taxes.

DESCRIPTION OF UNITED STATES FOREIGN TAX CREDIT

Briefly, section 131 (a) (1) grants to a United States citizen and a domestic corporation a credit against the tax imposed by the act for the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States. Furthermore, section 131 (a) (3) grants to an alien resident accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to the United States citizens residing in its territory.

Congress has taken cognizance of the fact that in order to do business in a foreign country it is often necessary to organize a subsidiary corporation under its laws, and in section 131 (f) it has granted a credit to a domestic corporation owning a majority of the voting stock of a foreign corporation, which places the domestic corporation in substantially the same position as if it had there a direct branch. The protection against duplicate taxation is just as necessary in one case as in the other. The American corporation is deemed to have paid the same proportion of the income tax paid by the foreign subsidiary upon its accumulated profits as the amount of dividends which is distributed to the parent corporation out of such profits bears to the total amount of the accumulated profits of the subsidiary. However, the amount of tax deemed to have been paid by the parent corporation shall not exceed the same proportion of the tax, against which credit is taken. which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included.

In all cases, the credit is subject under section 131 (b) to each of the following limitations: (1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's net income from sources within such country bears to his entire net income for the same taxable year; and (2) the total amount of the credit shall not exceed the same proportion of the tax, against which such credit is taken, which the taxpayer's net income from sources without the United States bears to his entire net income for the same taxable year.

A further indirect limitation results from the fact that in the Revenue Act of 1936, the allowance of 85 percent of the dividends from domestic corporations, which had previously been granted as a deduction in computing net income, is now taken as a credit against "net income" in arriving at normal tax net income, with the result that the taxpayer's "entire net income" in the denominator of the limiting fraction in section 131 (b) is padded with untaxed income, which causes a reduction in the allowable credit. This is contrary to the original principle of the credit, namely, that the foreign tax should be offset against the domestic tax to the extent of the proportion that foreign-taxed income bears to the total taxed income.

Despite the complexities in determining the credit, section 131 fulfills substantially the desired purpose of preventing double taxation of income derived from foreign countries. It thereby reduces a tax obstacle to establishing branches and subsidiaries abroad for selling American products as well as to bringing the profit back to the United States.

From the viewpoint of competition, the foreign tax credit places the American enterprise trading abroad in the following position:

1. The American enterprise pays no less tax by reason of its foreign business than if it operated exclusively at home.
2. If the foreign tax rate is higher than the United States rate, it bears the same tax burden as its competitors in the foreign country.
3. If the foreign tax rate is lower than the United States rate, it bears a heavier tax than its competitors in the foreign country, including those from third countries which exempt foreign income, because they bear only the lower rate, whereas the American enterprise must pay to the United States the difference between the foreign rate and the domestic rate.
4. In no case does the American enterprise pay a lower tax on its United States income than its domestic competitors with the same amount of income; but instead the United States tax, at progressive rates, is increased by reason of including the foreign income in computing the rate applicable to domestic income and the receipt of foreign income may accordingly be disadvantageous from a tax standpoint.

COUNTRIES GRANTING A SIMILAR CREDIT

In determining whether an alien resident in the United States is entitled to the foregoing credit, the Bureau of Internal Revenue has had to ascertain whether the country of which he is a citizen satisfies the similar credit requirement of section 131 (a) (3), either by allowing to citizens of the United States residing in such a country a credit for the amount of income taxes paid to the United States or, in imposing such taxes, by exempting from taxation the incomes received from sources within the United States by citizens of the United States residing in such country.

Countries which have been held by the Bureau of Internal Revenue to satisfy such requirements include Australia, Austria, Bulgaria, Canada, Italy, Newfoundland, Salvador,[4] and Spain.[5]

Australia taxes in principle any resident, whether a citizen, alien, or domestic corporation, on income from all sources but exempts income derived by such a resident from sources abroad "where that income is not exempt from income tax in the country where it is derived."[6]

Austria accords to individuals resident in Austria for more than 1 year an exemption in respect of income from real property or from carrying on a regular business, or salaries or pensions from public funds in another country, provided it can be shown that such income is already subject to tax in the country of source and that the latter country accords a reciprocal exemption of income derived from similar sources in Austria.[7]

Substantially the same provision is found in the laws of Czechoslovakia,[8] Hungary,[9] and Poland.[10]

The Canadian provision is perhaps the best example of a similar credit, section 8 of the Income War Tax Act [11] simply providing as follows:

"SEC. 8. (Other deductions.—) A taxpayer shall be entitled to deduct from the tax that would otherwise be payable by him under this Act.

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[4] Article 695, Regulations 74.

[5] I. T. 2901, XIV-2 C. B. 138.

[6] Secs. 17 and 23 (q), Income Tax Assessment Act, 1936.

[7] Sec. 153, Personal Tax Act of 1924, Collection of International Agreements and Internal Legal Provisions for the Prevention of Double Taxation and Fiscal Evasion, League of Nations, herein referred to as Collection, vol. I, p. 150; reenacted in the Personal Tax Law of 1934, Austria, Bundesgesetzblatt I, 1934, Nr. 141.

[8] Taxation of Foreign and National Enterprises, League of Nations (herein referred to as Taxation), vol. II, p. 94; unchanged in the codification of July 8, 1936, Czechoslovakia, Sammlung der Gesetze and Verordnungen, 1936, Nr. 227.

[9] Taxation, vol. II, p. 216.

[10] Art. 4, Income Tax Law of April 30, 1925, as amended, Collection, vol. II, p. 35, and slightly modified in art. 4, law of Dec. 14, 1935, Polnische Gesetze and Verordnungen, 1936, S. 18).

[11] Chap. 97, Revised Statutes of Canada of 1927, as amended.

"(a) Income tax paid in any other portion of British Empire: The amount paid to Great Britain or any of its self-governing colonies or dependencies for income tax in respect of the income of the taxpayer derived from sources therein; and

"(b) Income tax paid in any foreign country: The amount paid to any foreign country for income tax in respect of the income of the taxpayer derived from sources therein, if such foreign country in imposing such tax allows a similar credit to persons in receipt of income derived from sources within Canada.

"2. *Limit of deduction.*—Such deduction shall not at any time exceed the amount of tax which would otherwise be payable under the provisions of this act, in respect to the said income derived from sources within Great Britain or any of its self-governing colonies or dependencies or any foreign country."

It is to be noted that the condition of reciprocity appears only in paragraph (b) relating to foreign countries and not in paragraph (a) relating to other portions of the British Empire, but this is due to the fact that the United Kingdom and the various dominions have provisions for relief from double taxation, which will be examined below, with the consequencies that almost complete reciprocity exists between them.

It should also be noted that the relief is granted to any taxpayer whether a resident alien or a resident Canadian citizen or corporation.

The Italian tax system consists of several so-called schedular taxes on various classes of income from Italian sources and a superimposed complementary tax on total income. Thus, the taxes on land and on buildings apply only to income from such sources in Italy. The tax on income from movable wealth (ricchezza mobile) applies only to such income originating in the national territory, and with regard to business enterprises, Article 9 of the Royal Decree No. 1463, of August 12, 1927,[13] specifically provides that income of corporations and private firms having their headquarters in Italy which is earned at a branch outside the national territory, as well as salaries and other allowances paid abroad, shall not be taken into account in paying taxes in Italy, provided the enterprise conducts said branch on an independent basis and submits to the Department of Taxes proper accounts corroborated by such further evidence as may be necessary to apportion and distinguish between the various sources of income.

The complimentary tax is payable by individuals residing in Italy, generally speaking, on income from domestic sources and income from foreign sources which is consumed in Italy.

COUNTRIES ACCORDING OTHER FORMS OF RELIEF

Various countries have been held by the Bureau of Internal Revenue not to satisfy the similar credit requirement, but this has no special significance insofar as this report is concerned, for some of them impose no income tax while others, in their laws or in bilateral treaties, accord to their taxpayers either reductions in rates or exemptions which, in many cases, are much more generous than the relief from double taxation granted by the United States to its citizens and corporations. The foreign legislative provisions generally apply to Americans residing in the country, but the difference in the structure of the tax or the nature or extent of relief may be the reason for holding that they do not grant a credit similar to the very strictly construed credit in our own law.

Furthermore, the important question from the viewpoint of our foreign trade is not whether a foreign country accords to the relatively few American citizens residing in their territory a credit similar to our own, but whether they grant to their own nationals and corporations which are competing with our export enterprises more liberal treatment so that they may be in a better position to undersell American exporters.

The wisdom of not subjecting national enterprises to taxation higher than that borne by competing enterprises in foreign countries prompted the Spanish Government practically to exempt the income earned abroad by a Spanish company. The question was raised, in connection with studies preliminary to a revision of the law, whether the Spanish Government should renounce a portion of its tax equal to the amount collected by the foreign state if the rate applied by the latter was not higher than the Spanish rate, or if it would be preferable to deduct from the profits a part proportionate to the volume of business carried on abroad. The latter solution was adopted because of the advantage it possessed of putting the Spanish company on the same footing

[13] Collection, vol. I, p. 196.

from the viewpoint of taxation as the competing enterprise of a foreign state. The exemption is merely subject to the conditions that the Spanish company shall be taxable abroad on its profits made there, and that at least one-third of the entire profits of the enterprise (covered in most instances by domestic profits) shall be taxable in Spain.[13]

The Netherlands was formerly held to grant a credit similar to the United States credit, but recently a contrary ruling has been issued.[14] That country accords to a resident national a deduction from his home tax if he is taxed on income from certain sources in a foreign state, including immovable property and mortgages thereon, a trade or profession, emoluments or pensions paid by a foreign public authority. His home tax shall be reduced by the amount of the tax assessed according to Dutch law upon an income equal to that part of his income derived from the indicated sources. The same relief is granted to foreigners resident in the kingdom who either have resided therein for the preceding 5 years, or are nationals of a state which grants to Netherlands nations resident in its territory an equivalent exemption from double taxation.[15] With regard to domestic corporations, the Netherlands imposes no tax when profits are earned abroad, and includes in the dividends subject to the tax due, when profits are distributed, only one-third of the proportion of the dividends which consists of profits that have been taxed abroad.[16]

A general power has been granted to the Government of the Netherlands to approve reciprocal conventions for the prevention of double taxation provided that only income earned outside the kingdom be exempted, in law No. 3753 of June 14, 1930.[17] Hence, the Netherlands may forego by treaty the tax on one-third of the foreign income which was reserved for taxation under the previous law.

The principle of exempting income from foreign sources and taxing only income from domestic sources has been embodied in the national laws of a number of countries, including South Africa and Argentina.[18]

The French system consists primarily of a number of schedular taxes on income from certain sources in France and a superimposed general income tax on the total income of persons habitually resident in France, including their income from foreign sources. Viewing the French tax structure as a whole, income derived from sources abroad is not subject to the schedular taxes, and there is consequently only double taxation to the extent that the income taxed in another country is included in the total income of the taxpayer subject to the general income tax. An exception from this regime consists in the tax on income from securities which must be paid by residents on dividends and interest from foreign securities as well as from French securities. If such dividends and interest have been taxed in the country of source, double taxation will arise when they are again subjected to tax in France, not to mention that which results from being included in the total net income subject to the general income tax. However, in treaties concluded by France with Belgium and Italy, provisions have been incorporated to reduce double taxation of this type of income, which are modeled after the foreign tax-credit provisions in the United States Revenue Act.[19]

Belgium likewise has a system of schedular taxes and follows the principle of territoriality to the extent of taxing income from foreign establishments at only one-fourth of the Belgian rate on such income which has been taxed abroad. Also the 22 percent national rate on dividends is reduced to 6 percent for the part of the dividends corresponding to profits realized and taxed abroad.[20] A complete exemption for business income allocable to the other State is granted in treaties concluded by Belgium and France and Italy.[21] As regards income

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[13] Taxation, vol. I, p. 140.

[14] I. T. 2980, XV–1, CB 140.

[15] Ministerial decree of April 17, 1928, Collection, vol. I, p. 198.

[16] Art. 28, law relating to the tax on dividends and directors' fees, January 11, 1918, Collection, vol. I, p. 197.

[17] Collection, vol. II, p. 66.

[18] Thus the South African income tax act No. 40 of 1925 (Taxation, vol. III, pp. 170, 181) taxes only income derived from sources within the Union and certain minor classes of income deemed to be so derived.

The Argentine Law No. 11682 of December 30, 1932, as amended, is even more restrictive in article 1, which subjects Argentine citizens or foreigners to tax only on income from Argentine sources.

[19] See below under Treaty Provisions.

[20] Art. 34, No. 4, and Art. 35, par. 7, coordinated income-tax laws of Sept. 12, 1936, Bulletin des Contributions Directes, Sept. 1936, p. 308.

[21] France-Belgian treaty, Art. 7, Collection, vol. V, p. 59; Italo-Belgian treaty, Art. 6, Collection, vol. V, p. 65.

from stocks and bonds, the treaty with Italy gives the country of source the exclusive right to levy an impersonal tax,[22] and the France-Belgium treaty permits the country of source to withhold its full tax but requires the country of fiscal domicile to grant a deduction in respect thereto.[23]

RELIEF WITHIN THE BRITISH EMPIRE

The United Kingdom and various British Dominions have certain provisions in their income-tax laws which are intended to assure relief to their respective taxpayers, as well as some sections of more general application.

To encourage trade within the Empire, the United Kingdom grants against its tax a credit for taxes paid on income earned in one of the Dominions, which is known as "Dominion income-tax relief." The pertinent provisions are intended to relieve a person from having to pay upon any part of his income the full income tax (including supertax) chargeable in the United Kingdom,[24] as well as the full income tax and supertax chargeable in a Dominion.[25]

In general, the relief given is at the rate of one-half the "appropriate rate" of United Kingdom income tax, but where the Dominion rate is one-half or less than one-half of the appropriate rate, the relief is measured by the Dominion rate itself. In the 1919–20 report of the Royal Commission on the income tax, it was recommended that the relief given by the United Kingdom should not exceed one-half the rate of the United Kingdom tax, and that any further relief necessary in order to confer relief amounting in all to the lower of the two taxes should be given by the Dominion.[26]

India is the principal Dominion according the contemplated reciprocity.[27] Although the Australian Commonwealth grants reciprocal relief, many of the individual states do not and, to that extent, Australia is classified as a nonreciprocating Dominion. The same applies to South Africa and to Canada.[28] New Zealand Land and Income Tax Act, 1923, provides, in section 89, that "income derived by a person resident in New Zealand but not derived from New Zealand shall be exempt from income tax, if and so far as the Commissioner is satisfied that it is derived from some other country within the British Dominions and that it is chargeable with income tax in that country.[29]

The United Kingdom provision of more general application is that in schedule D, case V, rule 2 of the 1918 act which taxes resident individuals and companies only on actual remittances of income from certain foreign possessions, which include a business entirely managed abroad.[30]

Section 4 (k) of the Canadian act contains a provision which is somewhat similar to the foregoing exemption in the United Kingdom but it is much more liberal. It frees from Canadian tax under certain conditions the income of Canadian companies which carry on their business operations entirely abroad and have their assets entirely abroad.[31]

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[22] Final Protocol, No. II.

[23] Art. 6.

[24] Sec. 27 of the Finance Act, 1920, as amended by the act of 1927.

[25] The word 'Dominion" means the self-governing colonies, as well as any British possession or protectorate, or any terrtory for which any government in the Empire exercises a mandate.

[26] But where the laws in force in any Dominion make no provision for the allowance of relief in respect of United Kingdom tax, an additional relief is given. (Act of 1920, sec. 27 (4), proviso (b).) The difference between the amount of the Dominion income tax paid or payable and the total amount of the relief granted from United Kingdom tax in accordance with the general standard is deducted in estimating the income for the purpose of the United Kingdom tax. (Konstam, p. 30.)

[27] Section 49 (1) of the Indian Income-tax Act No. XI of 1922, as amended, provides that "if any person who has paid Indian income tax for any year on any part of his income proves to the satisfaction of the income-tax officer that he has paid United Kingdom income tax for that year in respect of the same part of his income, and that the rate at which he was entitled to, and has obtained, relief under the provision of section 27 of the Finance Act, 1920, is less than the Indian rate of tax charged in respect of that part of his income, he shall be entitled to a refund of a sum calculated on that part of his income at a rate equal to the difference between the Indian rate of tax or the appropriate rate of United Kingdom income tax, whichever is less, and the rate at which he was entitled to, and obtained, relief under that section. * * *."

[28] Newport, Income Tax Law and Practice, 9th edition, p. 211.

[29] Collection, vol. II, p. 39.

[30] *Colquhoun* v. *Brooks* (1889), 14 A. C. 493, 61 L. T. 518, and *Mitchell* v. *Egyptian Hotels, Ltd.* (1915) A. C. 1022; 6 Tax C. 542.

[31] No tax is to be levied on the income of incorporated companies (except personal corporations) "(i) whose business operations are of an industrial, mining, commercial public utility or public service nature, and are carried on entirely outside of Canada, either directly or through subsidiary or affiliated companies, and whose assets (except securities acquired by the investment of accumulated income and such bank deposits as may be held in Canada) are situated entirely outside of Canada, including wholly owned

LAWS AUTHORIZING TREATIES

In the laws of a number of States are found general provisions authorizing agreements to prevent international double taxation. The Netherlands provision has already been mentioned. Article 27 of Danish Law No. 74, of March 29, 1924, [52] provides that if the income of any person, company, or association liable in Denmark to communal taxes is also liable to the communal tax in another state, the government is authorized to avoid double taxation through concluding reciprocal agreements. The substance of this provision was reenacted as section 47 of law No. 28 of February 18, 1937, with the addition of a clause empowering the local fiscal authorities to take steps to eliminate double taxation in individual cases where it has not been prevented by treaty.[53]

An authorization for agreements concerning income and property taxation is found in the Swedish Royal Decree No. 155, of May 22, 1925.[54]

TREATY PROVISIONS

Over 40 agreements or treaties, most of which cover all classes of income, have been concluded since the World War for relief from international double taxation.

Countries which have accorded various exemptions in their laws for income derived from foreign sources, like Austria, France, Belgium, Italy, and the Netherlands, have broadened them in their treaties, and Germany, which accords no specific exemption for foreign items in its law, has granted generous exemptions in treaties with 12 of its European neighbors, including Czechoslovakia, Austria, Poland, Switzerland, Hungary, Danzig, Union of Socialist Soviet Republics, Sweden, France, Finland, Rumania, and the Netherlands.

In general, countries have negotiated treaties with other countries with which they have important trade relations. Thus, Austria has entered into agreements with Czechoslovakia, Hungary, Germany, Italy, and Poland. France has concluded general treaties with Italy, Belgium, and Germany, and a treaty dealing only with a limited number of items with the United States. It is understood that a similar arrangement has been negotiated with the United Kingdom but not signed.) It is of interest to note that the treaty between France and the United States, when applied in conjunction with section 131 of the United States Revenue Act, operates in the same manner as provisions in European treaties which recognize the prior right of the country in which an enterprise has a permanent establishment to tax income allocable thereto, but require the country in which the enterprise has its seat to grant some kind of relief from its tax for such income.

The United Kingdom has an agreement with the Irish Free State whereby each party exempts entirely income flowing to persons resident in the other,[55] and it has concluded arrangements for the reciprocal exemption of income derived by persons in one state from certain transactions effected through agents in the other state, with Sweden, Switzerland, Finland, the Netherlands, Canada, Greece, and Newfoundland.

Generally speaking, however, these treaties involve the relinquishment by one party of its right to tax designated classes of income originating in the other contracting state. Many of the treaties allot specific classes of income for taxation in the country of source and, in a residuary clause, recognize the right of the country of domicile to tax the balance of the income. Despite a provision that income from the state of source is exempt from the personal tax in the state of domicile, a method of computation, essentially similar to the United States credit for foreign taxes, is prescribed for progressive taxes levied by the country of domicile in the treaty between France and Germany, and, insofar

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subsidiary companies which are solely engaged in the prosecution of the business outside of Canada of the parent company; or (ii) whose business operations are of an investment or financial nature and carried on entirely outside of Canada, and whose shares have been officered for public subscription or are listed on any recognized stock exchange in Canada or elsewhere, and whose assets (except such bank deposits as may be held in Canada and except shares of other companies conforming to the requirements of this paragraph (k), are situate entirely outside of Canada. Shares, stocks, or bonds of Canadian companies shall, for the purposes of this paragraph (k), be deemed to be assets within Canada notwithstanding that they may be or have been transferred on any register outside of Canada."

[52] Collection, vol. I, p. 151.

[53] Denmark, Lovtidenden A, 1937, S. 75.

[54] Collection, vol. I, p. 178.

[55] Collection, vol. I, p. 56.

as Sweden is concerned, in its treaty with the Netherlands. Thus, article 14 of the Franco-German Treaty may be translated:

"The personal tax on the total income, imposed in the state where the taxpayer has his domicile, will be collected only on the income taxable in this state, according to the provisions of the present convention, but at the effective rate based on the total income of the taxpayer."[36]

The same principle is expressed in different language in the final protocol to the treaties concluded by the Netherlands with Sweden and Belgium.[37]

Many of the treaties employ the same classification of income, and allot practically all the important classes to the State of source for prior if not exclusive taxation. Almost uniformly the State of fiscal domicile exempts the following classes of income, which are therefore taxable only in the State from which derived:

1. Income from real property, and mortgage thereon, and, in some cases, mining royalties;
2. Income allocable to a business or professional permanent establishment, except that, in the case of shipping and air-navigation enterprises, the profits are taxable only in the State where the real center of management is situated;
3. Income earned in a given State (public salaries and pensions are usually allotted for tax purposes to the State of the debtor administration);
4. Directors' fees;
5. Dividends and interest subject to tax by withholding at source. The treaties concluded by France with Belgium and Italy provide for a sort of credit for the tax withheld at source against the impersonal tax in the country of fiscal domicile, and only a few treaties apparently permit the subjection of this income to the full tax at fiscal domicile.

On the contrary, annuities are generally exempt at source and taxable only at the fiscal domicile of the recipient, and some agreements treat patent and copyright royalties in the same manner.

SUMMARY

Briefly, the principle generally adopted in laws and treaties is that the income taxed in the country of source should be exempt from further taxation in the country of fiscal domicile. It is to be noted that no country has as complicated provisions restricting its allowance for foreign taxes as those in force in the United States. The laws and treaties granting an exemption for income taxed at source are obviously more liberal than the American credit for foreign taxes, as under them the State of fiscal domicile foregoes any claim to tax the income allocable to the other State, even though the latter's rate is lower than its own. The exemption is usually more generous for the additional reason that the exempt foreign income is not included in the total income in determining the rate applicable to the domestic income which remains taxable in the country of domicile. In other words, the domestic income thereby escapes being artificially brought into the higher brackets of a progressive tax. There has long been a precedent in the United States Revenue Act for exempting foreign income, namely, the exemption of income earned abroad which is granted to a citizen of the United States who is a bona fide nonresident for more than 6 months during the taxable year.[38]

Obviously, if the full benefits are to be derived from the Government's policy of promoting foreign trade, our exporters who have established sales branches or subsidiaries abroad should be protected in every way possible from double taxation. If, in addition to the present high costs of operation, these enterprises were forced to bear the burden of full taxation both here and abroad, the continuance of their foreign activity would become extremely difficult, if not im-

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[36] See also Collection, vol. VI, p. 17.

[37] The Netherlands Swedish treaty provides under No. X of the protocol:

"(b) In the case of taxpayers having their fiscal domicile in Sweden:

"The State of fiscal domicile in its assessment of the tax may apply the scale of taxation that would have been applicable if the income and capital, which under the present Convention are taxable only in the other State, had formed part of the income and capital taxable in the State of fiscal domicile" (Collection, vol. VI, p. 20).

A variation is found in paragraph (a) of No. X relating to the Netherlands and in the treaty between the Netherlands and Belgium (final protocol, No. III, Collection, vol. VI, p. 13). The State of fiscal domicile shall assess its tax on the basis of the entire taxable income, but it shall deduct from the amount of the tax thus computed the tax which according to its own legislation is applicable exclusively to the income derived from the other State. This corresponds to a provision in the Netherlands law cited above.

[38] Sec. 116 (a), Revenue Act, 1936.

possible. Companies persisting in their efforts to carry on foreign trade might be tempted, in order to avoid almost confiscatory multiple taxation, to keep the profits abroad through building up plant and sales services there instead of in the United States, or to resort to various methods of avoidance. In other words, the foreign-tax credit keeps the door open to the bringing home of foreign income. These profits from abroad, after being paid out to the shareholders, employees, and suppliers of the exporting enterprises, pass from hand to hand and the Treasury receives its share from each successive taxpayer. The importance of the flow into the United States of the income from the estimated 10 percent of our commerce which consists in international trade contributes immeasurably to the employment of labor and the general welfare of the country.

It is difficult to make a close comparison of the credit for foreign taxes in the United States law and the corresponding provisions in other laws because of the wide difference in the tax structures and the economic interests of the various countries. Nevertheless, from the viewpoint of Government revenue, the American credit provision is more advantageous than the United Kingdom exemption for British corporations with business establishments managed abroad because the latter relief applies only to the extent that income is not remitted to the United Kingdom. Having paid the local tax, such corporations may feel constrained not to submit the income to taxation again in the United Kingdom but rather to use it in developing the plant or making other investments in the foreign country. Therefore, little of the foreign profit is likely to be converted into tax revenues of the United Kingdom, and, at the same time, British industry and labor may be adversely affected by the retention of the income abroad. For similar reasons the American credit system is preferable to the foreign provisions based on reciprocity insofar as branches or subsidiaries are established in countries not meeting this requirement.

The United States credit for foreign taxes has the advantage, from an administrative viewpoint, of applying equally to income derived by United States citizens and corporations from all foreign countries and not depending upon reciprocal laws and treaty provisions which sometimes vary. Only insofar as resident aliens are concerned must the bureau determine whether the country of which the alien is a citizen or subject grants an equivalent credit.

From the viewpoint of our exporting enterprises, the American method is more advantageous than the system of Dominion income-tax relief as applied generally in the British Empire, because the corporation, instead of having to claim relief from each of the two governments concerned, looks to the United States Government alone, and its protection is more complete. Furthermore, the British system is intended to place on a preferential basis trade within the Empire. On the contrary, our system of relief is predicated upon a world market for American products, and our exporters receive equal treatment regardless of the foreign country in which they sell their goods. Consequently, from this standpoint our enterprises have an advantage over British enterprises trading outside the Empire which is needed to offset numerous trade handicaps.

However, the foreign-tax credit is not as advantageous as the provisions in the laws of France, Italy, Argentina, South Africa, and other countries which tax only profits realized at home and exempt those allocable to an establishment in any other country. The enterprises of these countries do not have to make the complicated computation of the credit and pay to their home government the difference between the home tax and the foreign tax on the foreign income, if the latter is lower.

The wisdom of taxing profits of an enterprise only at the permanent establishment to which they are allocable is evidenced by the fact that this principle has been incorporated in over 40 treaties. This Government should not lose much, if any revenue, if it followed the example of other countries in exempting income derived by American enterprises through permanent establishments or subsidiaries abroad. If it could not incorporate such an exemption in the law, it should maintain the foreign-tax credit for general application, and might accord an exemption in treaties with countries having equal or higher tax rates. This should involve no loss of revenue but rather should tend to increase the inflow of foreign income and resultant taxes and would save the taxpayers and Bureau officials a great deal of time and trouble in making the complex computation of the double limitation on the credit in conformity with extremely technical and restrictive rulings.

CONCLUSION

Recalling the resolution voted at the 1930 meeting of the American Bar Association in favor of the negotiation of further treaties to bring about the reduction of international doube taxation, it is respectfully suggested that—

1. In order to facilitate the carrying out of the administration's policy of promoting American trade abroad, the provision for the credit for foreign taxes in section 131 should be applied so as to fulfill its fundamental purpose and should not be curtailed by technical and inconsistent limitations.

2. If the cooperation of foreign governments to prevent fiscal evasion is desired, arrangements for that purpose should be incidental to agreements establishing fair bases of taxation for international commerce and investments and the prevention of international double taxation.

3. In such agreements the present credit for foreign taxes might be replaced, at least insofar as business income is concerned, by an exemption from American tax for the income allocable to a permanent establishment in the other contracting state.

4. The treaties might contain provisions for the reciprocal exemption of patent and copyright royalties similar to article IX of the Franco-American Treaty, as well as for other classes of income.

5. The provision for reducing the general withholding rate of 10 to 5 percent, which is authorized by sections 211 (a) and 231 (a) of the 1936 act in the case of contiguous countries, should be extended to other countries in agreements according substantially equivalent advantages to United States citizens and corporations, including provisions to prevent extraterritorial taxation and international double taxation.

6. In order to protect our enterprises from excessive and extraterritorial taxation abroad resulting from an improper allocation of income, and to reduce thereby taxes which may be credited against the United States tax, the draft convention for the allocation of business income for tax purposes, formulated by the fiscal committee of the League of Nations, should be used as a basis for treaties with other countries, especially as this and other governments have already indicated their willingness to do so.

7. As liability to estate and inheritance taxes in two or more countries gives rise to virtual confiscation of the property or to recourse to tax avoidance, provisions to prevent this double liability should be incorporated in treaties.

The CHAIRMAN. We will now hear from Mr. Mark Graves, commissioner of taxation and finance. New York State. I may say that Mr. Graves is the commissioner of taxation in New York State, and wishes to discuss the estate and gift taxes as carried in the House bill, and I am in receipt today of a letter from Governor Lehman, which I am going to read to the committee, calling attention to views similar to those now to be expressed by Mr. Graves.

(The letter is as follows:)

ALBANY, N. Y., *March 18, 1938.*

Hon. PAT HARRISON,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR HARRISON: Will you not have this communication read into the record of the hearings on the pending 1938 Federal Revenue Act? A busy legislative session, just concluded, has prevented me from communicating with you sooner.

At the very outset, let me say that I am asking on behalf of the Empire State and all other American States and Territories that the Federal Revenue Act be amended to provide for—

(*a*) Fifty percent credit against the Federal estate tax on account of death duties paid to the States and Territories; and

(*b*) An extension of the credit at the same rate to the Federal gift tax.

The reasons which impel me to make this request are as follows:

1. The independent sovereignty of the States is threatened by Federal taxing policies. This country was organized on the theory and has grown and prospered under a system of independent sovereign States, with exclusive authority in many fields and with independent taxing power—a power not second to but on a parity with the Federal Government itself. Under such conditions, if one of two governments having equal, concurrent jurisdiction to levy

a tax, actually monopolizes the field to the exclusion or the near exclusion of the other, it may follow that that other government will be destroyed or at least starved into impotency. The extent to which the Federal Government has and is ignoring the rights of the States in the income (personal and corporate) and estate tax fields and virtually monopolizing those fields to the exclusion of the States is truly alarming. The result is that the bulk of State and local revenue is shouldered on real property and that many of the States and their localities have been forced to enact tax laws not suited to State and local use and uneconomic in their effects. I give you these thoughts because I am profoundly convinced of their importance if this country is to continue according to the pattern originally planned.

2. The rights of American States to impose death duties are equal—superior it is believed—to those of the Federal Government. This is so for two reasons:

(a) The right to transmit property at death and the right to inherit property from a decedent are rights gained under State laws;

(b) Traditionally and historically, this field of taxation was recognized as belonging to the States and was used by them long before it was invaded by the Federal Government.

3. The Federal tax fixes a ceiling for State taxes. The proposed Federal estate tax is graduated to 70 percent, and in the case of the larger estates takes considerably more than one-half. In the lower brackets, the percentage taken is as high, if not higher, than should reasonably be exacted. It is unthinkable that the States will superimpose upon the Federal tax still higher duties. To do so would be unfair and uneconomic. Hence, for every practical purpose the rates of State estate taxes will be limited to one-sixth of the Federal rates in the various brackets.

4. The proposed law assumes the States have but a one-sixth right to tax estates. In this connection, it will be recalled that the Federal Revenue Act of 1926 graduated estate-tax rates to 20 percent and allowed as a credit against the Federal tax death duties paid to the States but not to exceed 80 percent of the Federal tax. Later, in 1932, the Federal Government imposed an additional estate tax with rates graduated to 70 percent but with no additional credit on account of death duties paid to the States. It is now proposed, and sensibly so, to combine the two Federal estate taxes. However, it is proposed to allow against the combined taxes a credit of 16½ percent on account of death duties paid to the States. Stated bluntly, this ignores the equal rights of the States to levy death duties and for every practical purpose tells these sovereign States they have a right to but one-sixth of the revenue to be derived from estate taxation. There is no justification for such an attitude on the part of the parent government. Its position cannot be defended. As the States have equal, if not a superior, claim to revenue from estate taxation, the credit for death duties should be not less than 50 percent.

5. Federal taxes increased, credit for State taxes decreased. An analysis of this measure discloses that on net estates of $700,000 and more, Federal taxes are increased from a fraction percent to more than 4 percent, and that the credit for State taxes is decreased from a fraction percent to 14 percent. Thus it will be seen that the States are left in a less favorable condition than they now find themselves. The consolidation of the two Federal estate taxes should not be used to cover an increase in rates or a decrease in the credit allowed for death duties paid to the States.

6. A credit should be allowed against Federal gift taxes for gift taxes paid to States. The Federal estate tax was supplemented by a Federal gift tax with rates graduated at 75 percent of the estate-tax rates, but no credit was allowed for gift taxes paid to the States and none is proposed in this measure. The principal purpose of the gift tax was to prevent evasion of the estate tax through the medium of inter-vivos gifts. A gift tax is necessary whenever estate taxes reach high levels. In such cases it may for every practical purpose be said to be an integral part of death taxation. It is, therefore, perfectly obvious that the Federal gift tax should be amended to allow credit for gift taxes paid to States and on the same percentage basis as is allowed in the estate tax.

In closing may I not leave with you two further thoughts which have a bearing on this subject:

The first is that the States have to plan not only for their own financing but for State aid to their municipal and political subdivisions. Except during war times the services which the States and their localities render to their people are just as important and beneficial as those rendered by the Federal Government. Certainly they are more intimate and personal. The States are encoun-

tering increasing difficulty in devising revenue means for their own financing and the financing of the localities.

The second is the ultimate effect of existing high rates of taxation on incomes and estates on revenue yields in future years. The yield of these taxes depend in a large measure on the high rates in the middle and higher brackets. The effect of existing estate-tax rates and those proposed in the measure before you will be to break up sizeable estates and require the payment of taxes out of capital. The effect of the present schedule of income-tax rates will be to prevent the accumulation of large estates. The result of both these will be a diminution of yield in future years, and this even though there be an increase in national income as great as may reasonably be expected. This is a problem which I am sure you and your colleagues will wish to consider. No doubt the need for revenue will be as great in future years as at present. Is it wise to continue a policy which will immediately secure additional revenue dollars at the expense of the revenue of future years?

Yours very sincerely,

HERBERT H. LEHMAN.

STATEMENT OF MARK GRAVES, ALBANY, N. Y., COMMISSIONER OF TAXATION AND FINANCE, NEW YORK STATE

Mr. GRAVES. What I am about to say, Mr. Chairman and members of the committee, I shall make brief in view of the Governor's letter, which has just been incorporated as a part of the record.

The CHAIRMAN. It will be read fully by each member of the committee.

Mr. GRAVES. If I may beg your indulgence, Mr. Chairman, I would like to say this, that the Governor's letter and what I shall say is not addressed solely to the interest of the State of New York but it applies with equal force to every American State and the citizens of that State.

The CHAIRMAN. I notice some other commissioners here of various States that are on the calendar.

Mr. GRAVES. Yes.

The CHAIRMAN. Have you talked to some of those gentlemen?

Mr. GRAVES. Yes.

The CHAIRMAN. I take those gentlemen right along now.

Mr. GRAVES. They wish me to assure you that they would occupy a very little time.

The CHAIRMAN. I understand; and I want them to get back to work, because we are not working down here.

Mr. GRAVES. I would like, Mr. Chairman, to say a general word about the revenue bill. We people back in the States have become increasingly conscious of the fact that legislation and administrative action in Washington has an influence on our State affairs, on our State finances, if you please. Things can be done and have been done and possibly will continue to be done in Washington which will unbalance State and local budgets. Anything which affects the economy of this country—and revenue legislation can affect it greatly—affects likewise the American States and their localities. Our national economy is becoming more sensitive as years go by for reasons which are obvious to you and which I shall not undertake to enumerate here.

I have listened all day to various speakers and witnesses and I wish to commend to your attention that which has been said by them. I am constrained to believe, if you will permit me to say so, that one of the important factors in current business recession are the revenue

laws of the United States and, to a lesser extent, the revenue laws of the States themselves. I have particularly in mind the exceedingly high rates of surtax on personal income, and I have in mind the high corporation taxes, the undistributed-profits tax, high rates of the estate tax, the capital gains and loss, and, finally, I might add the personal holding corporation.

I earnestly hope you shall give, as I am sure you will give, most thoughtful consideration to those aspects of the revenue law because of a man who is called upon to help in a small way planning State revenue programs, and planning State budgets, I have a feeling that the laws which have been enacted down here have presented serious problems to us. The current business recession has caused the State of New York to lose millions of dollars—how many I cannot tell you—I would say $25,000,000 or more. If it continues during 1938 it would cost additional millions.

Therefore, any action that the Congress can take to relieve what I believe are the undesirable economic defects of revenue laws will be a service performed not only for business and for the country as a whole, but for the individual States.

Coming down now to the immediate subject at hand, may I remind members of the committee that some 12 or 13 years ago we had this subject of the Federal estate tax on the carpet. Mr. Osgood in addressing you this morning mentioned the appointment of a committee which made a report, and which appeared before congressional committees arguing in behalf of its report. It will be recalled that at that time some people believed that the Federal estate tax law should be repealed in its entirety, and the revenue to be derived from estate and inheritance taxation left entirely to the States. There were, of course, opposing schools of thought, but it was recognized, and history records this, that the Federal Government had never used an estate or inheritance tax except during times of war. It was also recognized, and history records that fact, that the States had for more than half a century, many of them, depended upon the inheritance or estate taxes as an important source of revenue.

The outcome was the Federal estate tax of 1926, which provided a credit of 80 percent on account of death duties paid by the States. As I played a small part in it, as I understood it then and as I understand it now, the decision reached was based very largely on the thought that the States had a superior claim, a superior right to tax the estate of decedents. You will remember that every right to inherit property from another or to transmit property at death was gained under a State law.

Now, it is proposed in this statute to consolidate the two Federal estate-tax laws. That is in the interest of simplification. It is a commendable object to aim at, although as I shall point out a bit later on, it perhaps is not as important as it seems.

But in the process of combining the two, it is proposed to allow the States against their Federal tax a 16½ percent credit, on account of death duties paid to the States. It is said in the report of the House committee that is the substantial equivalent of 80 percent credit against the 1926 act. Time does not permit it, and statistics are somewhat meager for me to verify the correctness of that statement. I will simply say to you that as it applies to New York it is not true; insofar as I have, through our research organization, been able to make figures, it is not true generally throughout the country.

Senator BULKLEY. Do you know what the true figure would be for New York?

Mr. GRAVES. Approximately 25 percent. If the committee questions my figure I know that you have a very able expert in the employ of the committee, Mr. Parker, and I will leave it to him to figure it out for you.

The CHAIRMAN. Do you know anything about the average in the other States?

Mr. GRAVES. I think they vary in the other States, depending on the average size of the estate. The Federal credit, as I can figure it out under the proposed act, will for estates under $700,000 be somewhat larger than at present, but when you get into estates above $700,000 the credit will be smaller than is now provided under the 1926 act.

Senator BROWN. By that you mean to imply that New York would be a much larger loser than most of the States?

Mr. GRAVES. In dollars and cents, yes; but on a relative basis no greater than some of the other States.

Senator BROWN. But in a State having a much larger number of large estates, this exemption would be detrimental.

Mr. GRAVES. That is the idea. I said I would say something about simplification. While it is desirable to simplify the Federal estate-tax law by joining the two together, you will recall that the estate tax does not apply to a tremendous number of estates anyway; I believe about 12,000 annually, so that you are simplifying 12,000 returns annually. I make this request, that unless you decide to enlarge the credit you make no change at all because the States would be the sufferers under this plan. I would like to leave with you this thought.

The CHAIRMAN. Where did the Treasury get the statement on which they based their testimony that it would be about 16½ percent?

Mr. GRAVES. I really cannot tell you.

The CHAIRMAN. You did not appear before the House?

Mr. GRAVES. I did not appear before the House. We had a busy legislative session in Albany and that has kept me pretty well occupied.

The CHAIRMAN. Mr. Parker tells me it is on the aggregate of all the 48 States thrown together.

Mr. GRAVES. That is possibly so. Harking back to what I said before, we people in the States, and some of the people who were in Congress in 1926, believe that the States have a superior claim and right. So I am here today to ask that if you do pass this legislation you change the credit on account of death duties paid to the State to 50 percent because that recognizes merely a parity of claim, puts them on a 50-50 basis, whereas, I believe I could argue, and effectively, before a jury, that the States have a superior claim.

Senator BROWN. Mr. Graves, what is this amount to the Federal Government by way of collection?

Mr. GRAVES. I shall have to ask Mr. Parker or some of the experts of the committee. Frankly I have not looked the matter up.

Senator BROWN. For instance, last year what did we get out of the Federal estate taxes?

Mr. PARKER. The Federal estate-tax receipts are something over $270,000,000.

Senator BROWN. Quite a large item.

Mr. PARKER. It is a large item.

Mr. GRAVES. I would like to remind members of the committee that the States and their localities are having their financial problems as well. I might go so far as to say, as Governor Lehman says in his letter, I fear that if present trends continue, the time will come when the States will be reduced to an inferior and not a coordinate body, they will be no longer sovereign States, but they will become impotent as agencies of the Government.

If the Federal Government continues to invade or occupy and appropriate the principal tax fields, States have nothing left to do but to enact tax laws and revenue laws which will have uneconomic implications.

Mr. PARKER. The actual estate-tax collections for the fiscal year 1937 amount to over $281,000,000.

Senator GERRY. As I understand your contention, it is that the original estate-tax proposition in 1926, in which the 80-percent credit was laid down—in other words, that the 80 percent of the amount that the State collected in income tax could be deducted from the Federal tax?

Mr. GRAVES. That is right.

Senator GERRY. That was in order to make a level for all the States, and that if the State taxes up to a certain point, it had that 80-percent credit, and that was to the advantage of the State on the theory that the estate and inheritance tax was in a great many States, my own among others, a major tax of the State.

Mr. GRAVES. That is right.

Senator GERRY. In the subsequent law, no credit for the additional taxes put on in 1932 and 1934—and those are the only two, I think—no additional credit has been allowed to the States. Now, the proposition is simply to allow a credit at 16½ percent which apparently has been worked out on a general-accounting theory band on all the States, and that means that those States that have already been raising their revenue and have a well-organized system of estate and inheritance taxes would suffer, and that the really fair proposition is that the whole theory of the 80-percent allowance should be continued that was in the 1926 law, and if they do not want to do it that way, the only fair way to do is to give a 25-percent exemption.

Mr. GRAVES. That is right.

Senator GERRY. And that would be the same as the 80-percent proposition in the 1926 law, the same theory.

Mr. GRAVES. Yes. That is right, Senator Gerry, as applied to New York. It might result in allowing larger credits in some other States than they are now getting, and that is because of the difference in the size of the estates.

Senator GERRY. Size of estates and how the States are taxing.

Mr. GRAVES. That is right.

Senator GERRY. But it allows an advantage to the State that is collecting its revenue that way; and, after all, the States have to have some way of collecting revenue, as the Federal Government is now going into practically every field, as you have just stated.

Mr. GRAVES. Yes.

Senator KING. You mentioned a moment ago about the encroachment of the Federal Government upon the States, so that they are

being brought down to mere administrative organizations or units, much like the arrondisements of France. I was wondering if you had any suggestion to make with respect to an estate and inheritance tax that would more preserve the integrity of the States and yet at the same time give to the Federal Government a reasonable revenue. I have always taken the position that the States were paramount in the question of taxes upon property. States are sovereign, and they have their responsibilities, and originally I was very much opposed to the Federal Government collecting any taxes upon estates, because States should be permitted to resort to estates as the basis for their revenue. It is a fait accompli, and the Federal Government has reached out and is grabbing the States, if you will pardon that expression; and unless we are very careful, the States will be reduced more and more, and estate taxes will be the principal source of revenue to the extent of confiscation of the States.

Have you a remedy for the protection of the States and at the same time a policy which would give to the Federal Government a reasonable tax?

Mr. GRAVES. As it revolves around the estate tax alone, I could not suggest anything. I do not mind saying to you that I believe that the social and economic consequences of estate taxes graduated to 70 percent are undesirable.

Senator BROWN. How high is your New York top rate?

Mr. GRAVES. Sixteen percent. It is exactly 80 percent of the 1926 Federal rates, where the top was 20.

The CHAIRMAN. I did understand you to say that if we are going to retain the 70 percent, first you prefer to divide that on a 50-50 basis with the State, and then, secondly, to leave it alone as it is.

Mr. GRAVES. I did not intend to be understood as arguing for the top rate of 70 percent.

The CHAIRMAN. I understood that. First, it should be 50-50, if it is 70 percent; and, second, that you prefer the old provision of the estate law.

Mr. GRAVES. Yes. May I add one word about the gift taxes? The gift tax for every practical purpose is an integral part of a highly graduated estate tax enacted to prevent the evasion of the estate tax by reason of gifts given away during lifetime. The States therefore feel, and we in New York feel, that we should have the same credit against the gift tax that we are allowed against the estate tax, because one is complementary of the other. The two combined form a general scheme of taxing estates, gifts at death, and gifts during lifetime.

I think, Mr. Chairman, I would like to talk longer, but that is all I have to say.

The CHAIRMAN. Thank you. Have you filed a brief on this subject?

Mr. GRAVES. I have not. If the Governor's letter is not an adequate brief——

The CHAIRMAN. That is a very splendid brief, but I am sure the members of the committee would like to have your views.

Mr. GRAVES. I shall be glad to file a brief.

The CHAIRMAN. I would like to get your views on the undistributed-profits and other tax questions.

Senator KING. I think Mr. Graves, because of long experience, and I have had the pleasure of meeting with him on a number of

conferences where representatives of various States were present, and his judgment on the question of taxation and revenue I thought was better than any of those who were in attendance, I would like to get his views on the broad question of Federal tax policy.

Mr. GRAVES. I only wish my judgment was as good as you think it is.

The CHAIRMAN. If you will be able to, will you give it to us?

Mr. GRAVES. Yes.

Senator BROWN. I suppose one of the great difficulties you have in levying taxes on estates is this matter of men acquiring residences in other States where the estate taxes are not so high; is that a fact?

Mr. GRAVES. That has virtually been overcome. The multiple taxation and competition between States for people of wealth has virtually been overcome by the 1926 act, which was conceived on the theory that no matter where a man died under the Stars and Stripes his estate tax would be so much. The only question would be whether the Federal Government got the most of it or the States.

Senator BROWN. And that encouraged estate or inheritance taxes and laws immediately?

Mr. GRAVES. Yes.

Senator BROWN. And practically I think now every State in the Union has an estate tax.

Senator KING. Except one; Nevada.

The CHAIRMAN. Let us hear Mr. J. J. Truss, the State tax commissioner of Delaware.

STATEMENT OF J. J. TRUSS, WILMINGTON, DEL., STATE TAX COMMISSIONER OF DELAWARE

Mr. TRUSS. I want to endorse every word as strongly as I can that Commissioner Graves has said, and as a representative of one of the States whose interests are taken care of by Senator Townsend on this committee, that had time permitted, each tax commissioner from all of your various States would undoubtedly have been in touch with his Representative in Congress with the same thing that we have reported to our Representative, and which Mr. Graves has called to your attention today.

The CHAIRMAN. Mr. Ashley Greene, assistant attorney general of the State of Illinois. He is appearing in the place of Mr. Kerner and Mr. Leland, who are on the calendar.

STATEMENT OF ASHLEY GREENE, ASSISTANT ATTORNEY GENERAL, STATE OF ILLINOIS

Mr. GREENE. I appear here in support of Mr. Graves' statement for the State of Illinois. Illinois did not change its inheritance-tax act to conform with the Federal estate law in 1926. We still have an inheritance-tax act and as an inheritance-tax act the rates are relatively high, and they run up to 30 percent; that is, on gifts to strangers. So far as the actual effect of deduction under our law, it is better for us to have the 16½-percent provision than to have the 80 percent of the 1926 act, for the reason that the 16½ percent will apply to all the estates, and the 80-percent law does not apply to estates under 100,000. This would extend it all the way down to the lower brackets.

We have a considerable problem in connection with inheritance taxes on account of the Federal estate tax. One of these is that the Federal Government taxes the proceeds of insurance. The State of Illinois does not. In some cases the State tax is entirely wiped out by the allowance that we have to give for the Federal estate tax. We have to make a deduction for the Federal estate tax, but you do not deduct for the State tax.

The purpose of that 80-percent clause is to equalize more or less the tax rates in the various States. It has not worked out that way entirely, but it has been very helpful. We still have conflicts of jurisdiction with other States, particularly with Florida—our people want to live in Illinois and want to die in Florida. That comes up occasionally and sometimes unfortunately the taxpayer gets taxed twice, because he admits jurisdiction in Florida and actually lives in the State of Illinois.

I would like to call the committee's attention to another matter, and that is the gift tax. This exemption does not apply to the gift tax. For that reason the Federal authorities are inclined to construe a gift as an outright gift, and taxable under the gift law instead of a gift in contemplation of or intended to take effect at or after death, bcause in that case they do not have to give an exemption.

The result of that is that the taxpayer often pays a tax to the State on a gift in contemplation of death for which he gets no credit under the Federal act.

I agree very heartily with Mr. Graves that the estate tax has always been primarily a State tax. During the emergency it was necessary for the Federal Government to go into that field, and certainly the States are in no position since the Civil War to complain about the Federal Government coming into fields that they heretofore monopolized, but at the same time the Federal Government should be fair in coming into those fields. Right now the cry all over the country is to restore to the State government the functions now carried on by the Federal Government. The States must have revenue to perform such functions.

Senator KING. They would have to cry a little louder because the Federal Government is not listening thus far.

Mr. GREENE. In Illinois there is a Democratic government, and we very much appreciate the benefits we have had from the Federal Govment, but we think sooner or later State functions will go back to the States and must go back to the States if we are to have any kind of a normal business condition.

Senator KING. Do you know of any power acquired by the Government being released?

Mr. GREENE. We are talking about giving up the Philippines.

Senator KING. But we have not, and it is a question as to whether we will.

Mr. GREENE. In conclusion I would like to add that the State of Illinois requests the committee to give just as great an allowance as they can, consistent with the needs of the Federal Government. A credit is beneficial to the State, because it brings us the additional revenue for which we are now compelled to rely almost entirely on the sales tax, and that sales tax is only for the time being because the howl against it is terrible. We must have other sources of revenue and the estate taxes have been one of the most profitable.

Senator KING. Where will you get your revenue if we continue to increase the estate tax, the gift taxes, and the excise taxes and the general taxes, corporation taxes, and undistributed profits taxes, where will you get yours? On the farm, you will have to increase the burden of your farm and have an ad valorem tax or an occupational tax.

Mr. GREENE. That is right. We are losing a great number of citizens, and many of them are wanting to live in Florida, and they will find ways of living there without any property there. Of course, the Federal tax laws do not limit the State. We can increase ours as the Federal Government increases theirs, but sooner or later the source of revenue will be dried up. It seems only just and fair for the Federal Government to cooperate with the States and at least share the proceeds of a tax of this kind.

Senator KING. Mr. Martin, State Tax Commissioner of New Jersey.

STATEMENT OF J. H. THAYER MARTIN, TRENTON, N. J., STATE TAX COMMISSIONER OF NEW JERSEY

Mr. MARTIN. I also for the moment happen to be president of the National Association of Tax Administrators, having followed in that office Commissioner Stone, of Mississippi, who of course your chairman is very well acquainted with, and Mr. Stone immediately succeeded Commissioner Maxwell from North Carolina, who is here to follow me.

I am not going to take up the time of the committee this late in the afternoon with any discussion at all of the subject.

I want to rest the position of New Jersey squarely on what was said by Commissioner Graves. We had also made some calculations in New Jersey, although we cannot say they are complete, but we find that it would require in New Jersey over 20 percent and perhaps fully the 25 percent that Commissioner Graves spoke of for New York, to produce the same amount of credit for our taxpayers as the 80 percent credit now produces.

Therefore, we certainly join with Commissioner Graves in the statement that the United States Government should recognize to at least 50 percent basis the same parity of the States in connection with this tax that a few years ago you recognized to the extent of 80 percent, with the thought, as I understand, which was uppermost at that time that before long even the Federal 20 percent would be eliminated, and probably the Federal Government would entirely retire from that source.

In listening to the general discussions during the day there was one point mentioned by one of the earlier speakers that I want to endorse, and that is that the law of diminishing return is something that legislation cannot escape from. We have had that demonstrated in New Jersey in connection with some of our taxes. I will not take up any more of the time of the committee.

Senator KING. Did you have a brief that you would like to file?

Mr. MARTIN. I have no brief, but I would rather rely on the presentation by Commissioner Graves and such brief as he submits. We are very close together, and we reciprocate a good deal in the administration of our local tax problems, and I do not want to submit anything separately that would detract from the consideration you might give to his.

The CHAIRMAN. Mr. Levin, chairman of the State Tax Commission of Maryland?

(No response.)

Mr. Frank R. Kenison, assistant attorney general of New Hampshire?

(No response.)

Mr. A. J. Maxwell, Raleigh, N. C., commissioner of revenue of that State.

STATEMENT OF A. J. MAXWELL, RALEIGH, N. C., COMMISSIONER OF REVENUE OF NORTH CAROLINA

Mr. MAXWELL. Mr. Chairman and gentlemen of the committee, after the presentation made by Mr. Graves and these other gentlemen, and as the last name on your calendar for today——

The CHAIRMAN. But it is not the last. It is the last on this subject.

Mr. MAXWELL. On this printed calendar, I ask permission to present two or three brief observations. The first one is an expression of very genuine appreciation as a State tax administrator of the policy adopted by Congress in the 1926 act in the 80-percent credit provision of the Federal estate tax. That provision has been far-reaching in its consequences and in the wholesome effect of it. It has strengthened the tax structure of every American State with perhaps the single exception that Senator King refers to, the State of Nevada, which is still wealthy enough not to feel the need of taking advantage of this provision. It has cured what was formerly the serious problem of residents' migration to avoid inheritance taxes. I think it has completely cured that problem, and that seems to me a very wholesome thing that the Congress ought not to be willing to any extent to weaken. I am sure that it was not the intention of the House bill to weaken the effect of that provision, but as already pointed out it seems to me inevitable that the provision in the bill before you would have that effect.

The CHAIRMAN. Did you figure in North Carolina how it would affect you?

Mr. MAXWELL. Yes, to some extent, and I will give you some illustration. I think the principal difficulty is in this, that when you adopt a straight percentage of the combined taxes, you might materially increase the allowable credit on small estates, and substantially reduce the allowable credit on the large estates. Of course, the volume of revenue from inheritance taxes comes from the large estates.

I have a memorandum here of one estate settled by our Department in the last fiscal year on which the 80-percent credit amounts to $1,142,727.31. The 16½-percent credit would be $816,753.50, or a reduction of $325,974. On two large estates that we settled within the last fiscal year, the reduction in allowable credit would amount to more than the total collection of inheritance taxes from all other estates within that fiscal year.

The result of reducing the allowable credits on the large estates would be either one of two contingencies. Take a State like North Carolina, it would either have to lose that revenue or it would have to increase the rates of its inheritance tax in a sufficient sum to make up for the reduction in the allowable credit. If it did that, you would again open up the incentive for the transfer of residence to save this

kind of tax. Such analysis as we have been able to make of it hurriedly, gentlemen——

Senator GERRY (interposing). Is not that taking you back to the condition in 1926 when the States were competing?

Mr. MAXWELL. It leads right back to that point, and at the present time every State is substantially on an equal basis.

Senator GERRY. And you do not have to change all your State laws the way you might have to?

Mr. MAXWELL. Yes. There may be tax reasons other than inheritance taxes that would persuade some citizen to change his residence under the present tax laws, but generally speaking that does not exist with respect to inheritance taxation. I think it is of great public importance that that relationship should be continued, and that either we should retain the present provision of 80 percent or adopt, in lieu of the 16½ percentage figure a percentage figure that would with respect to large estates be the equivalent of the present 80 percent provision.

The CHAIRMAN. Mr. W. H. Hackett, tax commissioner of the State of Connecticut.

STATEMENT OF W. H. HACKETT, TAX COMMISSIONER OF THE STATE OF CONNECTICUT

Mr. HACKETT. At the present time the State of Connecticut has both a succession tax and an estate tax. Table A shows the amounts which have been received by the State government of Connecticut from both of these taxes during the 7-year period to be ended on June 30, 1938.

TABLE A.—*Connecticut receipts from succession and estate taxes during its 7 fiscal years ended on June 30, 1938*

Fiscal year ended June 30—	Succession tax	Estate tax	Total
1932	$3,975,380.58	$163,574.87	$4,138,955.45
1933	2,207,487.43	340,184.49	2,547,671.92
1934	1,736,335.43	688,859.73	2,425,195.16
1935	2,504,004.47	413,788.09	2,917,792.56
1936	2,001,647.03	250,056.60	2,251,703.63
1937	2,592,656.09	302,842.58	2,895,498.67
1938 [1]	2,600,000.00	700,000.00	3,300,000.00
Total 7 years	17,617,511.03	2,859,306.36	20,476,817.39
Average annual receipts	2,516,787.29	408,472.34	2,925,259.63

[1] Estimated.

It will be seen from the foregoing table that on the average during each of the last 7 years the State of Connecticut has received approximately $400,000 from her estate tax. This estate tax which was first enacted in 1931 was simply designed to absorb the 80-percent credit set up in the 1926 Federal Revenue Act as amended. If the proposed 16.5-percent credit in the 1938 revenue bill had been in effect during the last 7 years the State of Connecticut would have received nothing or practically nothing from her estate tax. This means that it would have been necessary for the State of Connecticut to have found other sources of revenue averaging $400,000 each year in order to make good this deficiency.

Table B shows the amounts which would be paid in Connecticut succession and Federal estate taxes under the present and proposed

laws for various sizes of estates. In each case the amounts in the first column represent the net estate after all deductions have been taken out other than for the specific exemptions allowed in the various acts. In figuring the tax painstaking care has been exercised to deduct each specific exemption allowed under the applicable law or proposed bill. Class A under the Connecticut succession-tax law represents roughly estates passing to lineals, class B passing to collaterals and class C passing to all others.

The rates shown for the Connecticut succession tax are those which became effective on estates of decedents dying on and after July 1, 1937, which rates are quite a bit higher than those previously in effect. It will be observed from table B that under the present class A rates the State of Connecticut will receive no Connecticut estate tax until the size of the net estate is in excess of $6,000,000, whereas under the proposed credit in 1938 Federal revenue law the net estate would have to be approximately $15,000,000. Up to the present time no estate in Connecticut has approximated this latter amount. This means that if this 16.5-percent credit should become law the Connecticut estate tax would yield nothing.

Since sovereignty extends to the States as well as to the Federal Government it would appear that from all justice and equity the credit which ought to be allowed against the gross Federal estate tax for State succession taxes should be 50 percent. In this manner the Federal and State Governments would share and share alike.

Specific attention should be directed to the two columns in table B, one showing the 80-percent credit under the present Federal law and the other showing the 16.5-percent credit in the new proposed law. It will also be noted that except for the net estate of $1,000,000 the 16.5-percent credit is substantially less than the present 80 percent approximating as much as 30 percent in the case of very large estates.

I respectfully request that the same credit allowed against the estate tax be equally applicable to the gift tax.

This last statement was contained in a letter that I wrote to the chairman of this committee.

Table B referred to in my statement above is as follows:

TABLE B.—*Comparison of Connecticut succession and Federal estate taxes for various sizes of estates*

Net estate [1]	Present Connecticut succession tax			Present Federal estate tax		
	Class A	Class B	Class C	Tentative tax 1932 act as amended	Total tax under 1926 act	Net additional tax
$1,000,000	$64,800	$74,910	$104,970	$211,000	$41,500	$169,500
$2,000,000	154,800	174,910	234,970	543,600	124,500	419,100
$2,500,000	199,800	224,910	299,970	732,400	173,500	558,900
$3,000,000	244,800	274,910	364,970	936,200	227,500	708,700
$3,500,000	289,800	324,910	429,970	1,155,000	286,500	868,500
$4,000,000	334,800	374,910	494,970	1,388,800	350,500	1,038,300
$4,500,000	379,800	424,910	559,970	1,637,600	419,500	1,228,100
$5,000,000	424,800	474,910	624,970	1,901,400	489,500	1,411,900
$6,000,000	514,800	574,910	754,970	2,460,200	638,500	1,822,700
$7,000,000	604,800	674,910	884,970	3,049,000	797,500	2,251,500
$8,000,000	694,800	774,910	1,014,970	3,658,200	966,500	2,691,700
$9,000,000	784,800	874,910	1,144,970	4,287,400	1,145,500	3,141,900
$10,000,000	874,800	974,910	1,274,970	4,936,600	1,334,500	3,602,100
$15,000,000	1,324,800	1,474,910	1,924,970	8,286,600	2,333,500	5,953,100

Footnote at end of table.

TABLE B.—*Comparison of Connecticut succession and Federal estate taxes for various sizes of estates*—Continued

Net estate [1]	Present Federal estate tax			Proposed 1938 Federal estate tax		
	80 percent credit, 1926 tax	Net 1926 tax	Total estate tax	Tentative tax	16.5 percent credit 1938 tax	Total estate tax
$1,000,000	$33,200	$8,300	$177,800	$211,000	$34,815	$176,185
$2,000,000	99,600	24,900	444,000	543,600	89,694	453,906
$2,500,000	138,800	34,700	593,600	732,400	120,846	611,554
$3,000,000	182,000	45,500	754,200	936,200	154,473	781,727
$3,500,000	229,200	57,300	925,800	1,155,000	190,575	964,425
$4,000,000	280,400	70,100	1,108,400	1,388,800	229,152	1,158,648
$4,500,000	335,600	83,900	1,302,000	1,637,600	270,204	1,367,396
$5,000,000	391,600	97,900	1,509,800	1,901,400	313,731	1,587,669
$6,000,000	510,800	127,700	1,950,400	2,460,200	405,933	2,054,267
$7,000,000	638,000	159,500	2,411,000	3,049,000	503,085	2,545,915
$8,000,000	773,200	193,300	2,885,000	3,658,200	603,603	3,054,597
$9,000,000	916,400	229,100	3,371,000	4,287,400	707,421	3,579,979
$10,000,000	1,067,600	266,900	3,869,000	4,936,600	814,539	4,122,061
$15,000,000	1,866,800	466,700	6,419,800	8,286,600	1,367,289	6,919,311

[1] But before deduction for specific exemptions which in case of the Connecticut succession tax is $10,000 for class A, $3,000 for class B, and $500 for class C; in case of the present Federal estate tax is $100,000 for 1926 tax and $40,000 for 1932 act as amended; and in case of the proposed 1938 Federal estate tax is $40,000.

The CHAIRMAN. We will next hear from Mr. J. D. Craig, Buffalo, N. Y., representing the firm of Spencer, Kellogg, & Sons.

STATEMENT OF J. D. CRAIG, BUFFALO, N. Y., REPRESENTING SPENCER, KELLOGG & SONS

Mr. CRAIG. I represent Spencer, Kellogg & Sons, Inc.; I wish to direct my remarks to title IV, section 702, subparagraph (d), which is the section which levies the 2 cents tax on the oil seeds, and is simply a restatement of the existing law.

Our company is one of the largest oil seeds crushers in the United States, operating nine different crushing plants in various locations extending from the Atlantic to the Pacific coast. We are asking that the 2-cent rate be adjusted to permit the importation of these oil seeds so that they can be crushed in this country rather than in oriental mills as is at present the case.

We are also asking that the status of rapeseed oil be restored to the provision of the 1930 Tariff Act, paragraph 1732, which would permit the tax free importation of that oil when in denatured form for use in lubricants used in reciprocating types of engines.

I will give you one example, using perilla seed to illustrate the present condition with which we are confronted. The present rate of 2 cents a pound on this seed is equivalent to a levy of 5.41 cents per pound on the oil contained in the seed, whereas the imported oil itself is subject to a tax of only 4½ cents. Obviously, now the oil enters this country in the form of oil, and the crushing has been denied the domestic crushing industry, being done in oriental mills. That disparity represents, expressed in percentage, a penalty of 8 percent on the importation of the seed. The penalty on hemp seed is 33.5 percent, on sesame seed 21 percent, on rapeseed 12 percent, and on kapok seed 37 percent. In other words, every one of these oil seeds is subject to a penalty of these varying percentages, with the flat 2-cent rate in effect.

To correct the gross disparity we can approach the problem by picking a zero protection line; in other words, establish the seed rate at a point which provides exact parity with the oil rate, and then in addition give the domestic crushing industry some degree of preferential protection ranging from 20 to 25 percent which will permit the importation of these seeds and at the same time equalizing the difference between the higher United States costs with the lower costs of crushing in Oriental countries. On that point I might mention that the average wages paid in the Japanese crushing mills is approximately 30 yen a month, which at recent rates of exchange is very little more than we pay our working men in this country in 1 day.

Senator KING. Do you think that if we remove that discrimination, apparently, that crushing would be done in the United States?

Mr. CRAIG. Very definitely, Senator, and I will illustrate it in this way. Last year, the calendar year of 1937, there were imported 44,000,000 pounds of perilla oil as oil. That quantity of oil is equivalent to approximately 120,000,000 pounds of seed, and if we could have imported that quantity of seed, it would have provided crushing material for three to four large mills operating at full capacity for 365 days of the year. As it is these mills are standing idle. Some of them are heading for bankruptcy.

My company has a million-dollar plant at Long Beach, which is not now turning a wheel because it is impossible to crush any of these seeds under the existing 2-cent tax rate. The plant is standing idle, with no employees there other than a mere skeleton organization which is being held together in the hope that these disparities in the rates will be corrected to a point which will again permit the importation of the seeds.

Senator KING. Where does the opposition come from to the plan you suggest?

Mr. CRAIG. One witness who preceded me remarked that the competition was with soybean oil. I should like to point out, however, that since these seed rates have been in effect, the use of soybean oil in drying oil channels has declined appreciably. This decline is undoubtedly explained by the fact that soybean oil can be used satisfactorily in the manufacture of paints and varnishes only when some stronger drying oil, like perilla oil, is used to carry it into consumption.

Senator KING. That was the contention made in 1936?

Mr. CRAIG. Yes; and that contention is now corroborated by statistical facts, as I have just pointed out.

Senator KING. The contention was then made by some witnesses in harmony with the views just expressed, that is, that perilla oil is needed for drying.

Mr. CRAIG. That is right. Perilla and hempseed oils are drying oils and used by the same industries employing linseed oil. These rates have been in effect since 1936 and were allegedly enacted in the interest of the domestic flaxseed and soybean crops. The flaxseed acreage has declined 50 percent since it was enacted. In 1936 the acreage was 2,550,000 acres. In 1937, after the tax had been in effect a year, that acreage was only 1,302,000 acres, and the report released by the Department of Agriculture this morning gives the indicated

acreage for this coming year 1938 at only 1,112,000 acres, which is 15 percent below the 1937 figure.

Senator KING. To what do you attribute that decline? Is it the reduction of flaxseed or that it is not profitable or no demand?

Mr. CRAIG. Yes; there is plenty of demand for it, but with the Government promising benefits to the wheat growers in that section of the country, where flaxseed is a companion crop, and with flax being a rather speculative and uncertain crop, I believe the decline is being caused by a will on the part of the growers to take the sure thing, hence the trend to an increased acreage of wheat this year. Farmers are promised benefits for growing wheat, but they will get nothing for growing flaxseed. Also, flax is a more uncertain crop than wheat, due to grasshopper pests, wilt, dry weather, and early frosts, all of which affect it adversely.

If there is any difficulty in establishing a mathematically exact rate, we sincerely hope that will not serve as the excuse for not taking some action to rectify these rates. We are asking that preferential protection of approximately 25 percent be provided, but at least give us something to put us on a parity with foreign competition plus a reasonable protective differential to cover difference in labor and production costs. We should not be penalized as compared to the foreign crushers, as is now the case.

Senator KING. As to perilla oil, you should let us enter perilla seed?

Mr. CRAIG. The major portion of it should come in as seed. The same should apply to all five of these seeds. In 1937 we imported 39,000,000 pounds of sesame oil. That quantity of oil would be the equivalent of approximately 82 to 85 million pounds of seed, again a quantity which would have afforded crushing material for three or four fairly large crushing plants and all of the other seeds would work out in about the same manner.

While on the subject of sesame seed I should mention that an inference was made by a previous witness to the effect that a rectification of these oil-seed rates would militate against domestic produced oils. This theory is unsound and has no substantial basis. The oil from sesame seed is the only one of importance of this entire group now under consideration which has a direct relation to cottonseed oil.

But the quantity of sesame oil imported either in the form of seed or oil has always been relatively small in comparison to the imports of cottonseed oil. The real force of competition confronting domestic produced cottonseed oil comes from imported cottonseed oil, not from sesame oil, as I can readily illustrate. In 1936 cottonseed oil imports totaled approximately 128,000,000 pounds compared to 60,000,000 pounds of sesame oil. In 1937 cottonseed oil imports mounted to 194,000,000 pounds with seasame oil declining 16,000,000 pounds from the preceding year to 44,000,000 pounds or less than one-fourth of the cottonseed oil imports for that same year.

Sesame oil possesses the unique property of having the greatest immunity to rancidity of any fat or oil which renders it highly useful in the manufacture of prepared flours like the familiar "Bisquick" and "Aunt Jemima" and for which purpose no domestic oil can be employed. Since sesame oil must of necessity be imported and is

now being imported for these specialized uses why, then, should we not be permitted to import it in the form of seed to be crushed in our domestic mills employing American labor and capital?

The CHAIRMAN. Where are these plants mostly located for crushing perilla and sesame seed?

Mr. CRAIG. The crushing industry operating on imported oil-bearing materials is concentrated principally on the Atlantic and Pacific Coasts, and at some interior points accessable through the Erie Canal and the Great Lakes.

The CHAIRMAN. How many of those plants are there?

Mr. CRAIG. There are approximately 25 plants which would operate on these various seeds. We can bring seed inland as far as Buffalo, up through the Erie Canal and crush at our mill there. At the present time we are not operating our Buffalo mill except in a very limited way, but if it were possible to bring in the hempseed and perilla seed which is now coming in in the form of oil, we would be able to crush the seed at that plant as well.

The CHAIRMAN. You would import less oil and more seed?

Mr. CRAIG. Yes; and I do not think it will make any difference in the revenue as far as the income obtained from the direct tax because it is merely a shifting of the tax from the oil to the seed. By crushing the seeds in the United States it affords a more dependable source of supply to the domestic users, the paint and varnish and linoleum industry, printing-ink and patent-leather manufacturers and other types of outlets which employ these drying oils.

The CHAIRMAN. How many people are employed by these crushing plants?

Mr. CRAIG. I have no accurate statistics, but I estimate it would be from two to three thousand plus an even greater number in all of the corollary operations embracing transportation, shipping, stevedoring, and so on.

The CHAIRMAN. Is it seasonal?

Mr. CRAIG. No. The crushing operation is seasonal on given seeds. We get the domestic flaxseed crop in the months of September, October, and November, and that affords crushing through to the early spring months. The Argentine crop comes on to the market in late December and early January and carries through to the late summer. The perilla seed comes in the early fall and it would make for a very balanced operation if we could import it continuously.

The CHAIRMAN. The crushing plants crush all of these seeds?

Mr. CRAIG. Yes. The crushing industry is so situated that a number of the plants are located in the interior of the country and crush principally domestic seed. The plants on the respective coasts operate principally on the imported seeds. There is a very large deficiency in the supply of drying oils produced in the United States. Domestic crushers buy every pound of oil-bearing material available which is grown in the United States for producing the various oils, but in addition we must import approximately 70 percent of our requirements of drying oils from foreign countries, principally in the form of flaxseed from the Argentine, tung oil from China, and we hope perilla seed and hemp from Manchukuo and Kwangtung.

Senator KING. Then we produce 30 percent of the drying oils?

Mr. CRAIG. In the calendar year of 1936, on the basis of Bureau of the Census figures, the ratio was 69.7 percent foreign oil and 30.3

percent of domestic oil. For the year 1937 the percentage of domestic oil will be less. The official Government statistics are not yet released, but the imports of flaxseed were approximately 20 percent greater than for 1936, and the consumption of drying oils no greater, so that the ratio of foreign oils has increased. What we are asking is simply that these rates be adjusted in such a way that it will permit the importation of the seeds.

Senator KING. What is the concrete suggestion?

Mr. CRAIG. I will file a schedule of rates which I have here, and which I believe is in close agreement with the suggestions just submitted by the Tariff Commission.

The CHAIRMAN. The Tariff Commission report is quite full on the data.

Mr. CRAIG. I will file this schedule of rates showing the penalties and the parity rate plus the schedule of rates which will afford varying degrees of protection from 15 to 30 percent. The industry is asking that this preferential rate be established between 20 and 25 percent, using even fractions of a cent in setting the individual rates, namely for perilla seed the rate would be 1.4 cents per pound.

Senator KING. In view of the limited quantity produced in the United States of these drying oils, to facilitate the importation of drying oils, would it not be competitive with domestic production?

Mr. CRAIG. No. As I have said before, the only drying oils produced in the United States come from flaxseed and in a very limited way from soybeans, but soybean oil is not readily adapted to drying purposes unless mixed with perilla oil.

Senator KING. It seems to me that you have such a brief résumé that you should have filed a brief.

Mr. CRAIG. I prepared no statement other than the schedule of rates which I will give the stenographer.

The CHAIRMAN. Mr. Lozier discussed this matter and made a very elaborate argument.

Mr. LOZIER. And I will file a brief.

Mr. CRAIG. The issue is now before your committee and I hope it has been clearly presented. The industry's hope is that you will amend the pending revenue bill by adopting seed rates approximately within the limits recommended, namely, to afford the domestic crushing industry at least 25 percent preferential protection. It should and must be done if an important industry is to be preserved.

There seems to be no valid reason for opposition to correcting the legislative mistake which imposed a flat 2-cent rate on these five important oil seeds irrespective of their varying oil content. No question of protection to domestic crushing interests is involved. The oil from these seeds is needed by United States industries whether it is extracted in this country or in the Orient. The whole question is whether a domestic crushing industry is to be killed in order to hand its business over to Japan.

American crushers purchase every bit of domestic raw material that is available from which drying oils are obtained accounting for approximately 30 percent of the total used in 1936. The deficiency must be supplied by imports—flaxseed from the Argentine, tung oil from China, and perilla and hemp (if the rate disparities are corrected) from Manchukuo and Kwantung.

Acting on your suggestion Senator King, I shall prepare and submit a brief to be incorporated as a part of my testimony.

(The brief and schedule of rates above referred to follow:)

BRIEF IN RE: RECTIFICATION OF 2-CENT EXCISE TAX ON PERILLA, HEMP, SESAME, KAPOK, AND RAPE SEEDS

PROVISIONS EXISTING LAW AND PROPOSED CORRECTIVE AMENDMENT

Title V, section 701, of the 1936 Revenue Act levied a flat 2 cents per pound excise tax on five oilseeds (perilla, hemp, sesame, kapok, rape) irrespective of their variable oil contents. It levied a 4½ cents per pound excise tax on the respective oils except sesame, on which a duty of 3 cents per pound was already in effect as levied by the 1930 Tariff Act. H. R. 9682, the pending revenue bill, as it passed the House simply restated this schedule of rates in section 702, subparagraph "D."

To correct the resultant maladjustment it is necessary to amend said subparagraph "D" of section 702 by striking out the flat 2 cents per pound tax applicable to each seed and inserting in lieu thereof the following:

"Perilla seed, 1.38 cents per pound; hemp seed, 1.24 cents per pound; sesame seed, 1.18 cents per pound; kapok seeds, 0.94 cent per pound; and rapeseed, 1.32 cents per pound."

PRACTICAL EFFECTS OF EXISTING LAW

The 2 cents tax on the seeds when expressed in terms of the oil equivalent is grossly in excess of the tax applicable to the respective oils as shown in the following comparative table.

Seed	Average oil content, basis Tariff Commission data	Present tax rate	Tax equivalent on oil content	Penalty against importing seed	Rate to provide 25 percent preferential protection
	Percent	*Cents per Pound*	*Cents per pound*	*Percent*	*Cents per pound*
Perilla	37	2	5.41	*8.0*	1.38
Hemp	24	2	8.33	*85.5*	1.24
Sesame	48	2	4.16	*21.0*	1.18
Kapok	18	2	11.11	*37.4*	.94
Rape	35	2	5.71	*12.0*	1.32

Figures in italics represent penalties or minus quantities.

The existing 2-cent tax is equivalent to an ad valorem tax ranging from 54.8 to 142.8 percent. The situation with respect to these oilseeds is analogous to having a high protective tariff on raw silk with a much lower duty on silk stockings, or a high duty on crude rubber with a low duty on tires.

DOMESTIC CRUSHING OPERATION TRANSFERRED TO ORIENTAL MILLS

In the face of the foregoing penalties obviously no seeds can be imported for crushing in this country by domestic mills. Instead, the crushing of these seeds, since the imposition of this 2-cent tax, has been forced out of this country to the oriental mills, so that now only the oil is imported. The 44 million pounds of perilla oil imported in 1937 required the crushing of approximately 120 million pounds of perilla seed. The 39 million pounds of sesame oil imported in 1937 required the crushing of approximately 82 million pounds of sesame seed. All of this seed was crushed in oriental mills. This amount of crushing alone would have provided sufficient volume to have kept seven average size crushing plants in continuous operation throughout the year.

The domestic mills, which normally should crush these seeds, accordingly stand idle or at best operate in a very limited capacity on other oil-bearing materials like flax and copra, of which there has developed a burdensome surplus. Several thousand employees have been thrown out of work and some of the smaller companies forced into bankruptcy with more headed in that direction if corrective legislation as herein proposed is not enacted.

REMEDIAL LEGISLATION SOUGHT

The domestic crushers are appealing to Congress—specifically to the Senate Finance Committee—to rectify the existing glaring disparities to make possible a resumption of the crushing of these seeds by domestic mills employing American labor and operating with American capital. To accomplish this objective the flat 2-cent tax must be reduced to a point where the rate on each individual seed in relation to the tax on the corresponding imported oil will provide the domestic crushing industry, in addition to a compensatory or parity rate, a reasonable degree of preferential protection. In short, we ask the removal of the existing penalty to the extent of being placed on a parity with foreign crushers, plus a sufficient protective differential to compensate for the higher labor, operating, and tax costs of American crushers as contrasted to the substandard levels, particularly the low labor costs, which prevail in the oriental mills.

UNITED STATES TARIFF COMMISSION DATA SUPPORTS POSITION OF CRUSHING INDUSTRY

In a letter to Chairman Harrison, dated March 15, 1938, the United States Tariff Commission points out the glaring disparities and inequalities which result from the existing flat 2-cent rate. The Commission also, in a memorandum attached to its letter, suggests alternative schedules of rates to provide varying degrees of preferential protection, indicating further that if this protection is inadequate, the major portion of the importations would continue to enter in the form of oil rather than as seed. To insure the bulk of the importations entering as seed a minimum preferential protection of 25 percent should be afforded the domestic crushing industry. The cottonseed- and flaxseed-crushing industries now enjoy a protective margin of 30 percent. In other words, the cottonseed and flaxseed duties (in terms of oil) are lower than the respective cottonseed-oil and linseed-oil duties by approximately 30 percent.

PROPOSED AMENDMENT

To afford the domestic crushing industry with a margin of protection of at least 25 percent between the respective seed and oil rates, it will be necessary to strike out the flat 2-cent rate from section 702, subparagraph "D" of the pending revenue bill, H. R. 9682, and insert in lieu thereof the following:

"Perilla seed, 1.38 cents per pound; hemp seed, 1.24 cents per pound; sesame seed, 1.18 cents per pound; kapok seed, 0.94 cents per pound, and rapeseed 1.32 cents per pound."

These rates are in agreement with those contained in the Tariff Commission memorandum.

On the attached table there is shown a complete schedule of rates based upon varying degrees of preferential protection ranging from 15 to 30 percent. The figures in italic show the existing penalties against importing seed under the flat 2-cent rate expressed in cents per pound, dollars per ton, and in percentage.

CORRECTIVE LEGISLATION WILL NOT ADVERSELY AFFECT DOMESTIC PRODUCERS OF OIL-BEARING MATERIALS

Perilla and hempseed produce drying oils of the linseed oil class. The United States during the last 5 years has been unable to produce more than 30 percent of its consumption of such drying oils. Imported oils or oil-bearing materials, i. e., flaxseed, have constituted from 70 to 80 percent of the total drying oils consumed in the manufacture of paints, varnishes, lacquers, linoleum, oilcloth, printing inks, patent leather, and a variety of other similar products. Since the United States is largely dependent upon foreign sources for its supplies of their drying oils, why then should not the rates be so adjusted as to permit the importation of the raw materials, viz., the oilseeds, rather than the finished product, i. e., the oil?

Sesame oil is admittedly related to cottonseed oil but in the strict sense not competitive because it sells at a price always appreciably above that of cottonseed oil. Sesame oil has the greatest immunity to rancidity of any fat or oil; hence must be imported for certain specialized uses for which no domestic oil is suitable, viz., in the manufacture of prepared flours like "Bisquick" and "Aunt Jemima's."

The quantity of sesame oil imported either in the form of seed or oil has always been relatively small in comparison to the imports of cottonseed oil. The

real force of the competition confronting domestic-produced cottonseed oil comes from imported cottonseed oil, not from sesame oil. For example, in 1937 imports of cottonseed oil totaled 194 million pounds, or more than four times the imports of sesame oil, which totaled only 44 million pounds in that same year The embargo tax on the seed has not and doubtless will not prevent the importation of the oil. Since sesame oil must of necessity be imported and is now being imported for these specialized uses why then should not the seed rate be so adjusted as to permit the importation of the seed instead of the oil and so afford crushing materials to the domestic crushing industry?

Rapeseed oil is noncompetitive and unrelated to any domestically produced oil. As such there can be no objection to removing the tax on rapeseed oil if denatured as provided for in paragraph 1732 of the 1930 Tariff Act. A rectification of the rate on the seed is therefore of no significance to domestic producing interests.

A more complete analysis of this subject with supporting reasons for a rectification of the rates on these five oilseeds will be found in the attached brief by the Honorable Ralph F. Lozier, general counsel of the National Institute of Oilseed Products, of which organization Spencer Kellogg and Sons, Inc., is a member.

Respectfully submitted by

SPENCER KELLOGG & SONS, INC.,
J. D. CRAIG,
Assistant to the President.

BUFFALO, N. Y., *March 24, 1938.*

Comparative schedule of oil-seed rates based upon varying degrees of preferential protection for domestic crushing industry

	Schedule of rates basis Tariff Commission report			Hempseed—computed on basis competitive relation with flaxseed, i. e. drying oil levy not exceeding 4½ cents
	Perilla seed—Excise tax drying oil rate of 4½ cents	Sesame seed—Excise tax edible oil rate of 3 cents	Hempseed—excise tax drying oil rate of 4½ cents and tariff duty of 1½ cents	
Oil yield from seed basis U. S. Tariff Commission findings:				
Percent	37	48	24	24.
Per ton	740 pounds	960 pounds	480 pounds	480 pounds.
Excise tax levied by Bailey amendment:				
Per pound	2 cents.	2 cents	2 cents	2 cents.
Per ton	$40	$40	$40	$40
Existing penalty against importing seed:				
Per pound	*0.16 cents*	*0.42 cents*	*0.35 cents*	*0.71 cents*
Per ton	*$3.22*	*$8.38*	*$7*	*$14.20.*
Existing penalty against importing seed expressed in percentage.	*8*	*21*	*17.5*	*35.5.*
Seed rate required to establish exact parity with oil rate:				
Per pound	1.84 cents	1.58 cents	1.65 cents	1.29 cents.
Per ton	$36.80	$31.60	$33	$25.80.
Seed rate required to provide 30 percent preferential protection:				
Per pound	1.29 cents	1.10 cents	1.16 cents	0.90 cents.
Per ton	$25.76	$22.13	$23.10	$18.06.
Seed rate required to provide 25 percent preferential protection:				
Per pound	1.38 cents	1.18 cents	1.24 cents	0.97 cents.
Per ton	$27.60	$23.71	$24.75	$19.35.
Seed rate required to provide 20 percent preferential protection:				
Per pound	1.47 cents	1.26 cents	1.32 cents	1.03 cents.
Per ton	$29.44	$25.30	$26.40	$20.64.
Seed rate required to provide 15 percent preferential protection:				
Per pound	1.56 cents	1.34 cents	1.40 cents	1.10 cents.
Per ton	$31.28	$26.88	$28.05	$21.93.
Seed rate required to establish exact competitive parity with flaxseed:				
Per pound	1.31 cents	1.05 cents	1.12 cents	0.76 cents.
Per ton	$26.20	$21	$22.40	$15.20.

	Schedule of rates basis Tariff Commission report		Schedule of rates basis existing edible oil tariffs	
	Rapeseed—Basis excise tax oil rate of 4½ cents	Kapok seed—basis excise tax oil rate of 4½ cents and tariff duty equivalent total levy of 5.7 cents per pound)	Rapeseed—basis edible oil rate of 3 cents	Kapok seed—Basis edible oil rate of 3 cents
Oil yield from seed basis, U. S. Tariff Commission findings:				
Percent	35	18	35	18.
Per ton	700 pounds	360 pounds	700 pounds	360 pounds.
Excise tax levied by Bailey amendment:				
Per pound	2 cents	2 cents	2 cents	2 cents.
Per ton	$40	$40	$40	$40.
Existing penalty against importing seed:				
Per pound	*0.24 cents*	*0.75 cents*	*0.77 cents*	*1.23 cents.*
Per ton	*$4.80*	*$14.94*	*$15.40*	*$24.64.*
Existing penalty against importing seed expressed in percentage.	*12*	*37.4*	*33.4*	*61.6.*
Seed rate required to establish exact parity with oil rate:				
Per pound	1.76 cents	1.26 cents	1.23 cents	0.77 cent.
Per ton	$35.20	$25.20	$24.60	$15.36.
Seed rate required to provide 30 percent preferential protection:				
Per pound	1.23 cents	0.88 cent	0.86 cent	0.54 cent.
Per ton	$24.60	$17.54	$17.22	$10.75.
Seed rate required to provide 25 percent preferential protection:				
Per pound	1.32 cents	0.94 cent	0.92 cent	0.57 cent.
Per ton	$26.40	$18.75	$18.45	$11.52.
Seed rate required to provide 20 percent preferential protection:				
Per pound	1.41 cents	1.01 cents	0.98 cent	0.61 cent.
Per ton	$28.20	$20 20	$19.68	$12.29.
Seed rate required to provide 15 percent preferential protection:				
Per pound	1.50 cents	1.07 cents	1.04 cents	0.65 cent.
Per ton	$30	$21.40	$20.90	$13.06.
Seed rate required to establish exact competitive parity with differential of 0.26 cents per pound afforded crushers of cottonseed under pars. 54 and 762 of the 1930 Tariff Act:				
Per pound	1.50 cents	1.00 cent	0.97 cent	0.51 cent.
Per ton	$30	$20	$19.40	$10.20.

Figures in italics represent penalties or minus quantities.

The CHAIRMAN. Mr. Glenn T. Stebbins, representing the United States Livestock Association.

STATEMENT OF GLENN T. STEBBINS, KANSAS CITY, MO., REPRESENTING THE UNITED STATES LIVESTOCK ASSOCIATION

Mr. STEBBINS. I have a very brief statement which I should like to submit for the record.

My name is Glenn T. Stebbins. I am executive secretary of the United States Livestock Association, the office of which is located at Kansas City, Mo. The membership of the association comprises approximately 85,000 livestock producers, the majority of whom reside within the Corn Belt territory and several of the States immediately adjacent thereto.

On behalf of the association I appear before you in support of section 703 of the Revenue Act of 1938 (H. R. 9682). The section

referred to provides a tax of 6 cents per pound on imports of processed or prepared pork and 3 cents per pound on unboned, fresh, chilled, or frozen pork.

The pork-producing industry of our country is faced with an extremely serious situation. Pork imports, particularly from Continental Europe, have increased by leaps and bounds during the past 4 years. The proposed tax will serve the double purpose of providing much needed revenue to the Government and of equalizing in part, at least, the competitive situation with which our domestic hog producers are confronted.

Let me present a brief table of figures which covers total pork imports from all countries as follows:

	Pounds
1934	1,647,000
1935	10,494,000
1936	41,843,000
1937	74,830,000

It can easily been seen that the proposed tax would yield considerable new revenue and yet it cannot be looked upon as otherwise than a compensatory measure to partially equalize the difference between domestic and foreign production costs.

Hog production in this country is returning to normal. Here is some indication of the future trend. The following figures show the estimated hog population of the country for respective years together with the total farm value thereof:

	Head	Farm value
Jan. 1, 1936	42,837,000	$544,911,000
Jan. 1, 1937	42,948,000	510,504,000
Jan. 1, 1938	44,418,000	498,025,000

It will be noted that, with an increase of 2½ million head compared to a year ago, total farm value is less by 12½ million dollars.

The February issue of Crops and Markets reveals that for January 1938, the index for meat animals including all three species, stood at 110 or 16 points below total living and production costs. Turning to parity prices we find that, for January 1938, the weighted average price for hogs was $7.59 per hundred, according to the Agricultural Situation of February 1, while the parity price was $9.39 per hundred. This simply means that for the month of January domestic hog prices were $1.80 per hundred under parity.

To state it from another angle, average hog prices received by farmers have declined more than $2.25 per hundred-weight since October 1937, dropping from an average of $9.78 as of October 15, 1937 to a present estimated level of around $7 per hundred. These figures emphasize and support the belief of our domestic hog producers that without a compensatory measure, they cannot hope to compete with low cost foreign production except that their standard of living be reduced to the level of that which exists at the source of these foreign pork products.

This problem is becoming increasingly serious not only to our Corn Belt hog producers but with the 13 Southern States now producing in excess of 25 percent of the total hog production of the country,

it is equally vital to the South. Let me point out that the tremendous increase in pork imports the last 2 years has developed in the face of increasing production in this country.

Gentlemen, this condition places upon our domestic hog producers an insurmountable handicap. Unless this Congress sees fit to adopt the compensatory measure here proposed, it is inevitable that the present inequitable situation will grow progressively worse. Moreover, for every cargo of foreign pork unloaded at the ports of this country we will be permitting what is tantamount to the immigration of poorly paid foreign labor to compete with our own laboring citizens.

Since these foreign products have already acquired a well-established consumer demand and since the proposed tax could not and would not constitute other than a compensatory levy, you will find in section 703 a new source of revenue and at the same time you will bring about a partial equalization of the unbalanced inequitable situation that now exists.

In addition, a witness appearing before this committee this morning proposed an excise tax on canned beef. Let me say at this point that we endorse that proposal. We strongly favor the proposed excise tax on imported canned beef.

In addition to my statement, if you please, Mr. Chairman, I should like to submit for the record a telegram which I have received from the Central Cooperative Association of Minnesota:

> The Central Cooperative Association is very much interested in retention of excise tax of 6 cents per pound on imported pork products and 3 cents on pork joints of internal revenue bill as passed by House. You can make this statement before Senate Finance Committee for us if you desire.

Mr. Chairman, unless there are some questions I thank you for the opportunity to present this statement.

The CHAIRMAN. Mr. Francis C. Flint, technical director, Hazel Atlas Glass Co.

STATEMENT OF FRANCIS C. FLINT, ZANESVILLE, OHIO, TECHNICAL DIRECTOR, HAZEL ATLAS GLASS CO.

Mr. FLINT. I am also past president of the American Ceramics Society.

Senator Bailey proposed an excise tax of $6 on nepheline syenite.

The CHAIRMAN. Have you prepared a brief on that?

Mr. FLINT. I have; but I will give a very brief statement of it.

I would like to call the committee's attention to glass manufacture. The fundamental basis of making glass using sand, soda, and lime produces bottles of a given average quality. For a period of years of research development gradually the use of alumina became common. In searching for a material to use to introduce alumina, feldspar was used in order to give these desirable qualities that the feldspar had in it. Feldspar also has in it some constituents that are not so desirable, and one of them is potash. After a number of years we have found material, nepheline syenite, which gives us this alumina that we desire but without the potash. Nepheline syenite costs $18 a ton delivered.

The CHAIRMAN. Where do you get that from?

Mr. FLINT. It comes from Canada. It is not found in the United States. I have brought a sample of the rock as it comes into the United States for $6 a ton. It is this material here. Its excise tax is equal to the value of the material. When this material is brought into the United States it costs another $6, and it is ground and put in this condition, and with a spirit approximately $6 a ton is delivered to the glass plants.

The CHAIRMAN. Is that necessary in the manufacture of glass?

Mr. FLINT. That is the thing I want to bring out. Glass can be produced without it, but not of such good quality. We would like very much to use alumina in glass; we would like to use it without the potash. We have not been able to get in the United States a material that will give us alumina without potash. We have tried a number of other minerals.

The CHAIRMAN. Are the chemists working on it all the time?

Mr. FLINT. Since the war this material has given us what we want. We have cut down the use of alumina during the depression when costs have been maintained, and we can cut it down by the sacrifice of some of the quality of the glass. We do not desire to do it.

There are one or two glasses that need it; opal glass which is used in the cosmetic trade has to have alumina in it. We would be forced to pay this higher price in order to use this material because though we used feldspar we have been handicapped, and now we have been able to improve the quality of the glass and to maintain production better than we ever could before. We do not desire and cannot under present conditions go back to the other material. However, for ordinary bottles and flat glass we can reduce the quality and considering that glass is a low-priced large-volume commodity, we would have to do so. That has been done.

This excise tax was offered, I believe, due to the feelings of the producers in North Carolina that nepheline syenite is competing directly with them. I am endeavoring to call to the attention of the committee the fact that it is not a replacement. It is giving us a material which we have searched for for some time and now finally have reached.

The CHAIRMAN. Do the manufacturers of North Carolina use this article?

Mr. FLINT. There are no glass plants in North Carolina. Glass plants are distributed pretty thoroughly across the United States. It is a large industry; the bottle industry alone employs around 30,000 men.

The CHAIRMAN. Why would the North Carolina people, if they are not interested in the manufacture of glass—what is it that is a substitute that they have?

Mr. FLINT. They have feldspar and they feel mistakenly that this is a competitor.

The CHAIRMAN. Your contention is that you are using all the feldspar that you can?

Mr. FLINT. And we will continue to use feldspar but we want to be able to use this material, and that if this commodity is put under a duty, it will shut out this material; shut out the progress that has been made.

The CHAIRMAN. Is there any duty now on this nepheline syenite?

Mr. FLINT. None at all.

The CHAIRMAN. Is there anything else you want to say?

Mr. FLINT. I should like to leave with you this information on nepheline syenite and feldspar industries.

(The paper referred to is as follows:)

INFORMATION ON NEPHELINE SYENITE AND FELDSPAR INDUSTRIES

NEPHELINE SYENITE

Definition.—Nepheline syenite is an alkaline silicate rock which contains the mineral nepheline as an essential constituent. With the nepheline may be combined various other minerals such as feldspar, pyroxene, amphibole, and accessory minerals such as the micas, magnetite, etc.

How used.—When ground and purified, it is used by approximately the same industries which use feldspar, namely in glassmaking and in pottery, chinaware, porcelain, ceramic enamels, etc.

Location of deposits.—No commercial deposits of nepheline syenite have ever been found in the United States. Canada has been, is, and probably will continue to be the sole source of this material for industries in the United States.

The Mineral Trade Notes of the United States Bureau of Mines for January 20, 1938, at page 24, says:

Owing to the growing demand for high-alumina feldspar and other silicates for container glass batches, some search has been made for domestic sources of nepheline. Occurrences in Arkansas have been known, but all samples tested by the Eastern Experiment Station of the Bureau of Mines were too intimately mixed with iron materials to permit making a concentrate acceptable to glassmakers. A deposit at Beemerville, N. J., about 3 miles long and one-fourth mile wide, looked much more promising, and upon preliminary examination material from Red Hill, N. H., looked even better, but the Bureau's laboratories were unable to get a reasonable iron-free product by mechanical means from such samples of either of these deposits as were tested.—Paul M. Tyler, Bureau of Mines.

Deposits of low-grade material are reported in Russia, where it is obtained as a byproduct from phosphate rock (apatite) production. It is very impure, but is reported to be used by local glass industries for low-grade glass products.

Work has been done in Germany on nepheline syenite.

Deposits are known in India and considerable work is being done on them as a source of nepheline syenite for the growing Indian-glass industry.

History.—Development work on Canadian deposits started about 1928 or 1929. About 1930 or 1931 samples of purified materials were sent to Ohio State University for experimental work. In 1936 the United States Potters Association suggested an extensive research by the Ohio State University into the use of this material in pottery. The first part of this work was completed and the results published in May 1937 (Use of Syenites in Semivitreous Ware, by C. J. Koenig, O. S. U., Eng. Exp. Sta. Bul. 94).

In the meantime development work on Canadian deposits was continued, a pilot processing plant built at Lakefield, Ontario, in 1935–36, and small shipments were made to the United States and Canadian glass plants during 1936. Trial runs in glass plants were so very interesting that a large United States glass producer urged the only (then) Canadian producer to build a plant in the United States to process the Canadian rock. With the aid of American capital an American company was formed, American Nepheline Corporation, and construction started in May 1937 on a plant at Rochester, N. Y. The plant was completed late in 1937 and small shipments made in that year. Due to mechanical difficulties the plant is, as yet, in partial operation.

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Size of the industry.—The industry, as yet, can hardly be said to have started. It is a very new industry, and United States plants are not yet in efficient production, so that production figures so far mean very little. In 1937 shipments from the Lakefield, Ontario, pilot plant to the United States probably did not average 500 tons per month. So far in 1938, combined shipments from the Lakefield and Rochester plants have not exceeded 1,000 tons per month. Except for small trial lots, all shipments have so far been made to glass plants, since no fine grinding unit (for pottery and enamel grades) has been built.

Investment, men employed, etc.—The American Nepheline Corporation has an investment at Rochester, N. Y., of about $350,000, and its affiliated Canadian company has a further investment of about $150,000. At the Rochester plant so far about 30 men are employed.

The New England Nephline Corporation is a wholly owned American company, the operators of which are also in the feldspar business. This plant and these people are not a part of this effort to have placed an excise tariff on nepheline. Their feldspar mined in New Hampshire would find itself more closely competitive than a material coming from as far south as North Carolina and Virginia. They feel that progress in the glass and ceramic business calls for the development of processes and the improvement of products, rather than by trying to force the customers to take old and unimproved materials. They are not fearful of the loss of business, but are anticipating an increase in their feldspar business because of these improvements and advancements which have been made and by adding new equipment and more men to the plant, rather than trying to go along in the older methods of operation. They do not want to substitute control of the industry by use of a tariff for monoplistic practices, nor aggressiveness for modern operation.

COMPARISON WITH FELDSPAR

While the physical and chemical properties of napheline syenite differ from those of feldspar, they are both used for much the same purposes and, of the ceramic materials available, nepheline syenite most closely resembles feldspar. Nepheline syenite may, for many uses, be said to supplement feldspar, rather than compete with or replace feldspar.

Feldspar production.—United States Bureau of Mines statistics for ground feldspar from "merchant mills"—excluding tonnage of crude ground by consumers for their own use—show that from 1922 to 1929 total sales rose from about 127,000 tons per year in 1922 to a pre-depression maximum of about 230,000 tons in 1929. Of these totals from 19,000 to 29,000 tons came from imported Canadian crudes annually. During the depression production dropped to a low in 1932 of about 108,000 tons (of which about 3,500 tons came from Canadian crude). Production has since risen to about 237,000 tons in 1936 (last year for which statistics are available), of which about 15,000 tons came from Canadian crude. Imports from Canada have not yet recovered their former position, due chiefly to the development of large deposits of Canadian-type spar in South Dakota. Glass uses about 120,000 tons a year.

With the exception of feldspar mined in Maine, for example, used in special processes, the feldspar had been located for a long time in the North Carolina district. This developed an attitude in that district that these operators controlled the feldspar industry, so much so that when the feldspar organization named delivered prices, then based them on the North Carolina district and it was impossible to get the producers to change this attitude. In spite of the fact that in the glass industry—which uses about 50 percent of the total ceramic feldspar—it would have liked very much to have obtained its alumina from sources more free from potash, there has been little effort on the part of the feldspar producers to locate materials which would do this. The prices named were high enough that the glass industry was rapidly losing interest in the use of the material. This was natural because alumina is not one of the basic constituents of glass, such being sand, soda, and lime. However, alumina is valuable in that it helps to improve the quality of the glass which every glassmaker is very desirous of doing. He cannot in the competitive condition of the industry afford to pay more than a certain amount for his raw materials. They are a large and necessary factor in his ultimate selling price of the glass. Therefore, as the price of feldspar was maintained at higher levels and the increased competitive situation in selling glass demanded economies, feldspar was slowly eliminated from the glass.

About this time the western producers from Colorado and South Dakota began to enter the market and the picture changed from a local North Carolina industry to a national one. The feldspar from the West is a very much better grade than that produced in North Carolina and, although nepheline is in part competitive with feldspar, it would not save the North Carolina feldspar production from competition in other districts.

The glass industry has looked for other materials as a substitute for feldspar such as kyenite, some clays, etc. They have endeavored to get these materials because they wanted to eliminate the potash which is a part of feldspar. The glass industry is not in the raw-material-producing business, but it has examined quite thoroughly other such products and found them not capable of giving the desired alumina content in a usable form. The feldspar industry, as it has been expending chiefly due to the introduction of more aggressive capital in the West, has been able to keep up the sale of feldspar to the glass industry. This spar is sold in the eastern territories in competition with the North Carolina product because it is better and these sales will continue regardless of the introduction of nepheline syenite, which will be used only in a portion of the glass industry where conditions warrant the effort to eliminate potash, which all glass spar contains.

If the glass industry now uses approximately 120,000 tons a year of feldspar, the future should hold at least about the same tonnage in view of the continuous growth of the glass industry. The percentage, however, will be somewhat less, for with the growth of the industry it should be able to absorb at least thirty or forty thousand tons of nepheline syenite, which is probably the limit of its productive capacity. From these figures it appears that nepheline syenite production has not yet reached even 5 percent of the domestic feldspar consumption.

Prices.—Nepheline syenite sells in the same price range as feldspar on a delivered basis. While theoretically 1 ton of nepheline syenite, due to its higher alumina content, will replace 1¼ to 1⅓ tons of feldspar in a glass batch, yet this really does not mean that it has that much price advantage, since most glass makers use them in the same quantities. If they did not, they would have to replace the one-fourth to one-third tons of feldspar with some other ingredient to make up the lost tonnage in the whole batch. The consuming trade in general will not pay the added price which the seeming advantage might give to nepheline syenite.

In pottery, chinaware, porcelain, etc., a nepheline syenite has no theoretical advantage due to its higher alumina content. The grades of nepheline syenite now available sell for $11 to $15 per net ton f. o. b. mill, depending on grade. Eastern feldspar sells from $10 to $19 per ton f. o. b. mill.

Chemical comparison.—Nepheline syenite and feldspar both contain soda, potash, alumina, and silica, but they exist in different ratios to one another. This results in different behavior when introduced into a glass batch or into a porcelain body or glaze. These different properties have given to all ceramic manufacturers a new raw material with which to work. It is the only new low-priced alkaline silicate flux material which has appeared in many years, and as such is of very great interest to all ceramic workers, both research and production men.

POSITION OF NEPHELINE SYENITE IN CERAMIC INDUSTRY

Nepheline syenite is so new that no one today can say what its position will be. It is in much the same position as cellophane was when it was first introduced, or as Duprene, the new artificial rubber. Duprene does not replace natural rubber, but supplements it. So, we believe, nepheline syenite will not replace feldspar, but supplement it. It will find new uses and new applications and result eventually in a larger use of alkaline aluminous fluxes rather than in replacing feldspar tonnage.

The ceramic industry has been based for a great many years on the use of clay feldspar and powdered silicate. Very little change has been made in the fundamentals of ceramic until recently. Studies made at universities and in commercial laboratories are now enabling the ceramic manufacturers to use materials which were heretofore considered inaccessible, such as talc, kyonite, etc. When these were first introduced into ceramic products, they were looked upon with fear by the feldspar industry, which felt that outside competition was encroaching on their prerogatives. The result of the introduction of these materials has been to help the feldspar industry, rather than to hinder it.

The ceramic manufacturers have to bear the burden of terrific competition in foreign materials for which labor rates are so low that they are not to be

compared with ours. The one thing that has helped keep the ceramic industry still in the picture has been the development and use of a broader variety of raw materials which have permitted the use of processes that enabled the industry to carry on. Contrary to the narrower belief, the use of these other ingredients has not cut down the use of feldspar, but helped to increase its volume because the total volume of the products has been maintained at a higher level than if the old-fashioned methods and materials had been used.

If these materials temporarily should come from a distance away, such as from Canada, it is only natural that if we can develop a source closer to the market at a later date, the material will be mined here, as well as being milled here, which is now the case.

TARIFF POSITION

Under the present tariff act and the present trade agreement with Canada, the following import duties are imposed:

	Feldspar	Nepheline syenite
	Percent	*Percent*
Ground	[1] 30	[1] 30
Crude	[2] 35	Free.

[1] Ad valorem.
[2] Per ton.

Canadian crude feldspar and Canadian crude nepheline syenite are both worth about $6 per ton, f. o. b. shipping points.

FRANCIS C. FLINT,
Technical Director,
Hazel Atlas Glass Co., Past President, American Ceramic Society.

The CHAIRMAN. Before the committee recesses, I desire to have placed in the record numerous letters, statements, and briefs submitted by interested individuals and organizations, relating either to provisions of the pending bill or suggesting amendments or changes.

NEW YORK, *March 21, 1938.*

The Hon. PAT HARRISON,
Chairman, Senate Finance Committee:

Please have recorded in official record of your hearings on tax revision before conclusion today on behalf of the American Steamship Owners' Association operators of approximately 4,000,000 tons of American-flag ocean-going ships, and the following amendment to the tax bill now being considered by your committee: "In section 702 (b) of the Revenue Act of 1938, line 17, after the words 'rapeseed oil,' add the following 'except as defined in paragraph 1732 of the Tariff Act of 1930'; or if it would be more satisfactory an amendment to read after said words 'rapeseed oil,' the words 'rendered unfit for use as food or for any other purpose than the manufacture of lubricating oils, by such means as shall be satisfactory to the Secretary of the Treasury.' Either amendment if adopted will be of material benefit to coastwise shipping by exempting it from the tax of 4½ cents per pound paid on rapeseed oil required as a lubricant for ships' engines and will be of additional assistance to American steamships operating in international commerce. This exemption of denatured rapeseed oil will, in no sense, injure any American producers of oils and fats since the commodity is not produced in the United States nor is any suitable substitute for use in steamship lubricating oils produced in the United States and will relieve shipowners of the constantly pyramiding costs of operation.

AMERICAN STEAMSHIP OWNERS' ASSOCIATION.

Memorandum Submitted by James D. Herrman on Behalf of the J. C. Groendyke Co., Miamisburg, Ohio

J. C. Groendyke Co. was established in Miamisburg, Ohio, in 1902 and became engaged in the business of manufacturing binder twine. With one exception, that is during the Dayton flood of 1913, the company has been in continuous and steady operation, providing employment for approximately 200 residents of the Miami Valley.

Binder twine was developed by the United States manufacturers more than 50 years ago for use in harvesting grain by the self-binder. The industry grew through development, and for many years supplied not only the American market but the foreign markets as well. The present annual consumption in the United States is about 200,000,000 pounds.

Binder twine is manufactured chiefly from henequen sisal, grown almost exclusively in Yucatan, Mexico. The finished product has always been on the "free" list. None of the grain-growing countries, other than Canada and the United States, permit the free entry of binder twine. Following the World War there was a great increase in fiber production in the East Indies and Africa, and these sources of supply joined with the European program of revival of industry, which led to a marked increase in the manufacture of binder twine in England, Ireland, Canada, Holland, Belgium, Mexico, and other countries. These countries began a concerted drive for world trade, and more particularly the American market.

Importations of binder twine increased from 12,000,000 pounds in 1925 to about 80,000,000 pounds in 1936. Exports of binder twine from the United States fell from 54,000,000 pounds in 1925 to less than 5,000,000 pounds in 1935.

Imports of binder twine in pounds are here shown for the years 1925 and 1936 to show the increase of imports of the product into the United States.

1925

	Pounds
Canada	6,798,430
Mexico	2,710,527
Cuba	635,769
Philippine Islands	32,850
Netherlands	787,469
Belgium	57,600
Germany	1,060
All other countries	53
Total	11,023,760

1936

	Pounds
Canada	9,163,214
Mexico	25,595,765
Cuba	5,010,543
Philippine Islands	101,701
United Kingdom	4,030,970
Netherlands	15,263,799
Belgium	12,807,297
Germany	None
British East Africa	3,968,800
All other countries	106,434
Total	75,038,523

The United States binder-twine industry is in present danger of being destroyed. Throughout its existence, the industry has realized its responsibility of the necessity of having enough manufactured twine each harvest to tie the crops despite the great varying crop conditions each year. This responsibility, a national necessity in time of war, has always been a point of honor in war or peace. But now, the industry generally is at a standstill, with production in all plants seriously curtailed and our plant in Miamisburg closed. Unless the present real dangers are quickly eliminated, the binder-twine industry in the United States will pass into oblivion and the American farmers will be dependent upon the foreign manufacturer.

Since Mexico is the chief producer of sisal from which binder twine is made, and since the American manufacturers have been the chief buyers of Mexican sisal, it was believed that some agreement might be made beneficial to Mexican growers, Mexican manufacturers, and American manufacturers. At the sug-

gestion of the Department of State, two conferences have been held in Mexico City, with representatives of these groups. Some progress has been made which may be beneficial to producers of Yucatan sisal, United States manufacturers, their employees, and American farmers.

What has caused this condition? A very great difference in labor costs exists between countries importing twine and the United States labor rates. As examples, in Mexico labor rates average 80 cents per day for an 8-hour day; in Cuba, $1 per day for an 8-hour day; in Great Britain and Ireland, 17 cents per hour for a 47-hour week; and in Holland and Belgium 11 to 12 cents per hour for a 48-hour week. The wage scale of American twine workers is from 45 to 55 cents per hour.

Foreign manufacturers are stimulated by Government concessions. As an example, for many months Mexican binder-twine manufacturers have been paying the Coopertiva (a Government controlled and operated sales agency for sisal growers) the sum of $3.40 (United States value) per 100 pounds for their fiber, while American manufacturers have been forced to pay the same agency $5.50 per 100 pounds for fiber of the same quality and for the same use. Then, too, tax and other concessions are made which amount practically to Government subsidation.

What has resulted from the above factors? Unfair competition practices which are destroying the binder-twine industry in the United States.

Sales offers have been received by American buyers from foreign manufacturers guaranteeing to sell at prices lower than any price that might be established by the American manufacturer. As a concrete example, it is possible to show that offers have been received directly by cable from Mexican manufacturers guaranteeing that the Mexican manufacturer's price will be 1½ cents per pound less than any American price that might be later established for twine to be used in the season which begins in the spring of 1938. The same practice of unfair competition has very recently occurred in offers received and sales made by Belgium manufacturers. The price of binder twine has always been established by the American manufacturers on a proper cost-plus basis in the spring of the year and then remains stable throughout the season.

The President of the United States is given authority (title 19, sec. 1337, U. S. Code, Annotated) to determine whether or not any unfair methods of competition and unfair acts in the importation of articles into the United States, or in their sale by the owner, importer, etc., are being practiced. And, if he finds that by reason of those acts there is a tendency to destroy or substantially injure an industry efficiently and economically operated in the United States, then he may forbid entry of such articles until an investigation is made such as the President deems necessary. Of course, a bond, satisfactory to the Secretary of the Treasury, may be given by the importer.

Because of this critical condition now existing, aid of the President is sought by J. C. Groendyke Co. to properly protect the company, its employees and their families. By so doing, this will also aid the employees and families of other companies in the binder twine industry through the creation of additional employment.

If the President is satisfied that such a condition does now exist, then it is requested that he issue an order such as he is permitted to do under the above cited act forbidding entry. After issuance of the order, such investigation as he deems necessary is respectfully invited to substantiate these statements regarding unfair competition and its result.

The evidence referred to relative to such unfair acts of competition cannot be obtained by private individuals, but it is known that full disclosure will be made to a proper Government official if the investigation sought is made.

There is another alternative means of protecting the American manufacturers, and that would be through the enactment of an amendment to the present revenue bill (H. R. 9682) which would provide for an excise tax on imported binder twine. It is respectfully suggested that if the Committee on Finance of the Senate desires to see that the American binder-twine industry continues in existence, that they enact an amendment to section 601 (c) of the Revenue Act of 1932 by adding at the end thereof a new paragraph as follows:

"SEC. —. Binder twine, 2 cents per pound. The tax on the article described in this paragraph shall apply only with respect to the importation of such article."

Respectfully submitted.

J. C. GROENDYKE CO.
By JAMES D. HERRMAN,
Its Representative.

STATEMENT OF BYRON G. CARSON, WASHINGTON, D. C., REPRESENTING THE OPERATIVE BUILDERS' ASSOCIATION OF WASHINGTON, D. C.

(Made before Ways and Means Committee, House of Representatives)

Mr. CARSON. Mr. Chairman and gentlemen, my name is Byron G. Carson, and I represent the Operative Builders' Association of Washington, D. C.

Mr. CULLEN. How much time will you require?

Mr. CARSON. About 15 minutes.

Mr. CULLEN. Can you not make it 10 minutes?

Mr. CARSON. I will try.

Mr. SANDERS. To what recommendations of the report are you going to direct your remarks?

Mr. CARSON. They will be in connection with the committee's recommendation No. 19, which pertains to section 353 of the Revenue Act of 1936, as amended by the Revenue Act of 1937, and a proposition concerning allowing corporations engaged in this type of business to use their earnings to pay certain debts that arise in connection with their operations.

Mr. SANDERS. Have you prepared language for your proposed change in the recommendation?

Mr. CARSON. No; I have not prepared specific language. I am adopting the language, however, in the brief of the National Association of Real Estate Boards, whose view is the same as that of the Operative Builders' Association.

Mr. SANDERS. You will cover that in your statement?

Mr. CARSON. Yes, sir. Before proceeding to the discussion of the points involved I want to state to the committee that the Operative Builders' Association is a voluntary association existing here in Washington, and I understand there are similar associations in most of the cities of the country. The assocation is composed of members who are engaged in the building of homes and commercial buildings for resale. The members of the Operative Builders' Association in this city accounts for more than 50 percent of all of the private building which is done in the city of Washington, and in doing so, of course, they employ a considerable number of men and purchase and consume a considerable quantity of commodities.

The source of income of the members of the Operative Builders' Association——

Mr. CULLEN (interposing). Do you represent any other operatives outside of the city of Washington?

Mr. CARSON. I do not directly, sir. We are acting in cooperation with the National Association of Real Estate Boards, which has filed a brief that in part includes our objectives, but I am not directly representing them. I was in hopes that General McChesney from the National Association would be here to speak on behalf of points in their brief, but he is not listed on the calendar, I notice.

The members of this association have income principally from three sources:

First, the cash that they receive upon sale of a home or a building;

Second, a second-trust note which is really second mortgage; and

Third, some rents. The first trust generally is assumed by the purchaser.

So that we have this situation—that a member of the Operative Builders' Association who has developed a subdivision or built a home will receive a cash deposit upon the purchase of the home and also receive a second-trust note. If the market is slow, he may put a person into a home and receive rent from that person until such time as the market is active, when he may sell the same.

Now, the interest which is received upon a second-trust note becomes personal holding company income by virtue of the provisions in section 353 of the Revenue Act of 1936, as amended. The rents also constitute personal holding company income under the provisions of that act unless rents exceed 50 percent of all income.

The amount received in cash upon the sale of a home or a building is not personal holding income, but particularly in inactive years, this would amount to only a small proportion of the gross income.

Most of the corporations in the Operative Builders' Association are what would be called close corporations, in fact, in many cases they will be composed of only one individual, but it is found necessary to incorporate because of the title complications making it more advantageous to operate as a corporation; if an individual is a married man and he takes title to property in his name, it is necessary to secure the signature of his wife to a deed when the property

is sold. The same thing applies where two or three persons may own an unincorporated business. It is much more expedient to operate as a corporation. However, these are bona fide operating companies building homes for resale—building buildings for resale—and are not the type of corporation which was aimed at in the provisions of the Revenue Acts of 1934 and 1936 as personal holding companies. None of the abuses which were sought to be corrected by that legislation apply in this case.

The Operative Builders' Association endorses and recommends to the full committee the recommendation No. 19 of the subcommittee, which would treat as rents the interest which members may receive upon the second-trust notes. We feel that that will in most cases prevent the imposition of a heavy tax that should not be placed upon a bona fide operating company.

The second proposition, which is of some concern here, is this: These corporations develop subdivisions. They incur expense in laying out streets and improvements, which necessarily must precede the building of homes. In so doing it is usually necessary for them to borrow capital to aid them in the financing of those operations. Then will come a time when the earnings start to flow in from these operations, but usually the indebtedness which they are carrying on the money which they have borrowed and which must be currently repaid will offset and sometimes even exceed the earnings, particularly in the earlier years. It greatly hampers the development of subdivisions and the building of homes on any large scale, and they feel that they could go along further with the expressed desires of the administration to build homes if they were allowed to deduct against their gross income any bona fide indebtedness incurred in connection with a development which they are fostering.

In the brief which was filed with the subcommittee by the National Association of Real Estate Boards that matter is very fully gone into, and I urge the committee to take notice of the contents of that brief, because it very much in detail covers that situation.

Mr. SANDERS. Does it cover the details of the plan?

Mr. CARSON. It is in the brief that was filed with the subcommittee, sir, the specific recommendation upon it.

The third point which I wish to lay before this committee does not concern the Operative Builders' Association, but concerns the undistributed-profits surtax. I am a tax practitioner and have recently had contact with several cases where they are concerned with this undistributed-profits surtax. I notice that in the recommendations of the subcommittee there is a proposal to allow what amounts to a $25,000 credit in the determination of the adjusted net income credit. I want to say that I feel that such a credit will be, of course, of assistance to the smaller corporations, but I feel that the larger corporations, whose welfare perhaps may be more important than that of the smaller corporations from the standpoint of the ultimate effect upon the country in general, need help too. For instance, I feel that if a large corporation, through lack of any "cushion" to tide it over a bad year, is forced out of business, that the larger number of people who will be deprived of employment, and the decreased consumption of commodities that would have been used by that corporation, probably will be more serious than would be the case with smaller corporations.

I want to suggest to the committee that they consider the advisability of doing away with the proposed specific credit of $25,000, and that a credit based upon a percentage of the earnings in relation to the capital of the corporation be used. For instance, I feel that if the committee were to provide that in determining the adjusted net income, there could be a reserve of, say, from 5 to 10 percent of the amount of the capital—and I would take the capital declared by a corporation for capital stock tax purposes—that that amount might be used, and then you would take care of the small corporations as well as the large corporations; you would then be putting them all on the same basis. You could provide that the reserves accumulated should never exceed a sum of, say, 25 percent, and I feel that you could still protect yourself as to the revenues you are seeking and yet that there would be no distinction and no discrimination as between the smaller corporations and the larger corporations.

Mr. SANDERS. In lieu of the $25,000?

Mr. CARSON. In lieu of the $25,000.

Mr. CULLEN. You are opposed to the $25,000?

Mr. SANDERS. I am not opposed to it, sir, if that is the only remedy and the only relief that can be afforded. I feel, however, that there should be some relief afforded so that some sort of a "cushion" can be provided for all corporations.

That concludes my statement, gentlemen. I thank you for your consideration.

Mr. CULLEN. Do you wish to incorporate your statement in the record?

Mr. CARSON. I would like to have it incorporated in the record.

Mr. CULLEN. Without objection, it may be done.

Mr. DUNCAN. Mr. Carson, have you gone over the committee's recommendation No. 19?

Mr. CARSON. I have.

Mr. DUNCAN. I am interested in this matter, and I might say that the subcommittee in considering it felt that every consideration ought to be given to operative real-estate companies, to encourage them in every possible way. Do you feel that the proposed change, as indicated by recommendation No. 19, will specifically take care of the holding companies—I mean the operating companies?

Mr. CARSON. As far as the members of the Operative Builders' Association of Washington, D. C., are concerned, I feel that it will. I understand from the National Association of Real Estate Boards that they are apprehensive, however, that there will be cases where the limitation of 50 percent on the rent is too high and should be cut back to 25 percent. And by that I mean this: That while rents will not constitute personal-holding-company income under the law, if they exceed 50 percent of the entire gross income, I am informed that in some parts of the country there are organizations and corporations where the rent may not attain 50 percent, and that they have other (sec. 353) income which make up 80 percent personal-holding-company income, and the limitation should therefore be put back to 25 percent to protect those cases.

Mr. DUNCAN. Under this suggestion, if interest is considered as rent, is it likely that when it is added to rent it will relieve that situation?

Mr. CARSON. As far as the members of our local association go, my answer is "Yes." I am informed, however, that as far as the situation in many other cities goes, that is not so, and I can explain the reason that is not so in this way: I understand that it has been found necessary in some cities to incorporate the operating or building company separately from the finance company that financed the operation, and that in so doing, dividends enter into the picture, so that you might have a situation where there would be, we will say, 40 percent of the gross income in rent and perhaps 45 percent would be dividends from the operating company, and that would make up 85 percent personal-holding income, if the 50 percent limitation does stand. But I am not familiar with that situation. It comes to me entirely by hearsay, and I do not believe it will exist in the city of Washington.

Mr. DUNCAN. As a matter of fact, these operating companies have a large portion of their income tied up in second mortgages, do they not?

Mr. CARSON. A great deal of it, sir.

Mr. DUNCAN. That is their profit?

Mr. CARSON. That is it.

Mr. DUNCAN. And if that is added to the rent, that is, the rents of the property which they may be required to take back under foreclosures and that sort of thing, it will render, if nothing can be obtained, it will render difficult assistance to those corporations?

Mr. CARSON. Correct.

Mr. DUNCAN. That will be desirable in carrying on a development building program?

Mr. CARSON. That is correct.

Mr. DUNCAN. That is all.

MEMORANDUM SUBMITTED BY MR. C. M. TRAMMELL, WASHINGTON, D. C.

MARCH 18, 1938.

MEMORANDUM TO COMMITTEE ON FINANCE, UNITED STATES SENATE

In lieu of appearing personally before the committee to suggest certain administrative changes in the revenue law, I am taking the liberty to submit a memorandum with respect to the reasons for the suggested changes, together with a form of such changes as would seem to be necessary in order to carry into effect the amendments suggested.

I will state that in suggesting these various changes for the sake of fairness in the administration of the law, that these are some administrative defects

which have been forcibly called to my attention in my long experience in the Bureau and on the United States Board of Tax Appeals, as well as in my practice after leaving the Board of Tax Appeals, and in suggesting these changes I do not represent any particular client.

Respectfully,

C. M. TRAMMELL.

MEMORANDUM RE PROPOSED AMENDMENTS TO REVENUE ACTS

The proposed amendments to the various revenue acts which are annexed hereto are designed to grant to the Commissioner of Internal Revenue the power to correct errors made by him in the making of jeopardy assessments and thus to remedy the situation which apparently exists at the present time.

The Board of Tax Appeals has held that it has no power to review the action of the Commissioner in making a jeopardy assessment and that the Commissioner's determination in this regard is final until such time as the Board has redetermined the tax liability of the particular taxpayer involved. *California Associated Raisin Co.* (1 B. T. A. 1251); *Couzens* v. *Commissioner* (11 B. T. A. 1040 at 1157); *Vecder* v. *Commissioner* (10 B. T. A. 884, aff'd. 36 Fed. (2) 342).

The Commissioner has been advised by his general counsel that once a jeopardy assessment has been made and a petition for the redetermination of the deficiency upon which such assessment is based has been filed with the Board of Tax Appeals, he has no power to vacate or in any way to modify such assessment until the decision of the Board has become final. It thus appears that taxpayers can obtain no relief from a jeopardy assessment, no matter how erroneous and regardless of the fact that the Commissioner may discover his error and wish to correct it.

This unfortunate situation may frequently arise. It is often necessary for the Commissioner to make a jeopardy assessment before the examination or field audit of the Bureau of Internal Revenue has been completed and, consequently, before the asserted deficiency of the taxpayer is accurately computed. In such cases the Commissioner must of necessity make such assessment on the basis of whatever information is available to him. Likewise, a jeopardy assessment may be made on the basis of information apparently showing the necessity therefor, which information may subsequently be determined to be without foundation, or on the basis of facts which cease to exist after the making of the jeopardy. As a result, the Commissioner may subsequently determine that no jeopardy in fact exists, or that the assessment originally made is excessive and without foundation in whole or in part. In such circumstances there should be some means of correcting an error which unjustifiably places the taxpayer involved in constant jeopardy and which may destroy him economically merely because of a lack of adequate administrative power.

It is believed that the basis of the Commissioner's present position that he is without power to vacate or modify a jeopardy assessment is the provision of section 322 (c) of the Revenue Act of 1936 and prior revenue acts and similar sections relating to estate and gift taxes, prohibiting the allowance of credits or refunds with respect to jeopardy assessments after a petition has been filed with the Board of Tax Appeals. It is, therefore, proposed to amend such sections of the various revenue acts to postpone the prohibition until such time as the Board renders its decision.

It is also proposed to amend section 273 of the Revenue Act of 1936 and prior revenue acts and the related sections dealing with estate and gift taxes, by adding thereto a new subsection specifically empowering the Commissioner to vacate or reduce a jeopardy assessment whether or not a petition has been filed with the Board of Tax Appeals, and to cancel or reduce any bond which may have been filed with respect to such assessment. It is believed that these amendments, while affording complete protection to the Government, will remedy the existing situation whereby taxpayers may unjustly be jeopardized solely because of an apparent lack of power on the part of the Commissioner and of the Board to correct an obvious error.

In order to make the foregoing fully effective, it is also proposed to amend section 3186 of the Revised Statutes, relating to the release of liens, so as to permit the release of a lien where an assessment has been abated or vacated and also, in the case of jeopardy assessments, where the collector has been furnished with a bond conditioned upon the payment of so much of the amount assessed as is not abated by a decision of the Board which has become final. This amendment will permit the collector to carry out any determination by the Commis-

sioner to vacate or reduce an erroneous jeopardy assessment and thus relieve the taxpayer from the burden of a lien which is wholly unnecessary for the protection of the Government.

Section 3186 of the Revised Statutes, as amended, provided for the release of property from lien only upon giving bond conditioned upon the payment of the amount assessed, regardless of the fact that the Commissioner may subsequently determine that no tax is actually due. The assessment once made must be paid regardless of the fact that the Commissioner himself recognizes that he has made an obvious error and that the tax is not due. It would seem that it would be in the interest of taxpayers generally to have these various administrative provisions amended to give the Commissioner power to correct errors which are found by him.

The result of the operation of the present law is that—

First: If the Commissioner asserts a jeopardy assessment for 2 years and one petition is filed before the Board of Tax Appeals involving those 2 years, later the Commissioner may file an answer admitting that there is no tax due for one of the years, yet he has no power either to reduce the jeopardy or reduce the jeopardy assessment when he admits there is no tax due.

Second: In a case where the Commissioner makes a jeopardy and he himself ascertains that he has made an error and that there is no jeopardy under the present law he has no power to correct his mistake.

Third: Under the present law when a jeopardy assessment is made with liens upon assets, there is no means now under the law to release those liens, except in certain exceptional cases not material on this point, even by giving a bond, unless that bond is conditioned upon a payment of tax assessed, notwithstanding the fact that the Commissioner determined that the assessment is erroneous.

These are purely administrative changes suggested in the interest of fairness and in no sense affect the collection of the revenue.

PROPOSED AMENDMENTS TO REVENUE ACTS

Section 273 of the Revenue Acts of 1936, 1934, 1932, and 1928 and section 312 of the Revenue Act of 1926 are hereby amended by adding thereto the following subsection:

"(k) Subject to such regulations as the Commissioner, with the approval of the Secretary of the Treasury may prescribe, the Commissioner may vacate or reduce a jeopardy assessment or the unpaid portion thereof, at any time after the making of the assessment, whether or not a petition has been filed with the Board of Tax Appeals, and if a bond has been previously filed, it may be canceled or reduced to such amount as the collector deems adequate to assure the collection of any deficiency which the Commissioner believes to be due."

Section 279 of the Revenue Act of 1926 is hereby amended by adding thereto the following subsection:

"(1) Subject to such regulations as the Commissioner, with the approval of the Secretary of the Treasury may prescribe, the Commissioner may vacate or reduce a jeopardy assessment or the unpaid portion thereof, at any time after the making of the assessment, whether or not a petition has been filed with the Board of Tax Appeals, and if a bond has been previously filed it may be canceled or reduced to such amount as the collector deems adequate to assure the collection of any deficiency which the Commissioner believes to be due."

Section 514 of the Revenue Act of 1932 is hereby amended by adding thereto the following subsection:

"(j) Subject to such regulations as the Commissioner, with the approval of the Secretary of the Treasury may prescribe, the Commissioner may vacate or reduce a jeopardy assessment or the unpaid portion thereof, at any time after the making of the assessment, whether or not a petition has been filed with the Board of Tax Appeals, and if a bond has been previously filed, it may be canceled or reduced to such amount as the collector deems adequate to assure the collection of any deficiency which the Commissioner believes to be due."

Section 1105 of the Revenue Act of 1932, as amended, is hereby amended by adding thereto the following subsection:

"(c) Subject to such regulations as the Commissioner, with the approval of the Secretary of the Treasury may prescribe, the Commissioner may vacate or

reduce a jeopardy assessment or the unpaid portion thereof, at any time after the making of the assessment, and if a bond has been previously filed, it may be canceled or reduced to such amount as the collector deems adequate to assure the collection of any deficiency which the Commissioner believes to be due."

PROPOSED AMENDMENTS TO REVENUE ACTS

The first sentence of section 322 (c) of the Revenue Acts of 1936, 1934, 1932, and 1928 is hereby amended to read as follows:

"If the Commissioner has mailed to the taxpayer a notice of deficiency under section 272 (a) and if the taxpayer files a petition with the Board of Tax Appeals within the time prescribed in such subsection, *and the Board has rendered its decision*, no credit or refund in respect of the tax for the taxable year in respect of which the Commissioner has determined the deficiency shall be allowed or made and no suit by the taxpayer for the recovery of any part of such tax shall be instituted in any court except * * *."

The first sentence of section 284 (d) of the Revenue Act of 1926 is hereby amended to read as follows:

"If the Commissioner has mailed to the taxpayer a notice of deficiency under subdivision (a) of section 274 and if the taxpayer, after the enactment of this act, files a petition with the Board of Tax Appeals within the time prescribed in such subdivision, *and the Board has rendered its decision*, no credit or refund in respect of the tax for the taxable year in respect of which the Commissioner has determined the deficiency shall be allowed or made and no suit by the taxpayer for the recovery of any part of such tax shall be instituted in any court except * * *."

The first sentence of section 528 (c) of the Revenue Act of 1932 is hereby amended to read as follows:

"If the Commissioner has mailed to the taxpayer a notice of deficiency under section 513 (a) and if the taxpayer files a petition with the Board of Tax Appeals within the time prescribed in such subsection, *and the Board has rendered its decision*, no credit or refund in respect of the tax for the calendar year in respect of which the Commissioner has determined the deficiency shall be allowed or made and no suit by the taxpayer for the recovery of any part of such tax shall be instituted in any court except * * *."

The first sentence of section 319 (a) of the Revenue Act of 1926 is hereby amended to read as follows:

"If the Commissioner has mailed to the executor a notice of deficiency under subdivision (a) of section 308 and if the executor after the enactment of this act files a petition with the Board of Tax Appeals within the time prescribed in such subdivision, *and the Board has rendered its decision*, no refund in respect of the tax shall be allowed or made and no suit for the recovery of any part of such tax shall be instituted in any court except * * *."

NOTE.—New matter set in italics.

PROPOSED AMENDMENTS TO REVENUE ACTS

Section 3186 of the Revised Statutes, as amended, is amended to read in part as follows:

"* * * (c) Subject to such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, the collector of internal revenue charged with an assessment in respect to any tax—

"(1) May issue a certificate of release of the lien if the collector finds that the liability for the amount assessed, together with all interest in respect thereof, has been satisfied, *or that the assessment has been abated or vacated* [or has become unenforceable];

"(2) May issue a certificate of release of the lien if there is furnished to the collector and accepted by him a bond *(1)* that is conditioned upon the payment of the amount assessed *or, (2) in case of a jeopardy assessment of income, war-profits, excess-profits, estate, or gift taxes, that is conditioned upon the payment of so much of the amount assessed as is not abated by a decision of the Board of Tax Appeals which has become final*, together with all interest in respect thereof, within the time prescribed by law (including any extension of such time) and that is in accordance with such requirements relating to terms, conditions, and form of the bond and sureties thereon, as may be specified in the regulations * * *."

NOTE.—New matter set in italics. Matter in brackets to be eliminated.

MEMORANDUM SUBMITTED BY MR. RAY MURPHY, ON BEHALF OF THE ASSOCIATION OF CASUALTY AND SURETY EXECUTIVES, NEW YORK CITY

BEFORE THE FINANCE COMMITTEE OF THE SENATE OF THE UNITED STATES

Statement of Association of Casualty and Surety Executives in the matter of taxation of insurance companies other than life or mutual

PRELIMINARY

The membership of this association consists of executives of 61 capital-stock casualty and surety companies doing business in the United States.

Capital-stock companies doing 75 percent of the insurance business in the United States pay 99 percent of all taxes paid to the Federal Government by all insurance companies of the country. Such capital-stock companies pay 97½ percent of the total of all taxes paid by all United States insurance companies to all the States.

* * * * * * *

H. R. 9682, section 204, as passed by the House, provides that there shall be levied, collected, and paid for each taxable year upon "the special class net income" of every insurance company (other than a life- or mutual-insurance company) a tax of 16 percent of the amount thereof.

This constitutes an increase of 1 percent in the rate applicable to such companies as provided in the Revenue Act of 1936 and an increase of 6⅔ percent of taxes paid.

To arrive at "Special class net income" the credit provided by section 26 (b) of H. R. 9682 is deducted from "Adjusted net income." Such credit is 85 percent of the amount received as dividends from a domestic corporation which is subject to taxation under this title but not in excess of 85 percent of the "adjusted net income."

Thus a definite limit or ceiling is established, differing from the 1936 act, and compelling the use of the lesser of (1) 85 percent of such dividends, or (2) 85 percent of the adjusted net income.

The effect of the proposed change will not be uniform, depending upon whether a company shows an underwriting profit or an underwriting loss. For example:

A. COMPANY WITH UNDERWRITING PROFIT

OLD LAW

Taxable net underwriting gain	$128,000
Taxable net investment dividend	242,000
Total	370,000
85 percent of dividends	206,000
Net tax income	164,000
Tax at 15 percent	24,600

PROPOSED LAW

Taxable net underwriting gain			128,000
Taxable net investment dividend			242,000
Total			370,000
85 percent of dividends	$206,000	use lesser	206,000
85 percent of net tax, inclusive	314,000		
Total			164,000
Tax at 16 percent			26,000

B. COMPANY WITHOUT UNDERWRITING PROFIT

OLD LAW

Taxable net underwriting gain	$128,000
Taxable net investment dividend	242,000
Total	114,000
85 percent of dividends	206,000
Total	82,000

NOTE.—No tax due.

PROPOSED LAW

Taxable underwriting gain	128,000
Taxable investment gain	242,000
Total	114,000
85 percent of dividends, 206,000 } use lesser 85 percent of net tax income, 97,000 }	97,000
	17,000
Tax at 16 percent	2,720

It thus appears that under the provisions of H. R. 9682 a company without underwriting profit would be required to pay a tax, unless its underwriting deficit were equal to or in excess of its investment income. While it may be said that companies quite generally showed underwriting profits in 1936 and 1937, it is also true that in 1935 and previous years many companies showed underwriting losses, a condition which may return, and, in periods of depression, is likely to return; and that therefore there is always danger in such provisions to the continued solvency of the companies. They cannot indefinitely continue to operate if underwriting losses are incurred, especially when such losses are aggravated by a tax upon the investment income of such nature as H. R. 9682 provides.

CONCLUSION

It is generally realized that if relief is to be afforded to business and affected taxpayers through repeal or modification of certain provisions of the 1936 act, it is nevertheless the great responsibility of the Congress to provide means for obtaining the revenue necessary to maintain essential governmental services and to meet the appropriations provided by law; that to the extent required new revenues must be added and remaining levies augmented to take the place of those eliminated.

We believe that a case can be made against Federal taxation of insurance companies. Their supervision in the public interests is constitutionally and properly, solely the prerogative of the several States. The companies not only fully pay for such State supervision but they contribute heavily through additional taxation to the general funds of the States. The cost of supervision by the States is only a small percentage of the taxes paid the State by the companies.

Nonetheless, we appreciate the special difficulties which confront the Congress in this trying period of national and international stress.

Therefore we at such a time only respectfully ask for careful consideration of the proposal to increase the rate from present 15 to 16 percent, as provided in H. R. 9682, and that if found consistent with the public welfare no increase of rate be made; and especially do we ask that careful consideration be given to the matter of dividend credits.

We believe that the provisions of the 1936 Revenue Act in this respect are fairer and sounder than the related provisions of H. R. 9682, and that for the benefit of companies operating at an underwriting loss the "ceiling" provision should be stricken.

Respectfully submitted.

RAY MURPHY,
Assistant General Manager.

A STATEMENT BY W. R. HOPKINS, PRESIDENT, HAZELETT METALS, INC., NEW YORK CITY, IN SUPPORT OF AN APPEAL FOR A MODIFICATION OF THE DEFINITION OF PERSONAL HOLDING COMPANIES

This company has from its inception been actively and exclusively engaged in the business of perfecting, applying, and bringing into general commercial use the inventions of C. W. Hazelett for the fabrication of molten metal directly into sheets, strips, and other shapes. It is not and never has been a real holding company but does happen to fall within the tax-law definition of such companies. It was organized to furnish the financial and business support necessary for the perfection, expansion, patenting, and commercialization of inventions too far-reaching to be effectively handled by any individual inventor.

Since it acquired these inventions in January 1933, the company has devoted all its energies and resources to the active business of perfecting and extending the Hazelett inventions, securing patents on them (35 in 27 countries), negotiating 9 licenses under them in this country (3 in Canada, 2 in Great Britain, 1 each in Germany, France, and Italy, and 3 in Japan), and in designing and supervising the building of Hazelett mills for 5 licensees in this country, 3 in Japan, and 1 in Germany. For its work the company developed and maintained a skilled technical organization under the personal direction of Mr. Hazelett. Without such organization and work the royalties derived from the inventions in various metal fields could not have been realized. If the company should now limit its operations to holding its patents and collecting royalties on their use, there would soon be no royalties to collect.

These inventions, the only property the company holds, have yielded and can be made to yield income only by intense and continuous efforts and expenditures to perfect them, protect them by adequate patents, apply them successfully in various metal fields, protect them from infringement, and keep them superior to all others. Without the leadership and direction of Mr. Hazelett himself this would have been, and still is, impossible and there would have been, and will not be, income on which taxes could be levied.

In addition to the fact that in 5 years the company has obtained 35 patents in 27 countries and has negotiated licenses with nearly a score of great companies here and abroad, deriving 47.75 percent of all its income from foreign countries, we submit the following figures to indicate the nature and extent of its activities:

	1933	1934	1935	1936	1937	Total
Gross receipts from royalties:						
Domestic	7,000	72,500	105,000	57,095	34,025	275,620
Foreign	10,000	37,500	35,000	50,000	70,000	202,500
Total	17,000	110,000	140,000	107,095	104,025	478,120
Profits from mills constructed:						
Domestic	11,285		9,638		159	21,082
Foreign				34,196	34,449	68,645
Total	11,285		9,638	34,196	34,608	89,727
Expenses, patent and royalty accounts:						
Salaries	10,234	11,867	12,400	12,400	12,817	59,718
Wages	5,114	7,200	8,642	10,285	16,406	47,647
Legal	5,551	12,394	17,216	12,530	12,149	59,840
Patents purchased		8,449	524			8,973
Commissions	2,500	1,500	1,000	4,676	8,501	18,177
Research and other expenses (taxes not included)	7,158	16,882	7,563	9,355	7,336	48,294
Total	30,557	58,292	47,345	49,246	57,209	242,649

New problems in the application of the Hazelett process to the production of steel and brass require increasing expenditures for equipment and pay rolls for experimental work.

The company has never had any property other than the inventions acquired from Mr. Hazelett and patents acquired from others to protect these inventions and equipment necessary to carry on research and experimental work. It has never had any income excepting from licenses, royalties, and engineering services rendered to its licensees. It has never been, in any true sense, a holding company but has, nevertheless, come within the scope of the law relating to personal holding companies. This situation arises from the fact that

a majority of its stock is owned by less than five persons and the further fact that in most years more than 80 percent of its gross income falls under the classification of "royalties." The company has therefore been unable since 1934, without the payment of excessive dividends or the payment of special taxes as a personal holding company, to establish proper reserves for the protection of its patents against infringement, which it is under obligation to do under the terms of all its licenses, and increase its expenditures for experiment and research.

The company finds it impossible to escape either of the two tests which the law provides to fix the character of personal holding companies. A majority of its stock is owned by less than five people who are responsible for its past success and indispensable to its future success. In the ordinary course of events its income will consist more and more exclusively of royalties. In the past it has had substantial earnings from supplying mills to licensees, but this was done chiefly to insure successful operation and so expedite the collection of royalties. In the future there will be less of this business.

It would, therefore, appear that relief can be had only by exempting from the classification of personal holding companies all companies which are actively and primarily engaged in the development, improvement, and commercialization of inventions.

It is, therefore, respectfully submitted that this company is, upon the facts and its record, entitled to relief from classification as a personal holding company, and we respectfully request action by the committee which will be appropriate to that end.

HAZELETT METALS, INC.,
By W. R. HOPKINS, *President.*

NEW YORK, *March 18, 1938.*

The Honorable PAT HARRISON,
The United States Senate, Washington, D. C.

BROADENING THE TAX BASE

MY DEAR SENATOR: I enclose a copy of a letter which I recently wrote to the New York Times and which they published with certain omissions on February 26, last. I do this in the hope that the suggestions therein will be helpful to you in your consideration of this subject.

Greatly as the common good would, in my judgment, benefit at this time from the removal of several particularly evil forms of taxation, I am convinced that a broadening of the tax base and a moderation of the punitive rates on larger incomes are of even more vital importance.

There has never been any question in my mind that where the franchise is broad the tax base should also be broad. By the adoption of a graduated normal tax for individuals the ability-to-pay theory can still be retained. Furthermore, if the suggestion contained in my letter to the Times could be adopted, I feel confident that even with a reduction of surtax rates to a high bracket of say 35 percent, more revenue would be collected than under the suggestion contained in the 1938 revenue bill.

Very truly yours,

DONALD ARTHUR.

To the EDITOR OF THE NEW YORK TIMES:

In 1936 the population of the United States was estimated at 128,000,000. In the presidential election that year there were some 45,000,000 votes cast. According to preliminary estimates there were 2,000,000 individuals who paid income tax in 1936 upon 1935 income. It is true that some 4,000,000 individual returns were filed, but of that number approximately half showed no tax payable.

From these figures the astounding fact emerges that more than 95 percent of the voters of the United States paid no direct Federal income taxes.

In 1918, some 20 years ago, the honorable Daniel C. Roper was Commissioner of Internal Revenue and a very excellent one he was. Faced with the administration of the first really intricate income- and excess profits-tax law, he called upon many practicing accountants and lawyers to assist the Bureau of Internal Revenue. On his own initiative he was successful in creating and maintaining a fully cooperative spirit between the Bureau and the taxpayers, which is sadly lacking today. In the fields of both legislative action and

Bureau administration there is at the present time an evident lack of fairness which is justifiably resented by taxpayers. Face-saving in the preservation or attempted preservation of demonstrably wrong principles seems to be the order of the day.

Among other suggestions made to Mr. Roper in 1918 were the following:

(1) That the work of the Bureau be decentralized by having a Commissioner with full authority to settle tax difficulties appointed in each congressional district; and

(2) To broaden the tax base so that a substantially larger proportion of voters would become direct-income taxpayers and take a keener interest in government.

Mr. Roper thought both suggestions were good but that they were politically inexpedient. I think what he really meant was that they were inexpedient for politicians—an entirely different thing. The same situation holds true today.

I believe, with many, that the capital-gains tax as it stands is a real flaw in our system of taxation. I also believe that the Siamese twins—the capital-stock tax and the excess-profits tax—are vicious. More recently, in common with countless others, I have thought that the undistributed-profits tax has no proper place in our tax structure.

While these three features of our present tax law are important and should be repealed, I am convinced that as compared with the question of broadening the tax base they are of minor significance.

In my opinion (after an experience of over 20 years as an adviser in tax matters) personal exemptions should be materially reduced and a graduated normal tax should be substituted for our present flat rate tax. The graduation might run from 1 percent on low incomes to 15 percent on high incomes and our present surtax rates should be reduced to a high bracket of say 35 percent so that the aggregate tax on those in the highest brackets, that is normal plus surtax, would be less than 50 percent. I think it can be demonstrated that the loss in tax by reducing the surtax rates would be much more than offset by the increases resulting from reduction in the exemptions and the increase in the normal tax, not to mention the immeasurable long-term benefits to the revenue to be expected upon freeing commercial initiative and the motive for investment in productive ventures from the stifling effect of present confiscatory tax rates.

Furthermore, there should be no question that the increase in the normal tax suggested would produce sufficient revenue to warrant Congress in greatly modifying, if not entirely eliminating, the present indirect taxes, which it is claimed fall most heavily, dollar for dollar, on the low-income class of our population.

It is of great interest to know that in England Mr. Gladstone in 1876 fought strenuously in the House of Commons against a proposed reduction in income tax through the medium of an increase in personal exemptions. (He condemned an increase in the exemption from £100 to £150). The gist of his argument was not that he disapproved of the income tax but that to reduce or eliminate the tax on low incomes was the first step toward the introduction of communism. With conditions as they are today in the United States it seems unnecessary to point out what a true prophet Gladstone was 62 years ago.

FEBRUARY 23, 1938. DONALD ARTHUR.

NATIONAL LAWYERS GUILD,
Washington, D. C., March 14, 1938.

HON. PAT HARRISON,
Chairman, Senate Committee on Finance,
Senate Office Building, Washington, D. C.

DEAR SENATOR HARRISON: Enclosed herewith you will find a copy of a resolution supporting the principle of the undistributed-profits tax passed at the recent convention of the National Lawyers Guild. This resolution is called to your attention as evidence of support of the principle of the undistributed-profits tax.

The National Lawyers Guild stands behind this tax and urges its retention in the present tax bill.

Sincerely yours,

MORTIMER RIEMER, *National Secretary.*

54886—38——41

RESOLUTION ON THE UNDISTRIBUTED-PROFITS TAX

Whereas the undistributed-profits tax was enacted to prevent the avoidance of individual taxes by stockholders, to reduce the control of corporate managers over large corporate surpluses and to accomplish other commendable ends; and

Whereas the House Ways and Means Committee has recommended a drastic reduction in the rates of the tax upon undistributed profits, which is tantamount to an abandonment of the entire tax; and

Whereas we believe that there has been no demonstration in theory or in practice that the tax should be abandoned;

Now, therefore, be it resolved that:

1. We favor the continuation of the undistributed-profits tax at rates no lower than the existing rates and disapprove the reduction in rates recommended by the Ways and Means Committee.

2. We believe, however, that corporations whose net income is less than $25,000 should be exempt from the tax and that certain minor amendments should be made so as to eliminate inequities in the present law.

COMMITTEE ON TAXATION, NATIONAL LAWYERS GUILD

REPORT ON UNDISTRIBUTED-PROFITS SURTAX

The principal purpose of the undistributed-profits surtax was to prevent the avoidance of individual taxes by the shareholders of corporations. Other important incidental purposes were to place the shareholder on the same tax basis as the individual proprietor or partners, who pay taxes on the earnings of their businesses irrespective of distributions; to reduce the frequency and severity of economic depressions; and to lessen the control by corporate managers over corporate surpluses. To accomplish these purposes a graduated surtax was placed upon undistributed net income, increasing in rate as the proportion of retained earnings increased.

Although there has been an avalanche of criticism of the tax, there has thus far been an insufficient factual basis upon which to determine whether the tax accomplishes its purposes, whether it unfairly discriminates against any group or groups and how it actually works. We do know that in 1936 there was a sharp increase in dividend payments. The Ways and Means Subcommittee has reported that in 1936 corporations distributed 81.2 percent of their adjusted net income: the studies referred to below show a distribution of smaller percentages of income in years before the surtax was effective. How far the tax was responsible for dividends paid no one can tell but it seems reasonably clear that the tax was a definite factor in forcing dividends distributions. The adjusted undistributed net income of corporations (other than banks, insurance companies, and corporations in bankruptcy or receivership) is taxed at the following rates:

First 10 percent at 7 percent.
Next 10 percent at 12 percent.
Next 20 percent at 17 percent.
Next 20 percent at 22 percent.
Next 40 percent at 27 percent.

The criticism of the tax most frequently made and the one which has received the most widespread support is that the tax will deplete corporate reserves so as to prevent expansion and to eliminate the corporate cushion for rainy days, thus preventing corporations from maintaining dividends, wages, and employment.

Fundamental to a consideration of this criticism and of the tax itself is one's attitude toward corporate saving. There are advocates of the position that industrial managers direct savings in more desirable channels than do stockholders, and the studies made by the Securities and Exchange Commission indicate that securing money through borrowings or additional stock flotations is expensive. Moreover, it is pointed out that corporate savings are in the nature of dividend insurance, enabling the corporation to pay regular dividends. It strengthens the corporation's credit and enables it to weather bad times. State laws and contracts restrict dividend payments. Nevertheless, there are serious dangers attendant upon excessive corporate saving. It encourages overoptimistic

and uneconomic expansion, the purchase of unnecessary plant and equipment. Enormous economic power is vested in the hands of corporate managers to control related businesses and the temptation to pay unwarranted salaries and bonuses to themselves is great; and, in general, to play fast and loose with other people's money. Small stockholders who need dividends are frozen out by large stockholders who prefer to save tax by retaining profits in the corporation. Instead of dividend insurance, corporate surpluses frequently produce dissipation of assets by corporate managers through speculation or otherwise. Moreover, increased dividends to stockholders would be likely to produce increased purchases of consumers' goods. Some economists believe that the most important contribution to business stability and healthy expansion of industry which can be achieved is the increase in purchasing power of consumers.

The "corporate cushion" which is important in "rainy days" is a cash reserve. There is no close connection between a surplus shown on a balance sheet and cash. From 1931–33 all corporations taken together lost 6½ billion dollars. Yet at the end of that period they had more cash than at the beginning. At the end of 1931 United States Steel Corporation, for example, had accumulated undistributed net income of about $1,200,000,000. Yet in April 1932 it passed its common-stock dividend and in January 1933 reduced the dividend on its preferred stock from $7 to $2.

The effect of the tax is not to eliminate corporate surpluses but to reduce them. The following table shows rates of tax based upon the corporation's adjusted net distributable income (not merely to its adjusted undistributed net income):

Distributable profits retained:	*Average percentage of distributable profits paid as surtax*	Distributable profits retained—Continued:	*Average percentage of distributable profits paid as surtax*
5 percent	0.35	60 percent	9.70
10 percent	.70	65 percent	11.05
15 percent	1.30	70 percent	12.40
20 percent	1.90	75 percent	13.75
25 percent	2.75	80 percent	15.10
30 percent	3.60	85 percent	16.45
35 percent	4.45	90 percent	17.80
40 percent	5.30	95 percent	19.15
45 percent	6.40	100 percent	20.50
50 percent	7.50		
55 percent	8.60		

What has been the dividend practice of corporations? Various studies have been made of the dividend practices of corporations. The Means studies indicate that for the years 1922 to 1927 the 108 largest nonfinancial corporations paid out dividends of 61.5 percent of profits as compared with 70.6 percent for all reporting nonfinancial corporations. Another study of distributions for the period 1922 to 1929 shows a general average distribution for 135 of the largest industrial corporations of 56.5 percent. A Treasury study for the year 1924 showed a distribution of 58 percent for 50,000 corporations. In other words, during a fairly prosperous period the distribution for corporations averaged from 57 to 70.6 percent. Another study shows a payment of 29.3 millions from 1922 to 1929 and retention of 12.9 millions, or retention of 69.6 percent. Thus in prosperous years the total dividends paid averaged from 57 to 70 percent, with the actual amounts paid out showing total for 1922 to 1929 of 69.26 percent during the period. This same result is shown by the report of Standard Statistics Co. that during 1926–36 accumulated surplus represented 30 percent of the stockholders' equity.

Turning to the depression years, the Crum studies show that large corporations paid greater dividends than small corporations. In 1931 the range is from 41 percent of net income for small corporations to 95 percent for the largest corporations and in 1932 from 54 to 98 percent, in 1933 from 29 to 91 percent. In 1936, 8 percent of the large corporations studied by Dun & Bradstreet paid out little or nothing from their earnings against 7 percent for the 1920–28 period. In 1920 to 1928, 49 percent of the small companies retained all or almost all of their income. This figure was reduced to 29 percent in 1936; in the medium-sized group the figures for these periods were 23 and 13 percent, respectively. For 1936, the percentages of corporations paying out 90 percent or more

of their earning were, respectively, 32, 31, and 27 percent in the large-, medium-, and small-size groups as against 9, 12, and 12 percent for the period 1920–28.

If from these studies we take, conservatively, 60 percent as the average dividend paid out by corporations, the average increased tax by reason of a continuation of the present dividends policy would be 5.3 percent of distributable net income. Assuming that corporations decreased their retained earnings by one-half and distributed an average of 80 percent of their earnings as a result of the statute, the undistributed-profits surtax would average 1.90 percent of net income. As indicated above, the report of the Ways and Means subcommittee discloses that the corporations filing returns distributed in 1936 81.2 percent of their adjusted net income. The committee disclosed that the undistributed surtax profits rates paid by corporations for 1936, in terms of percentages of net income, were as follows:

	Rate
Under $5,000	$3.85
$5,000 to $10,000	2.85
$10,000 to $15,000	2.81
$15,000 to $20,000	2.71
$20,000 to $25,000	2.64
$25,000 to $50,000	2.80
$50,000 to $100,000	2.86
$100,000 to $250,000	2.78
$250,000 to $500,000	2.41
$500,000 to $1,000,000	2.12
$1,000,000 to $5,000,000	1.62
$5,000,000 and over	.83
Aggregate	1.81

In our opinion, such a tax is likely to act as a stimulus to increased dividends, but on its face it does not appear to be large enough to cause a depletion of surplus, but only a diminution, since a substantial reserve can apparently be retained with a fairly small tax.

There are two other factors to be considered:

(*a*) We have been discussing general averages of dividend policies. Undoubtedly, there is a considerable variation among corporations, some of which have been accustomed to paying for less than 60 percent of their earnings in dividends. Nevertheless, if industry as a whole can manage with a 30-percent or a 20-percent reserve, the policy of some corporations of retaining a larger part of their surplus should not be used as an argument for attacking the tax on the ground that it improperly depletes corporate reserves.

(*b*) We have discussed averages for various periods of years. What provision have we made for the lean year or for cyclical industries? The tax would tend to cause distribution of reserves or the payment of large taxes in good years and it makes no allowance for bad years. We believe that there should be a loss carry-over provision so as to allow the taxpayer to take advantage of losses for a previous year. Such a proposal, which was made by the House Ways and Means Subcommittee, will lend itself to stabilization of corporate funds and will set up a corporate cushion for bad years.

The record shows that the tax may work especial hardship upon small corporations. The difficulties and large costs to such corporations of borrowing money and the lack of existing reserves would make the tax a particularly heavy burden. Moreover, the undistributed-profits surtax is aimed at persons of wealth who are in the higher surtax rates, whose stockholdings are likely to be primarily in corporations of substantial size. The Treasury has reported that 90 percent of the corporation returns filed for 1936 were filed by corporations whose net income was $25,000 or less; that this 90 percent paid about 10 percent of the corporate income tax; and that the 10 percent of the corporations with incomes above $25,000 paid 90 percent of the corporate tax. We believe, therefore, that the recommendation of the House Ways and Means Subcommittee that corporations whose net income is less than $25,000 should be exempt from the tax is sound.

We believe that certain other amendments are necessary to avoid inequities in the statute, which would in no way impair the carrying out of the major purposes of the tax:

(1) Dividends declared within a reasonable period after the close of the taxable year, perhaps within 3 months, should be allowable as a dividends-

paid credit. Many corporations are unable to determine what their income will be until their books have been closed and statements are prepared. A reasonable period after the close of the taxable year is therefore necessary within which to declare and pay dividends.

(2) In many cases the Bureau and the taxpayer will differ as to the taxpayer's net income and the controversy will not be settled for several years. These disagreements are often on difficult points and we believe the taxpayer should be given an opportunity, in the event that such a controversy is settled in favor of the Government increasing the net income, to obtain a dividends-paid credit by distributing dividends within a reasonable time after the income is so increased.

(3) There is undoubtedly a hardship upon corporations which prior to the enactment of the tax incurred heavy obligations and agreed to declare no dividends until the obligations are provided for; similarly corporations with impaired capital and which cannot declare dividends under State law are in a far from happy position. While there is a measure of discrimination involved in treating such corporations more favorably than corporations which have not incurred heavy obligations, we believe that practical considerations call for some relief, which will better enable debt-ridden corporations, and corporations with impaired capital, to pay debts and restore deficits without the heavy penalty of the undistributed-profits surtax.

(4) Under the law as it now stands a corporation may be subject to the tax where it has ordinary net income which is more than wiped out by capital losses, the capital losses not being applicable against the ordinary income. We believe this aspect of the statute is inequitable and unrealistic and that capital losses should be allowed as an offset to ordinary income for the purposes of the undistributed profits surtax even though they are not so allowed for purposes of the normal tax.

(5) As we have previously stated, we believe the statute should include some provision for a loss carry-over.

With these amendments we believe that, insofar as can be determined without more experience with the statute, there is reasonable ground for believing that the statute may help eliminate tax avoidance through failure to declare dividends and may act as a brake upon unwise expansion and as an instrument for preventing uneconomic accumulation of corporate surpluses, and at the same time leave corporations with sufficient reserves and cushions for sound expansion and rainy days. The tax may aid the stability of business cycles. To the extent that the tax places individuals, entrepreneurs, and partners in a favored position, such a result may be justified on the ground that the privilege of doing business in the corporate form is a valuable one for which a charge may be made. Absence of personal liability and other advantages of incorporation are highly important; otherwise more than 500,000 corporations would not be existent in the United States.

From the foregoing we conclude that the critics of the tax have not made out a case warranting the discarding of the tax without giving it a chance to prove itself. The experience with the tax has been too brief to measure it by any standard other than general principles. We believe that there is enough merit in the tax to warrant its being tested by experience to measure its efficiency in practice.

We disagree with the proposal of the Ways and Means Committee adopted by the House of Representatives that the surtax rates should be so materially reduced. The subcommittee proposed that corporations earning more than $25,000 (with special provisions for corporations in the "notch" between $25,000 and $37,000) should pay a tax of 20 percent instead of the present normal tax rate upon such incomes of 13–15 percent, and that corporations should be given a reduction at the rate of 0.4 percent for each 10 percent of adjusted net income distributed. This means in effect that the normal tax rate is 16 percent instead of 13–15 percent and the surtax on undistributed profits is graduated to a maximum of 4 percent of adjusted net income. This is a sharp reduction from the present rates which impose a maximum tax of 20.50 percent.

Since the subcommittee reached the conclusion "that the principle of the undistributed-profits tax, is sound and should be retained," we believe that it is a serious error to reduce the rates to a point where the purposes of the tax are not likely to be accomplished. Under the rates as they now stand, a corporation retaining 80 percent of its dividends pays a tax of 15.10 percent of its adjusted net income; such a corporation would pay a tax of only 3 percent of such income. Since the maximum tax on a corporation retaining all of its profits is

4 percent, which is the normal tax rate, the proposed rates mean that the failure to declare dividends cannot subject the corporation to a larger tax than its stockholders would be obliged to pay. It would thus frequently be to the advantage of large stockholders who pay substantial surtaxes, to bring pressure on the corporation not to pay dividends, the result which the statute was enacted to remedy. We believe that there is no proper basis in experience for this sharp reduction in the rates, amounting almost to an abandonment of the basic purpose of the tax.

We believe that with the amendments suggested above the present tax should be retained and that the other changes proposed by the Ways and Means Committee and those contained in the House bill should be rejected.

Dated, March 19, 1938.

Respectfully submitted.

COMMITTEE ON TAXATION OF THE NATIONAL LAWYERS GUILD.

MARCH 10, 1938.

Recommendations for increase in internal revenue.

Hon. PAT HARRISON,

Finance Committee, United States Senate, Washington, D. C.

DEAR CONGRESSMAN: Under the Revenue Act of 1926, section 402, the following schedule of internal-revenue taxes on cigarette paper in packages or books is provided:

(a) Containing not more than 25 papers each, not taxable.

(b) Containing more than 25 but not more than 50, $0.005 per package.

(c) Containing more than 50 but not more than 100, $0.01 per package.

(d) Containing more than 100, $0.005 for each 50 papers or fraction thereof.

The original intent of permitting manufacture or importation of packages of cigarette paper containing not more than 25 papers free of such tax was to make possible the distribution of free sample packages of paper to stimulate the sale of the larger packages subject to tax.

However, in reviewing the sales of cigarette-paper booklets, there was found to be a rapid increase in the distribution of nontaxable papers for the 6 years, 1931 through 1936, and a rapid falling off in the distribution of taxable papers during the same period. The figures as supplied by the Department of Commerce show sales of nontaxable booklets in 1931 to have been 211,492,481, whereas for the year 1936 there was an increase of 10½ times this amount or 2,861,552,000.

Investment of capital in an American factory and employment of American labor.—For your information we wish to say that we have a plant at New London, Conn., where money is invested in land, buildings, and modern equipment and where we are employing citizens of the local community. There are manufactured at this plant booklets of the type which are subject to tax. However, this business is greatly impaired and the labor depending upon its continuance immediately affected by the rapid increase in the distribution of nontaxable booklets with the consequent lower sales of taxable booklets.

Tax on all booklets.—To our minds, if the principle of applying an internal-revenue tax on the cigarette-paper booklets is correct, such tax should apply to all booklets and subdivision (a) under section 402 should be entirely eliminated thereby, providing a minimum tax of $0.005 per package of 50 leaves or less. Or, should some consideration wish to be given to a lower tax for sample booklets, then at least section (a) should provide for a tax of $0.0025 per package of less than 25 papers. Either the tax should apply to all cigarette papers or it should be rescinded entirely.

Increase in Government revenue.—It is our belief, of course, that even the imposition of a minimum tax of $0.0025 per package for booklets of 25 leaves would discourage the promiscuous distribution of nontaxable papers and that the sale of taxable papers would be greatly increased. On this basis, and taking the figures for 1935 and 1936, the Government would have had an addition revenue of more than $15,000,000 had there been a tax on all booklets.

Summary.—Therefore, we summarize our plea for relief for the following reasons:

1. An American manufacturer whose business and employees' welfare are adversely affected by the unintended operation of the present tax.

2. That the Federal Government loses revenue which, for the 2 years of 1935 and 1936, amounted to more than $15,000,000.

Suggested changes.—It is recommended that under section 402 of the internal-revenue law, either of the following changes be made: (1) Elimination of subdivision (a) and modification of subdivision (b) to read "Containing not more than 50 papers each, $0.005 per package"; or (2) modification of subdivision (a) to read "Containing not more than 25 papers each, $0.0025 per package."

Respectfully submitted.

BRAUNSTEIN FRERES, INC.,
C. CAMPBELL, *President.*

Tax on booklets having less than 25 leaves

Estimated maximum sales of small booklets of less than 25 leaves (100,000,000, at $0.0025)	250, 000
Additional sale of taxable booklets (80 percent of nontaxable sales in 1937, 2,209,230,000, equivalent to 541,847,000 booklets of 100 leaves, at $0.01)	5, 418, 470
Additional sale of ready-made cigarettes (20 percent of nontaxable books sold in 1937 equals 552,309,000); if sold as cigarettes of 20 to the pack, would equal 27,615,450 packs, at $0.06)	1, 656, 927
Total	7, 325, 397

Sales of packages of cigarette-paper books

[From figures supplied by the Department of Commerce]

Year	Tax-free		Taxable		Total
	Imported	Domestic	Imported	Domestic	
1931	112, 462, 049	99, 030, 432	122, 697, 587	1, 695, 537	335, 885, 605
1932	242, 599, 233	1, 018, 676, 818	119, 645, 072	8, 007, 826	1, 388, 928, 949
1933	457, 074, 483	1, 458, 496, 429	57, 894, 783	9, 819, 889	1, 983, 285, 584
1934	539, 625, 666	1, 930, 133, 447	59, 141, 230	9, 729, 959	2, 538, 630, 302
1935	2, 482, 000	2, 684, 926, 000	59, 448, 000	11, 693, 000	2, 758, 549, 000
1936	1, 333, 000	2, 860, 219, 000	21, 622, 000	69, 797, 000	2, 952, 971, 000

STATEMENT SUBMITTED BY KENNETH N. PARKINSON, WASHINGTON, D. C., CONCERNING INCOME FROM BONDS OF JOINT-STOCK LAND BANKS

In response to the invitation of the committee to give any suggestions with respect to possible new sources of taxation, I desire to call attention to an item which is not now, but should be taxed, i. e., the income from joint-stock land bank bonds.

The bill as it comes from the House, on page 17, at line 20, aims to tax hereafter the income of joint-stock land banks which has not up to the present been taxed. (See Recommendation No. 9, p. 67, report of House subcommittee.) The House amendment, however, does not tax the income derived from the bonds issued by these banks, and it is with that subject that I propose to deal.

The Federal Farm Loan Act of July 17, 1916 (39 Stat. 380), by section 26 exempted two classes of income from taxation:

1. It exempted the income made by any Federal land bank, including joint-stock land banks, on the capital and reserve or surplus of said banks. It has seemed for some time that since the joint-stock land banks are privately owned institutions this exemption was probably unwarranted, and the House has attempted to remedy this situation by providing, although the language is not very clear, that these banks shall hereafter be subject to taxation.

2. The same statute provided that the bonds issued by Federal land banks, including joint-stock land banks, "shall be * * * instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation." This provision is left unchanged by the House bill. It is submitted that all income derived from any of these bonds issued hereafter (except interest) should be subject to taxation the same as all income (except interest) derived from Liberty Loan and other governmental bonds.

Attached hereto as exhibit A is a compilation of various governmental statutes under which Government or quasi-Government bonds are issued. It will be

noted that in all of them save three, the only thing exempted from taxation is the "interest derived from the bonds." In the other three (bonds issued under the Federal Farm Loan Act of July 17, 1916, the Federal Intermediate Bank Act of March 4, 1923, and the Federal Farm Mortgage Corporation Act of July 31, 1934) there is an exemption as to all "income derived from the bonds." It would seem that under these latter statutes not only interest is exempt but also the difference between the purchase and sale price of such bonds. This is illustrated by the ruling of the general counsel of the Bureau of Internal Revenue of April 3, 1933, with respect to the Des Moines Joint-Stock Land Bank. In that case the bank went out into the market and purchased back a lot of its own bonds at considerably less than par and retired them at par. The general counsel thought the difference constituted "income" and was expressly exempt from taxation under the Federal Farm Loan Act. A copy of the general counsel's opinion is attached hereto as exhibit B.

It is submitted that the present revenue act should amend the three statutes which grant a total exemption from all income derived from bonds issued thereunder so as to provide that on bonds issued hereafter only interest derived therefrom shall be exempt. This will mean that the three statutes herein enumerated will have no greater exemption than Government bonds. The suggested result can be accomplished by the insertion of the following amendment on page 22 at the end of line 7:

"All income, except interest, derived from mortgages or farm-loan bonds, issued hereafter pursuant to the provisions of the Federal Farm Loan Act of July 17, 1916 (39 Stat. 380), as amended, the Federal Intermediate Bank Act of March 4, 1923 (42 Stat. 1459), as amended, and the Federal Farm Mortgage Corporation Act of January 31, 1934 (48 Stat. 344), as amended, shall be included in gross income; and all acts pertaining to said mortgages and bonds are hereby amended accordingly."

Respectfully submitted.

K. N. PARKINSON.

MARCH 22, 1938.

EXHIBIT A

STATUTES IN WHICH ONLY "INTEREST" IS EXEMPT FROM TAXATION

First Liberty Loan Act of April 24, 1917 (ch. 4, 40 Stat. 35, 35 Code Title 31 746, 755, 759, 764, 768, 774, 804)

The principal and interest hereof shall be payable in United States gold coin of the present standard value and shall be exempt, both as to principal and interest, from all taxation except estate or inheritance taxes, imposed by authority of the United States, or its possessions or by any State or local taxing authority; but such bonds shall not bear the circulation privilege.

Second Liberty Loan Act of September 24, 1917 (ch. 36, 40 Stat. 291, 288 Code Title 31, 747, 752–754, 757, 758, 760, 764–766, 769, 771, 773, 774, 801, Sept. 24, 1918, ch. 176, 40 Stat. 965, Code Title 31, 757, 774)

SEC. 7. That none of the bonds authorized by section one nor of the certificates authorized by section five or by section six, of this act, shall bear the circulation privilege. All such bonds and certificates shall be exempt, both as to principal and interest from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes commonly known as surtaxes and excess profits and war-profits taxes, now or hereafter imposed by the United States upon the income or profits of individuals, partnerships, associations, or corporations. The interest on an amount of such bonds and certificates the principal of which does not exceed in the aggregate of $5,000, owned by any individual, partnership, association, or corporation, shall be exempt from the taxes provided for in subdivision (b) of this section.

Third Liberty Loan Act of April 4, 1918 (ch. 44, 40 Stat. 502, code title 31, 752, 754, 765, 766, 771, 774)

N. B.—These bonds were issued under statutory enactment by way of amendment of the Second Liberty Loan Act. Hence, the exemptions are identical with the latter.

Fourth Liberty Loan Act of July 9, 1918 (ch. 142, sec. 3, 40 Stat. 844, code title 31, 750, 752, 772, 774)

N. B.—These bonds were issued under statutory enactment by way of amendment of the Second Liberty Loan Act. Hence, the exemptions are identical with the latter except the following:

SEC. 3. That notwithstanding the provisions of the Second Liberty Bond Act as amended by the Third Liberty Bond Act, or of the War Finance Corporation Act, bonds and certificates of indebtedness of the United States payable in any foreign money or foreign moneys, and bonds of the War Finance Corporation payable in any foreign money or foreign moneys exclusively or in the alternative, shall, if and to the extent expressed in such bonds at the time of their issue, with the approval of the Secretary of the Treasury, while beneficially owned by a nonresident alien individual, or by a foreign corporation, partnership, or association not engaged in business in the United States, be exempt both as to principal and interest from any and all taxation now or hereafter imposed by the United States, any State or any of the possessions of the United States, or by any local taxing authority.

Victory Liberty Loan Act of March 3, 1919 (ch. 100, sec. 18 (b), 40 Stat. 1309, code title 31, 749, 750, 753, 754, 763, 767, 774, 802, 803)

SEC. 18. (b) The notes herein authorized may be issued in any one or more of the following series as the Secretary of the Treasury may prescribe in connection with the issue thereof: (1) Exempt, both as to principal and interest, from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, any State or any of the possessions of the United States or by any local taxing authority; (2) exempt both as to principal and interest from all taxation now or hereafter imposed by the United States, any State, or any of the (a) estate or inheritance taxes, and (b) graduated additional income taxes commonly known as surtaxes and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations; (3) exempt, both as to principal and interest, as provided in paragraph (2); and with an additional exemption from the taxes referred to in clause (b) of such paragraph, of the interest on an amount of such notes the principal of which does not exceed $30,000, owned by any individual, partnership, association, or corporation; (4) exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States or by any local taxing authority, except (a) estate or inheritance taxes, and (b) all income, excess-profits, and war-profits taxes now or hereafter imposed by the United States upon the income or profits of individuals, partnerships, associations, or corporations.

* * * * * * *

SEC. 2 (a) That until the expiration of five years after the date of the termination of the war before the United States and the German Government, as fixed by proclamation of the President in addition to the exemptions provided in section 7 of the Second Liberty Loan Act in respect to the interest on an amount of bonds and certificates authorized by such act and amendments thereto the principal of which does not exceed in the aggregate $5,000, and in addition to all other exemptions provided in the Second Liberty Bond Act or the Supplement to Second Liberty Bond Act the interest received on and after January 1, 1919, on an amount of bonds of the First Liberty Loan converted dated November 15, 1917, May 9, 1918, or October 24, 1918, the Second Liberty Loan converted and unconverted, the Third Liberty Loan and the Fourth Liberty Loan the principal of which does not exceed $30,000 in the aggregate owned by an individual, partnership, association, or corporation, shall be exempt from graduated additional income taxes commonly known as surtaxes, and excess-profits and war-profits taxes now or hereafter imposed by the United States upon the income or profits of individuals, partnerships, associations, or corporations.

(b) In addition to the exemption provided in subdivision (a) and in addition to the other exemptions therein referred to the interest received on and after January 1, 1919, on an amount of the bonds therein specified the principal of which does not exceed $20,000 in the aggregate, owned by any individual, partnership, association or corporation, shall be exempt from the taxes therein specified, provided that no owner of such bonds shall be entitled to

such exemption in respect to the interest on an aggregate principal amount of such bonds exceeding three times the principal amount of notes of the Victory Liberty Loan originally subscribed for by such owner and still owned by him at the date of his tax return.

War Finance Corporation Act of April 5, 1918 (40 U. S. Stats. 511, ch. 45, secs. 16 and 17)

SEC. 16. That any and all bonds issued by the Corporation shall be exempt both as to principal and interest from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States upon the income or profits of individuals, partnerships, corporations, or associations. The interest on an amount of such bonds the principal of which does not exceed in the aggregate $5,000 owned by any individual, partnership, corporation, or association, shall be exempt from the taxes referred to in clause (b). The Corporation including its franchise and the capital and reserve or surplus thereof, and the income derived therefrom, shall be exempt from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except that any real property of the Corporation shall be subject to State, county, or municipal taxes to the same extent, according to its value or other real property is taxed.

SEC. 17. That the United States shall not be liable for any payment of any bond or other obligation or the interest thereon issued or incurred by the Corporation, nor shall it incur any liability in respect of any Act or omission of the corporation.

Reconstruction Finance Corporation Act of January 22, 1932 (ch. 8, sec. 10, 47 Stat. 9)

Any and all notes, debentures, bonds, or other such obligations issued by the Corporation shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The Corporation, including its franchise, its capital, reserves, and surplus, and its income, shall be exempt from all taxation now or hereafter imposed by the United States, or by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that any real property of the Corporation shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed.

Federal Home Loan Bank Act of July 22, 1932 (ch. 522, sec. 13, 47 Stat. 735)

Any and all notes, debentures, bonds, or other such obligations issued by any bank shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The bank, including its franchise, its capital reserves and surplus its advances, and its income, shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority, except that any real property of the bank shall be subject to State, Territorial, county, municipal, or local taxation to the same extent, according to its value, as other real property is taxed. The notes, debentures, and bonds issued by any bank, with unearned coupons attached, shall be accepted at par by such bank in payment of or as a credit against the obligation of any home-owner debtor of such bank.

Home Owners' Loan Corporation Act of June 13, 1933 (sec. 4 (c) of Home Owners' Loan Act of 1933, 48 Stat. 130)

* * * The bonds issued by the Corporation under this subsection shall be exempt, both as to principal and interest, from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United

States or any District, Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The Corporation, including its franchise, its capital, reserves, and surplus, and its loans and income, shall likewise be exempt from such taxation; except that any real property of the Corporation shall be subject to taxation to the same extent, according to its value, as other real property is taxed.

STATUTES WHICH EXEMPT NOT ONLY "INTEREST" BUT ALL "INCOME"

Federal Farm Loan Act of July 17, 1916 (ch. 245, sec. 26, 39 Stat. 380)

Every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section 761 and section 781 of this chapter. First mortgages executed to Federal land banks, or to joint-stock land banks, and farm loan bonds issued under the provisions of this chapter, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation.

Federal Intermediate Bank Act of March 4, 1923 (ch. 252, title I, sec. 2, 42 Stat. 1459)

SEC. 210. The privileges of tax exemption accorded under section 26 of this Act shall apply also to each Federal intermediate credit bank, including its capital, reserve, or surplus, and the income derived therefrom, and the debentures issued under this title shall be deemed and held to be instrumentalities of the Government and shall enjoy the same tax exemptions as are accorded farm loan bonds in said section.

Federal Farm Mortgage Corporation Act of January 31, 1934, as amended February 26, 1934 (ch. 7, sec. 12, 48 Stat.; ch. 33, 48 Stat. 360)

(a) The Corporation, including its franchise, its capital, reserves, and surplus, and its income shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that any real property of the Corporation shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed.

(b) Mortgages executed to the Land Bank Commissioner and mortgages held by the Corporation, and the credit instruments secured thereby, and bonds issued by the Corporation under the provisions of this subchapter, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation (except surtaxes, estate, inheritance, and gift taxes).

EXHIBIT B

OPINION OF GENERAL COUNSEL'S OFFICE RESPECTING TAXABILITY OF DISCOUNT ON BONDS OF DES MOINES JOINT STOCK LAND BANK

APRIL 3, 1933.

In re Des Moines Joint Stock Land Bank, Des Moines, Iowa.

DEPUTY COMMISSIONER WILMER: Reference is made to the memorandum (IT: AR: D-4: JWH) dated July 19, 1932, addressed to the representative of this office attached to the income-tax unit by the head of the Audit Review Division, in which an opinion is requested as to the taxability in general of all profits on the capital and surplus of joint-stock land banks.

At a hearing before this office and in brief filed on October 3, 1932, four specific issues were raised, as follows:

* * * * * * *

4. Taxability of discount on taxpayer's own bonds purchased during the taxable year.

* * * * * * *

ISSUE 4

Relative to the fourth issue it appears from the facts that the taxpayer, during 1929, purchased on the open market a total of $1,144,000 par value of its own bonds. Of this amount the taxpayer canceled and retired all but $230,000 par value of these bonds. The $230,000 par value not retired were pledged as collateral with the First National Bank of Chicago to secure notes owing to that bank in the sum of $84,425. For the bonds not canceled, the taxpayer paid $139,235, a discount of $90,765.

The taxpayer contends (1) that all discount on Federal farm loan bonds purchased by it is tax exempt; and (2) assuming that the discount realized on the purchase of the bonds retired is taxable, the sum of $90,765 was not income realized by actual retirement of bonds during that year.

Relative to the taxpayer's first contention, reference is made to section 26 of the Federal Farm Loan Act, quoted in part under the discussion of issue 2. It will be noted that the act provides that farm-loan bonds and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation. Section 26 is cited and stated in article 85 of regulations 74, which provides that the interest from farm-loan bonds is not subject to the income tax.

Section 22 (b) (4) (B) of the Revenue Act of 1928 provides that interest upon securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of said act as amended, shall be exempt from taxation.

Article 68 of regulations 74 provides that if a corporation purchases and retires any of its own bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year. This establishes the fact that the gain from the purchase of the taxpayer's bonds constitutes income. (See also *Kirby Lumber Co.* v. *United States* (284 U. S. 1).)

The United States Supreme Court, in holding unconstitutional a Massachusetts statute taxing corporations in proportion to their income, including income from farm-loan bonds, said: "Federal farm-loan bonds issued under authority of chapter 245 Thirty-ninth Statutes at Large, 360 (July 17, 1916), United States Code, title 12, No. 641, and by No. 26, page 380, title 12, No. 931, are declared to be instrumentalities of the United States and both as to principal and income exempt from all State taxation)" (*McCallen Co.* v. *Massachusetts* (49 Sup. Ct. Rep. 432)).

The original Federal Farm Loan Act was approved on July 17, 1916. The Revenue Act of 1916 was approved on September 8, 1916, and contained, among others, the following provisions relative to income exemption from tax:

Section 4: "Interest upon the obligations of a State or any political subdivision thereof or upon the obligations of the United States or its possessions or securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916."

Section 11 (a) (14): "Joint stock land banks as to income derived from bonds or debentures or other joint stock land banks or any Federal land bank belonging to such joint stock land banks."

The above provision appears under the head of "Conditional and other exemptions," relating to corporations, and was eliminated in the draft of the 1918 act. The report of the Committee on Ways and Means, in the draft of the 1918 act, states as follows:

"The bill makes no change in the corporations exempt from income tax."

Section 22 of the Revenue Act of 1928 includes in the term "gross income" the gains and profits derived from "sales, or dealings in property, whether real or personal."

In re *Federal Land Bank of New Orleans* v. *Crossland* (43 Supp. Ct. Rep. 385) a writ of mandamus was requested, to require the recording of a mortgage upon the payment of the recording fee, without the payment of an additional sum of 15 cents for each $100 of the principal sum secured. In that case the Supreme Court held this to be a tax upon the mortgage and forbidden by the law of the United States.

The Federal Farm Loan Act, as amended, contains both the words "income" and "interest." Paragraph 22 of that act specifically provides that amortization and other payments on the principal of first mortgages shall, in the case of a joint-stock land bank, be applied or employed to pay off farm bonds issued by such bank as they mature and to purchase at or below par farm-loan bonds. It is

apparent, therefore, that Congress recognized the fact that income might be realized through the purchase at below par of farm-loan bonds.

There is no statute which exempts all income derived from State and municipal securities similar to the Federal Farm Loan Act exemption with reference to joint-stock and Federal land-bank bonds. The distinction is brought out by the Supreme Court in *Wilcutts* v. *Bunn* (282 U. S. 215), which held that income derived from dealing in State and municipal securities was not exempt from Federal income tax, since the exemptions were limited to interest therefrom.

It is important to note the distinction between the words used in granting the exemption to various other tax-exempt bonds. The Federal Farm Loan Act provides that farm-loan bonds "and the income derived therefrom" shall be exempt from all taxation. Other statutes authorizing the issuance of tax-exempt bonds provide that such bonds shall be exempt "as to principal and interest." First Liberty Loan Act, Second Liberty Loan Act, War Finance Corporation Act, Third Liberty Loan Act, Fourth Liberty Loan Act, Victory Liberty Loan Act.

Section 26 of the Federal Farm Loan Act specifically exempts Federal land banks and national farm-loan associations from Federal, State, municipal, and local taxation, except taxes upon real estate held. The exemption specifically applies to the capital and reserve or surplus and the "income derived therefrom." The words "income derived therefrom" as there used have been interpreted by the Bureau to mean any gains or profits derived from dealing in capital and reserve or surplus. In the same paragraph of the same section farm-loan bonds and the "income derived therefrom" are exempted. It would be inconsistent to define the words "income derived therefrom" found in the third line of section 26 to include profits or gains while at the same time defining the same words found in the tenth line of the same section to include only interest.

In the instant case, the bonds in question were issued by this taxpayer, and purchased by it at a discount, both under specific authority of the Federal Farm Loan Act. As a result of the purchase, the taxpayer derived income within the meaning of the Revenue Act of 1928. *Kirby Lumber Co.* v. *United States, supra.* Under such circumstances, it is the opinion of this office that the income so derived was derived from the bonds as contemplated by the Federal Farm Loan Act. It is concluded, therefore, that the discount on the taxpayers own bonds purchased during the taxable year, constitutes exempt income and is, therefore, nontaxable. It becomes unnecessary to pass upon the taxpayers' alternate contention relative to the question of bond discount.

In conclusion, it is the opinion of this office (1) that the interest paid on taxpayer's bonds in 1929, in excess of the tax-exempt interest received on first mortgages owned by the taxpayer, constitutes a proper deduction in computing taxable net income; (2) that the exemption granted to the income from first mortgages ceases when the mortgages are converted into substituted form of collateral; (3) that the appraisals made by the Federal Farm Loan Board after the acquisition of property at foreclosure sale, in the absence of fluctuation in value between date of acquisition and date of appraisal, form a proper basis for the recognition of gain or loss; and (4) that discount on the taxpayer's own bonds purchased during the taxable year constitutes exempt income and is, therefore, nontaxable.

The administrative file is herewith returned.

C. H. CHAREST,
General Counsel, Bureau of Internal Revenue.

WILLIAM HUFF WAGNER,
Washington, D. C., March 19, 1938.

Hon. PAT HARRISON,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

MY DEAR SENATOR: On behalf of the American Rutile Corporation, 120 Broadway, New York, N. Y., I am directed to suggest the following amendment to H. R. 9682, entitled "An act to provide revenue, equalize taxation, and for other purposes."

Amend section 114 (b) (4), page 115, line 11, by adding after the word "depletion" and the period, a new sentence to read as follows:

"Any taxpayer who failed to elect the percentage depletion basis in computing his taxable income for prior years with respect to properties then held, may make such election for the taxable year 1938."

REASON FOR AMENDMENT

The percentage depletion provisions with respect to metal mines were first written into the Revenue Act of 1932. They were rewritten into section 114 (b) (4) of the Revenue Acts of 1934 and 1936. These provisions of the last two acts are identical and are continued in section 114 (b) (4) of H. R. 9682. As a part thereof are these three sentences:

"A taxpayer making his *first return* under this title in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to percentage depletion, and the depletion allowance in respect of such property for such year shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for such year shall be computed without reference to percentage depletion. The method, determined as above, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer * * *." [Italics supplied.]

In administering the Revenue Acts of 1934 and 1936, the Treasury Department holds a taxpayer makes his first return in respect to a property in the first year he has any income to report from said property or deducts in his tax return any expense thereon.

This interpretation of the act means that all taxpayers who failed to attach a statement to their 1934 income-tax returns, electing the percentage-depletion basis with respect to each property then owned, leased, or otherwise held, whether operating, idle, or undeveloped are forever prohibited from making such deduction with respect thereto.

For example, a taxpayer owned several separate properties in 1934, one or more of which were idle and held for future development and operation. In its income-tax return for 1934, reporting on its operating properties, said taxpayer deducted the local State and county taxes on these idle properties as an expense as permitted under the law. Such return then constituted its first return with respect to such idle properties. If said taxpayer failed to attach a statement to its 1934 return, electing the percentage-depletion basis with respect to such idle properties, it is then forever denied such depletion thereon.

A great number of taxpayers are adversely affected by such interpretation of the act. In the case of idle or undeveloped properties it was the natural and reasonable thing not to elect percentage depletion thereon until such a time as there was income from such properties against which to charge such depletion. Further, the interpretation placed by the Treasury Department on these provisions of the act appears to be wholly without the intent of the act or the subsequent governing regulations. This interpretation of the act, which could well have been expressed in the regulations, was not given to taxpayers until too late to make such election in their original return for the year 1934. Amended returns making such election are not being accepted.

This grave injustice can be corrected by amending H. R. 9682 so as to give these taxpayers the new election suggested. It is not intended that this election is to be a continuing one. It is intended to be good only for the year 1938. It is a simple manner of granting the great number of mining taxpayers who failed to make such an election in 1934 an opportunity to correct their situation in the light of the Treasury Department's subsequent interpretation of the act, thus putting such taxpayers on a fair competitive basis with other mine operators.

Respectfully submitted.

AMERICAN RUTILE CORPORATION,
By WM. HUFF WAGNER, *Agent*.

FOLLOWING IS THE TEXT OF A STATEMENT SUBMITTED TO THE CHAIRMAN OF THE SENATE FINANCE COMMITTEE, WASHINGTON, D. C., BY MORRIS S. TREMAINE, COMPTROLLER OF THE STATE OF NEW YORK, MARCH 21, 1938

I respectfully appeal to the Congress to repeal or drastically modify the capital loss and gains tax and the undistributed-profits tax, which are nonproductive, punitive, and are definitely destroying enterprise and opportunity for employment. This statement is supported by experienced tax men and Treasury officials, and more particularly by the record.

Laboring men have recently been laid off by the hundreds of thousands, due to the severity of the extreme taxes that prevents their being engaged in new enterprise and definitely retards existing business.

Labor is well aware of this and unquestionably will resent it at the next election. Only a short time ago the American Federation of Labor, in convention in Florida, declared for the repeal of the capital loss and gains tax.

In recent speeches Hon. Mark Graves, president of the New York State Tax Commission, publicly stated that, in his opinion, this tax did not produce any net revenue over a business cycle. Commissioner Graves, as the Senate Finance Committee well knows, is one of the outstanding tax men in America, if not the outstanding tax man. This same opinion was expressed to me by a former Under Secretary of the Treasury. Three other Under Secretaries of the Treasury made substantially the same observation, and whatever adherents these extreme taxes have seem to come from inexperienced people who have not been engaged in business, who are not large employers of labor, and who, for the most part, are unfamiliar with current business.

The fact remains that there have been practically no new enterprises started in the last 5 years because of the retardant effect of the capital loss and gains tax, the undistributed-profits tax, and the extreme upper brackets of the income tax.

The repeal of the capital loss and gains tax, the undistributed-profits tax, and the drastic modification of the income tax would unquestionably promote new enterprise and put to work at least 2,000,000, and possibly 4,000,000 men. This added employment would reduce relief rolls by a like number, thus cutting the cost of government and increasing its net income by from 2 to 4 billions of dollars.

The picture I have tried to present is obvious to those seeking jobs. An increase of only 5 percent in the turn-over or velocity of trade would increase the net revenue of the Government by half a billion dollars. Most of the increase in the net revenue of the Government, from the low point to the present day, is due to the increase in volume not to the increase in rate. Now that the volume is shrinking, the picture will be different a year hence. The great jury of the American people will determine what should be done in the event that the Government fails in its responsibility.

Majorities in democracies, in fact, overwhelming majorities, shrink to minorities when the voters find their representatives unconscious to the public needs. The American people are progressive and resent curbs on opportunity that deprive labor of occupation and business of its productive possibilities.

The Senate Finance Committee well knows the temper of the American people and that they will change their Government if it does not recognize the right to industrial and commercial progress and act fairly to all.

The capital loss and gains tax produces no net revenue, acts as a punitive measure, is a retardant of trade, a destroyer of opportunity, and robs labor of employment. Inasmuch as it discourages speculative capital, which promotes new business and new enterprise, it locks out investment capital which flows only to established businesses. Capital is merely a memorandum of unused, accumulated labor, and when its opportunity for use is destroyed, opportunity for increased employment is destroyed.

As to the undistributed-profits tax, when profits are not distributed they partly belong to labor and act as a bulwark in its defense. When they are distributed, they no longer help labor.

The extreme upper brackets of the income tax prevent the investment of capital except in tax-exempt securities.

I urge, therefore, with all my energy that the Congress act promptly in the best interests of the country, and that it reepal or drastically modify these taxes, or else it must accept retirement forced on it by the wrath and common sense of the voters.

I am fighting for the people of the State of New York; I am fighting for the general increase in production which controls farm prices. When New York State is not prosperous, no State is prosperous. It is the market of the world. New York State pays one-third of the income tax of the country, has the largest manufacturing area in the world; its prosperity makes prosperity for the country, and when industrial production is at its peak, farm prices are at their peak; when industrial production is at the bottom, farm prices are at the bottom. Industrial production controls the volume of labor, the wages of labor, farm prices, and national prosperity.

These taxes hurt the volume of production, which destroys farm prices, reduces rates of wages and factory pay rolls.

All of which is respectfully submitted.

STATEMENT OF RICHARD A. STADERMAN, OF NEW YORK CITY AND WASHINGTON, D. C., UPON H. R. 9682, A BILL TO EQUALIZE TAXATION, PROVIDE REVENUE, AND FOR OTHER PURPOSES, BEFORE THE SENATE FINANCE COMMITTEE, MARCH 19, 1938

Chairman Harrison and gentlemen of the committee, in appearing to make a statement on the tax bill H. R. 9682 which has already passed the House, I wish to emphasize that I speak merely as a private citizen who resides in the Seventeenth Congressional District, Manhattan, N. Y. I am not retained by or representing any individual or interests.

As a matter of information, however, I may state that I am president and editor of the Democratic National Research League of Washington, D. C.; chairman of the board of governors of the American Good Government Society; and since 1934 an economic adviser to certain Members of Congress.

Mr. Chairman, I have been interested in taxation ever since studying with Prof. Davis R. Dewey, author of Financial History of the United States, as well as later teaching economic and business subjects myself.

Senators, it is a sad commentary on our general theory that government exists to serve the people, for us to have personal income-tax laws under which millions of people have to endure the agony of making out and filing income-tax returns when they either pay no tax at all or pay less than the cost of collecting the tax.

The data, I believe, shows that about half of the people who file returns pay no tax on their incomes to the Federal Government. The number who pay a tax less than the cost of Uncle Sam collecting it is probably well up in the hundreds of thousands of persons.

Therefore, to avoid this lost motion and nuisance for both the United States Government and our fellow citizens, I propose that there shall be added a subsection (4) under subsection (4) under subsection (b) of section 25 of H. R. 9682 to read substantially as follows:

"(4) No person shall be required to file an income-tax return if his income and legitimate deductions are such that he pays no tax thereon or if the average cost of collecting the tax otherwise payable exceeds the amount of such tax. The cost of handling returns and collecting income taxes shall be defined as amounting on the average to $3 per return filed, and persons otherwise liable for tax whose amount of tax is equal to or less than said $3 shall be exempt from such tax."

As a matter of practical application, it would be a matter of national gain if we saved millions of our fellow citizens from the useless labor of puzzling out a return and then have to pay little or no tax. For example, a man with a wife and 10 children has his hands and mind more than full already, so why burden him with filing a return if he has a gross income of say $5,200 a year, as he now is required to do, even though he and his wife are allowed $2,500 exemption and $400 for each child making a total of $6,500 exemption allowed. He does not pay any tax, therefore why burden him and Uncle Sam?

Similarly a single man with a net income of $1,010 is now required to file a return and pay a few cents tax, less than the cost of collecting the tax. Why not save him the trouble, too? And so with millions of others who deserve our consideration in relieving them of useless "headaches."

A similar principle might be applied to corporations. Some who are small and pay little or no tax, should be relieved of obligation to file returns or pay any tax unless the amount of the tax exceeds the average cost of collecting the tax.

Inasmuch as one of my chief interests is the welfare of the working man, I would suggest that if this proposal should be incorporated in the bill, as I hope it will be, that it be provided that no one shall be dismissed or receive a lesser salary in the Government service due to the lessened amount of attention by the Bureau of Internal Revenue to care for less than half the present volume of returns.

Any bureau personnel which might for the time being seem unnecessary could be used to check returns of those liable for taxes more carefully, thereby probably "earning their keep" until natural deaths and resignations will have reduced any excess in the numbers of personnel to the number actually needed under the revised statute. Of course other units of the Treasury or other departments may be short-handed so that any surplus personnel could be transferred thereto.

This amendment to the bill which I have suggested fits in with the general policy of the United States Treasury to try to reduce the outgo of the Government by its ultimate savings in collection costs. It also serves to aid in bringing

Treasury income and outgo nearer together, which is the main objective of the Treasury.

I therefore feel that there is everything to gain and nothing to lose by adoption of this amendment.

Turning to another phase of the bill, I should like to record my categorial opposition to proposals to reduce exemptions.

The persons with incomes now exempt pay more than plenty of taxes indirectly if not directly. Therefore it would be a travesty on justice to reduce the present exemption for single persons from $1,000 to $800 and for couples correspondingly.

Aside from the matter of unfairness to tax the proper people any more, I should like to call attention to the fact that the additional trouble and expense of collecting such an additional tax might easily take much if not all of the additional revenue obtained by the Treasury.

If anything it is time to think of gradually doing away with the many correctly termed "nuisance taxes" which reach the working people whenever they strike a match or put oil into a sewing machine or auto.

I believe we might well consider the principle of adopting "no new taxes nor higher taxes."

Insofar as the Treasury may require additional revenue to meet expenditures, I should like to call attention to the fact that under a scientific money and credit system, there would be substantial grants made to the Treasury by a central monetary authority in order to furnish a constant supply of new credit to our economic structure which is vital if we are to have a growing and expanding business structure and civilization.

Such activities of credit grants to the Treasury by a monetary authority are advocated in conservative quarters by James H. R. Cromwell in his In Defense of Capitalism; by Prof. Irving Fisher, of Yale, in his 100% Money, in which I had the pleasure of collaborating, as well as by many bankers and progressive thinkers.

It certainly would be better for the Nation and everyone in it to have a monetary authority supply additional credit lifeblood to Uncle Sam's veins rather than have increased taxes drain lifeblood out of his economic system. We would not starve a growing child of necessary food nor in our day use leeches to draw away his blood. Uncle Sam is a growing individual just like such a child, therefore we should consider our credit and tax policies in that light.

I thank you.

Brief From Nonpartisan Lobby for Economic and Democratic Rights to Chairman of Senate Finance Committee on the Subject of the Government Tax Program

We are insensible neither to the delicacy nor the magnitude of this problem of taxation. We are aware, however, of the relation of this question to the "politician" and the statesman. Further, we feel that the cardinal principles of taxation need reiteration in view of the trend of recent events.

The tax base must be broadened, and the fundamental principle of taxation, "the ability to pay," must be firmly and unhesitatingly applied. We are mindful of the Marshallian dogma, "that the power to tax involves the power to destroy," *McClough* v. *Maryland*, I. Cranch. But today there is upward of 10 millions of unemployed in this Nation. The economy in this period of decline inevitably must throw an ever-increasing responsibility for these men and women upon the National Government. The Nation will dearly pay for the shattered morale, disordered health, and lowered self-respect, in ways that cannot be computed in dollars and cents.

A public-works program is an essential responsibility of any democratic government, and absolutely necessary in view of the inability of private enterprise to absorb the unemployed.

To adequately provide for such a long-range productive program of public works we believe the following must be done in regard to the tax system; first, the income base must be broadened, but this broadening must be made contingent upon the repeal of consumption taxes of all descriptions. The destruction of consumers' power through these consumption taxes is, ironically enough, both brutal and cruel; secondly, an increase of the normal tax rates and surtaxes; thirdly, a modification of the present undistributed-profits tax to protect small businesses agreeing to retire their debts.

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The measure which is before you, gentlemen, is undoubtedly a retreat before the disheartening and confusing results of the earlier "pump-priming" devices of the administration; it is also a retreat before the intimidations of staggering private wealth; it is finally a retreat which is fraught with serious consequences, even catastrophe.

We petition you, gentlemen, as statesmen, to stick to your guns and courageously meet and avert the impending prelude to chaos, with the firm conviction that your first responsibility is to the majority of our people and to democracy. You can make it work.

TAX ANALYSIS 1928–29, 1935–36

In the precrisis years corporate and individual income taxes, collected from corporations, wealthy individuals, and upper middle class, made up the major part of Federal receipts. In the fiscal year 1928–29 the relatively wealthy paid 63 percent of total receipts of the Government, while in 1935–36 the wealthy provided only 48 percent of these receipts.

Taxes levied on workers and broad consuming masses accounted for only 37 percent of Federal income in 1928–29, but increased to nearly 52 percent in 1935–36. The wealthier classes paid $174,000,000 less in 1935–36 than in 1928–29, while the workers and consumers generally, with sharply reduced purchasing power compared with 1928–29, paid $688,000,000 more during 1935–36 than in 1928–29.

In 1920 the personal and corporation income taxes and excess-profits tax produced 69 percent of total Federal tax revenue. But in 1936 produced only 36 percent.

In 1936 consumers paid $8,600,000,000 in invisible taxes on an estimated volume of purchases totaling $52,000,000,000, or 15.6 cents out of every dollar. This is the estimate of the Northwestern National Life Insurance Co.

Two hundred and six manufacturers, jobbers, and retailers, tax and sales records showed the following invisible tax percentages of retail prices:

	Percent		*Percent*
Food	7.1	Clothing	8
Bread	6.4	Men's suits	10.49
Beef	8.14	Fuel and light	9.5
Sugar	18.3	Sundries and miscellaneous	10.2

Records gathered on rentals on single and multiple family dwellings in 48 cities revealed that an average of 25.3 cents for taxes is contained in each dollar spent for rent.

Professor Walter B. Pitkin gives us a most illuminating picture of how the American people fare in an economic sense:

Income in classes in 1935

	Number in each class	How much they receive per capita	Total
1. Upper class, very rich	500,000	$10,000	$5,000,000,000
2. Middle class	12,000,000	1,000	12,000,000,000
3. Self-supporting workers, farmers, small-business men	34,500,000	500	17,250,000,000
4. Marginals, earning most living, but receiving some aid	15,000,000	300	4,500,000,000
5. Submerged idle, mostly on relief	65,000,000	75	4,875,000,000
Total	127,000,000		43,625,000,000

It is not necessary here to go into the question of the ethical right or wrong of this vast concentration of wealth in the hands of a few, though it is quite obvious that those receiving vast incomes render no service to society at all proportionate to the benefits they derive from it; nor can their relative ability correspond to their income. What concerns us here is that this concentration of income would by logical progression absolutely endanger the perpetuation of our democratic society. It is axiomatic, with realistic students of economics, that our economic order and profit system can be healthy only when there is wide distribution of purchasing power among our people. No unusual shrewdness is necessary to perceive that our system depends on large-volume sale at

high prices and must produce and sustain a consuming public amply equipped with income to purchase these goods. Despite the elementary character of this logic our economic tycoons are rarely able to master it.

The present concentration of wealth and income in this country makes impossible adequate mass purchasing power. The wealthy cannot purchase and consume in proportion to their income. Statesmen must act now.

FRANKLIN RAYON CORPORATION,
Providence, R. I., March 19, 1938.

Hon. PAT HARRISON,
Senate Office Building,
Washington, D. C.

DEAR SIR: We wish to add our congratulations to you on the strong stand which you have taken regarding readjustment of taxes to assist business at this time. The elimination of the undistributed-profits tax and drastic modification of the capital-gains tax will be very helpful. We have, however, one specific suggestion which we would like to make for your consideration. It is in our opinion most important to encourage business at this time to spend money on replacing obsolete equipment and buildings and repairing plants and machinery. If the Government could make real inducements to the business taxpayers we believe it is possible that a program of some magnitude could be started. Obviously the Government is in a position to offer sufficient inducement at this time and we would like to suggest the following specific plan:

Any amounts paid in cash, notes, or other fixed obligation by a taxpayer in 1938 and 1939, to buy or build new property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (L) or to rebuild or repair old property of the same class, may at the taxpayer's option at the end of each year be as a whole or in part (1) capitalized or (2) set up in a property suspense account to the extent that such expenditures exceed the normal depreciation charges of the taxpayer for such year.

The property suspense account shall be subject to the following provisions:

1. Additions to this account shall be limited to the years 1938–39.
2. No depreciation shall be allowed on any property held in this account.
3. On January 1, 1943, any unabsorbed balance of this account shall be capitalized and thereafter be subject to the allowance for depreciation provided in section 23 (L).
4. At any time from January 1, 1939, through December 31, 1942, the taxpayer may at his option deduct from his taxable net income any amount remaining in this account provided such amount does not exceed 50 percent of the net income for the year.
5. In event commissioner disallows any additions to this account such amounts shall be considered to have been capitalized at time of entry and tax returns adjusted accordingly.

In making the above proposal we have tried to bear in mind two points.

First.—That the Government does not want to reduce its tax income during the next 2 years. By not permitting any deductions from the property suspense account until after January 1, 1939, the Treasury Department would not actually lose any income until the year 1940, and in the meantime they would have an opportunity to see how much in the aggregate had been set up by business taxpayers into such property suspense account so that if in the opinion of Congress the amount proved to be excessive there would still be time to provide income from other sources to offset the possible revenue losses from this source.

Second.—We feel the plan would have enough appeal from the taxpayer's point of view to warrant spending substantial sums during this year and next when they will do the most good for the country. Furthermore, money spent this year and next for plant additions and improvements should begin to produce income during 1939 through 1942.

As you are now holding public hearings regarding the 1938 Revenue Act we would appreciate your reading this proposal into the records as it was impossible for the writer to make a personal appearance.

Yours very truly,

FRANKLIN RAYON CORPORATION,
ROYAL LITTLE, *President.*

BRIEF FILED BY JOHN W. MAHER, GENERAL COUNSEL, AMERICAN TAXPAYERS' LEAGUE, INC.

At this time, when the Government must have maximum revenues to meet its obligations, it is of primary importance that Congress should locate the rate of diminishing returns in all taxes and never exceed that point. It is equally important that Congress adjust existing tax levies in such a manner as to stimulate employment, increase business, and at the same time produce the revenue necessary for the economical operation of the Government and necessary Governmental expenditures. For that reason the American Taxpayers' League, Inc., desires to express to the committee its convictions that a sound tax program is the most vital concern of the American people today.

A sound tax policy must take into consideration three facts: It must produce sufficient revenue for the Government; it must rest, so far as possible, the burden of taxation on those best able to bear it; and it must also remove those influences which might retard the continued steady development of business and industry on which so much of our prosperity depends. Taxation should not be used as a means of rewarding one class of taxpayer or punishing another. Any public official who attempts to promote legislation by arraying one class of taxpayers against another shows a complete disregard for those principles of equality on which this country is founded. The American taxpayer, in our opinion, is perfectly willing to meet his constitutional obligations within reasonable limitations. He is, however, opposed to the use of our taxing system as a means of social reform or as a weapon of destruction of any group or class of our citizens.

The American Taxpayers' League, Inc., therefore, respectfully submits for your consideration the following recommendations:

1. Repeal of the undistributed-profits tax.
2. Repeal of the capital gains and losses tax.
3. A horizontal reduction of 25 percent in the surtax rates of individual incomes in the higher and intermediate brackets.
4. Amendment of personal holding company taxes to release frozen capital.
5. Amendment to section 113 of the Revenue Act of 1936 to determine the basis of capital gains and losses where a gift tax has been paid.

LOWER TAX RATES WILL PRODUCE HIGHER REVENUE

High rates of taxation inevitably put pressure upon the taxpayer to withdraw his capital from productive business and invest it in tax-exempt securities, or to find other lawful methods of avoiding the payment of taxable income. The result, inevitably, is that the sources of taxation are dried up, wealth fails to carry its share of the tax burden, and capital is diverted into channels which yield neither revenue to the Government nor profit to the people. The net result is that unemployment increases; the laborer is thrown out of work; and the wealthy taxpayer, therefore, is not the one who suffers, but rather the laborer who is deprived of the means of earning a livelihood for himself and those dependent upon his daily wages.

It seems difficult for many to understand that high rates of taxes do not necessarily mean large revenues to the Government, and that more revenue may frequently be obtained by lower rates. Proof of this statement is found in the tax yield during the years 1924 and 1927. During the year 1924, when the maximum normal and surtax rates were 46 percent, the Federal Government collected in individual income taxes $704,255,390. In the year 1927, when the maximum normal and surtax rates were 25 percent, the Treasury collected in individual income taxes $830,639,434. Thus in 1927, with a maximum rate of 21 percent below that of 1924, the yield to the Federal Treasury was $126,274,044 greater than in the year 1924. The striking point in the comparison of these returns lies in the fact that the increased yield began in the brackets showing incomes of $50,000 per annum and increased progressively in all brackets upward until the income was $1,000,000 per annum and over. In these groups the yield in 1927 was $176,278,726 more than in 1924.

Another striking comparison may be made for the period from 1916 to 1920, inclusive. During those years the surtax rates on incomes went from 13 to 65 percent, with no change in 1919 or 1920. During this period the following results occurred:

Year	Total net income reported	Net incomes over $300,000	Number of returns over $300,000
1916	$6,299,000,000	$993,000,000	1,296
1917	13,652,000,000	731,000,000	1,015
1918	15,925,000,000	401,000,000	627
1919	19,859,000,000	440,000,000	679
1920	23,736,000,000	246,000,000	395

It will be noted here that in a period when the total net income reported for tax purposes was rapidly expanding both the total net income and the number of returns of persons reporting individual incomes in excess of $300,000 were violently contracting, so that at the end of the period there were less than a quarter of the number of persons reporting such incomes, and the total income they reported was only a little more than a quarter of what it was originally.

This paradox can be accounted for only by the high income rates. Although the peak rate for 1921 was reduced to 50 percent on incomes over $200,000, the same trend of diminishing number of returns of incomes over $300,000 continued, falling in that year to 246, while the amount reported by this class of taxpayers fell to $154,000,000.

Our income tax is to be judged, not merely by the revenue it immediately raises but by its effect upon the total production of wealth. While part of the disappearance of high incomes when the rates rise to extreme levels is explained by the increased temptation put upon taxpayers to resort to various devices, much of it is doubtless explained by the resort to the device, provided by the Government itself, of tax-exempt bonds, which becomes more attractive for the very rich as tax rates advance. A substantial part of the disappearance of high incomes under high rates must be attributed to the fact that when Government takes two-thirds to four-fifths of personal income above certain amounts many men cease to take the risk or to exert the effort necessary to earn those amounts. The action of these men, therefore, must have some effect in preventing the growth that might otherwise take place in new industries, in employment, and in total production of wealth. If we want to pay this price for the sake of maintaining a very high income-tax rate, then we must at least do it with our eyes open and not pretend that the policy is costing us nothing.

The same approach to the whole problem, therefore, would be a revision of the income-tax structure so as to reduce extremely high rates in the upper and intermediate brackets. This would make tax avoidance by this means so much less attractive. It would result in a larger total yield from the income tax, making less attractive the purchase of tax-exempt securities. Confiscatory income taxation tends to defeat itself through imposing a flight to tax-exempt securities and non-income-bearing taxes. At a time when business recovery is so urgently desired, encouragement to capital to enter nonproductive channels is hardly a logical course of action.

THE UNDISTRIBUTED-PROFITS TAX

When the undistributed-profits tax was proposed by the President in his message of March 3, 1936, there was contemplated the repeal of the corporation-income tax, capital-stock tax, and excess-profits tax. This new tax on undistributed profits was to be in lieu of the other Federal levies. As finally enacted, the undistributed-profits tax was in addition to all other taxes levied, and not a substitute for them. The corporations were taxed as heretofore, and in addition must pay a tax on earnings which they withhold.

Furthermore, some rather startling prophecies were made concerning this tax. Spokesmen of the Treasury Department offered this tax as a potent device that would operate significantly to prevent business depression. Experience has shown how far these predictions have missed their mark, and the present business recession is convincing evidence of the fallacy of this tax.

While the House bill exempting from the provisions of this tax all corporations with incomes of not in excess of $25,000 would effect approximately 88 percent of the corporations in the entire country, there would still be 12 percent of the corporations, according to Treasury statistics, earning in excess of $25,000 per annum. What is not shown, however, is that this 88 percent of the corporations earned only 8.5 percent of the net income for income-tax computa-

tion, while the 12 percent earned 91.5 percent of the net income for income-tax computation. It is this small percentage of corporations with large taxable incomes that give employment to the masses of laborers in this country. They not only employ most of the workers, but they purchase most of the raw materials and constitute the most vital factor in the revival of business generally.

There is almost unanimous agreement that this tax has been one of the most important contributing factors to our present business depression. Almost without exception every survey that has been conducted, including that of the National Bureau of Economic Research, the Brookings Institution, the Twentieth Century Fund, and others, has advocated the repeal of this tax in toto. Enlightened leaders of labor have also gone on record as advocating its repeal. The American Federation of Labor, at its recent convention in Miami, adopted a resolution calling for the outright repeal of this tax. We cannot overlook the findings of the surveys above referred to nor the sentiment expressed by labor leaders throughout the country who believe that the repeal of this tax would be the greatest contributing factor to the stimulation of business, so greatly needed at present.

The effect of this tax is of far greater importance to the farmer and to the laborer than it is to the businessman. It penalizes business thrift and virtually stops business saving, which is a main factor determining industrial production. Industrial production is a main factor determining demand for farm products; and if there is no demand for farm products the farmer, naturally, is the greatest sufferer. Less business savings mean less industrial production, and less industrial production means less jobs and consequently less pay for the laborer. That, in a nutshell, is the way this tax works.

It is a tax resting on nothing more than disputed economic theory and temporary considerations. It doesn't work as anyone intended it to work. The amount of revenue produced is of minor importance in comparison with the adverse effect on agriculture, labor, business, and everyone. It forces corporate lawlessness by requiring corporations to disregard State laws restricting the payment of dividends. It also assumes that a business can determine its net income before the year ends, which usually is an impossibility.

Earnings retained by a business seldom remain long in the form of cash. Because a business has a surplus does not often mean that it has that amount of cash. Capital must be put to work to earn its keep. Earnings retained must soon become capital and thereby add to producing capacity. This finally means more earnings, and therefore more earnings to tax, so that the tax collector, in the end, gets a larger cut out of the earnings.

We might learn a lesson from foreign countries who experimented with this theory of taxation for many years before it was suggested in the United States. Practically every important nation that has tried this method of taxation has dropped it like a hot poker. Instead of penalizing corporate thrift and the accumulation of corporate earnings, many countries actually offer a premium by giving a lower rate of tax to those corporations who retain their earnings and use them for expansion, replacement, and the further employment of labor. England, for example, considered the idea of taxing corporate savings in 1919. It was rejected because it was believed that such a tax would penalize business at a time when the national welfare required the maintenance of corporate savings that were as large as possible.

This tax does not fit the American enterprise system on which the United States has grown great, and will undermine it. It is not even a good tax idea, as it tends to destroy the sources from which the revenue must come. It induces and will prolong depression; therefore it should be repealed outright at the earliest possible moment.

THE CAPITAL GAINS AND LOSS TAX

The capital-gains tax as a weapon for economic reform has failed; as a measure for raising revenue it has likewise failed. A capital gain is not income. Our present tax system, however, intermixes genuine income with gains from sales or exchanges of capital assets. The sum of all the capital gains in any particular year does not constitute any national income in the sense that the annual and regular recurrent profits from the production of goods and services does. A capital gain or loss is involved neither in regular production, regular sales, or regular sevices.

This tax has rightly been called "the No. 1 job killer." It has been so called because it confiscates and thus cuts down the amount available for new investment. It removes the incentive to enterprises and thus slows down the activity in existing investments. It works while you sleep, and it always works against you. It should rightfully be called a capital-levies tax, which confiscates the means of providing the equipment, tools, etc., with which labor earns a living. It has the same effect as eating the seed corn at a time of famine. It is a "heads I win tails you lose" tax because it takes all the gains but allows credit for losses only up to $2,000 in addition to capital gains of the year. It is a job killer because it confiscates and sterilizes the capital that ought to be put to work to provide more jobs.

This tax does not distinguish between capital and income. Capital is the source from which income flows—the tree on which the fruit is grown. We should tax the fruit, not the tree which bears the fruit. This tax forces capital to lie idle. It restricts and hinders both individuals and corporations when they try to sell capital assets, thus hampering the transfer of funds to more productive enterprises. It keeps investment out of new enterprises. Under the stifling effects of this tax men of outstanding ability, who in the past have provided employment and opportunity for others, refuse to assume the risks of new enterprise and are retiring from business. It discourages profit taking and thus retards the circulation of money and slows down business all along the line.

This tax creates frozen positions in securities and real estate and thereby restricts business activity and the tax income normally attendant on such activity. According to reliable estimates the capital-gains tax costs the Government $250,000,000 a year in tax income from other sources.

Improved business conditions can arise only from speeding up the wheels of industry and commerce, which (through wages and cost of materials and other costs) distribute the increased supply of money and credit in the form of incomes (wages, salaries, profits, etc.) throughout the social organism like the beneficial flow of blood through the human body. To expand business requires new capital for expansion of plant and machinery and for new enterprises and inventions; and also increased working capital to carry the increased inventories and receivables, without which an expansion of business breaks down, as happened in 1937. This capital has to be "risk capital" in the case of industrial and service concerns. This applies to small business even more than to big business. It has been computed that it takes not less than $8,000 investment to carry an additional man in productive industry, of which $3,000 is working capital. In this country the average investment in industry as a whole is $12,000 per man. In the experience of over 100 years of our past prosperity up to 1937 there was required each year additional new capital of between 5 and 5½ percent of the total national income. Therefore, to restore prosperity requires an annual investment of new capital in industry at the present time in excess of the entire present annual expenditures of all Federal agencies for recovery and relief.

Risk capital is not provided by the banking system nor by the multitudes. The savings of the people usually go into home ownership and into life insurance and savings banks. They are invested by the insurance and savings institutions only in mortgages and high-grade bonds, which presuppose the prior investment of risk capital. Risk capital is obtained only from those who have a sufficient surplus to permit them to take a chance—chiefly the rich.

The barrier to the investment of risk capital due to the present taxes on the earnings on risk capital, and particularly the undistributed-profits tax and the capital-gains tax, is absolute. Of these two taxes the more vicious is the capital-gains tax. It is entirely a capital tax and not an income tax. It not only inhibits the use of risk capital but destroys it in confiscatory amounts.

The Government cannot invest the sums needed to expand industry out of the tax money it collects. Taxes are expended either for current purposes or for mainly nonproductive capital purposes, such as post offices, bridges, etc., which, like fine houses, are desirable to the extent we can afford them, but do not directly add to the annual product of industry, which is the real problem of the Nation. Moreover, it is administratively impossible for Government to initiate or finance the billion and one new adventures which are necessary to a wide expansion of industry.

In this connection it is interesting to observe that the United States is the only important country in the world which has a capital-gains tax interwoven into the income-tax structure. Great Britain has the longest record of all nations of income-tax administrative experience. In England's 95 years of income tax it has developed a technique that is probably the best in the world. It has

studiously avoided the imposition of a tax on capital gains and has shunned such proposals like the plague. Great Britain balances her budget without such a tax. We have yet to balance ours. We believe that we could with profit follow the experience of Great Britain and other nations that have grown wise with experience, but have persistently refused to impose a capital-gains tax.

PERSONAL HOLDING COMPANY TAXES—FROZEN CAPITAL

The proposal to segregate capital gains from normal incomes and impose a flat rate of 15 percent on such gains will free much capital. It will, however, still leave not less than $5,000,000,000 paralyzed and tied up in personal holding companies because capital profits made by such companies incur over 70 percent tax, whereas the same profits made by an individual would incur only 15 percent tax. The following contrast is most striking:

If an individual in the 70-percent brackets realizes a profit of $100,000 on property held over 2 years, it is proposed that he pay a 15-percent tax on such profits, or a total of $15,000. If his personal holding company sells the same property at the same price, it pays a $79,000 tax if the profit is not distributed. If distributed as a dividend, the corporation pays $16,000 tax and the individual $58,800, or a total of $74,800. On the basis of Treasury information, it is estimated that there is more than $5,000,000,000 of capital tied up in these corporations at the present time.

These companies should be permitted to liquidate and the sections of the bill dealing with the present tax on personal holding companies should be so amended as to permit this liquidation. The owners of personal-holding companies generally cannot pay the present cost of liquidating because to raise the necessary money for the tax the property would have to be sold at a considerable sacrifice. For example, under the House bill, the New York stockholder of a corporation where the value is $5,000,000 more than the cost basis, incurs $1,200,000 tax, made up of Federal taxes amounting to $800,000 and the New York State taxes of $400,000. He cannot raise $1,200,000 cash. Smaller companies have the same difficulty in proportion to their size. Extension of the period for payment still leaves the taxpayer with a fixed indebtedness to be met by the sale of some property each year regardless of the price obtainable. Partial liquidation does not incur taxes at these rates, but is subject to the full normal and surtax rates.

The American Bar Association recommended as the best means for making liquidation possible for such companies that the capital-gains tax be collected when the assets are sold by the stockholder after liquidation, instead of being collected upon liquidation. This recommendation in our opinion is sound and we believe that its adoption by your committee would enable these personal-holding companies to put to work billions of dollars of capital assets that are now "frozen."

AMENDMENT OF SECTION 113 DETERMINING THE BASIS OF CAPITAL GAINS AND LOSSES WHERE A GIFT TAX HAS BEEN PAID

There is an inconsistency in the present law between the gift-tax section and the estate-tax section in assessing the basis of capital gain or loss in case of a sale of property received by the donee. This inconsistency is continued in the bill just passed by the House and referred to your committee.

The estate taxes are based on the value of the property at the date of decease, and in the event of a sale a capital gain or loss is based on the appraised value at the date of death. In the case of a gift, the gift tax is payable on the value at the date of the gift, but in the event of a sale by the donee the capital gain or loss is based on the original cost to the donor.

As the gift tax was introduced ostensibly to take the place of a devise under a will, it is manifestly unfair that the original cost to the donor should be the test. Section 113 of the Revenue Act of 1936, which is continued as the same section in the revenue bill now before your committee, contains the following subdivisions:

(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—

(2) *Gifts after December 31, 1920.*—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that for the purpose of determining loss the basis shall be the basis

(2) *Gifts after December 31, 1920.*—If the property was acquired by gift whichever is lower.

(3) *Transfer in trust after December 31, 1920.*—If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a bequest or devise) the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made.

(5) *Property transmitted at death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair-market value of such property at the time of such acquisition.

It will appear from the above that where property is given away after December 31, 1920, either as an outright gift (subsection (2)) or as a gift in trust (subsection (3)), the profit on any sale by the donee or trustee is based on the cost of the donor, whereas if a man dies (subsection (3)) the profit is based on the value at the date of death. The reason for using the value at the date of death is said to be due to the fact that an estate tax is paid on that value. As the gift tax is an excise tax, to supplement the estate tax, on the transfer of property during life, no logical reason has been advanced why property which has been subjected to the gift tax should not have a basis for income-tax purposes of the value at the date of gift on which a gift tax has been paid.

The argument also has been made that the present law discourages gifts of property which has appreciated in value and consequently prevents the Government from collecting gift taxes now, leaving it to wait for death to obtain estate taxes. The high income taxes may discourage sales by prospective donors, so that the Government doesn't get either gift or income taxes.

The inconsistency in the act should be cured by inserting after the first sentence of subsection (2) and at the end of subsection (3) a sentence reading somewhat as follows:

"If, however, the property was included by the donor (grantor) in the amount of gifts reported for gift-tax purposes under title III of the Revenue Act of 1932 and corresponding provisions of later revenue acts, the basis shall be the fair-market value of such property at the time of such gift (transfer)."

CONCLUSION

No matter what may be advanced in the way of argument as to special purpose or other justification, we cannot afford, in such a period as now exists, to discourage the enterprise of willing people and force shut-downs of active businesses through violent changes in ownership through forced transfers, to obtain income taxes which will represent but a very small proportion of the Government's total revenue.

We, therefore, most earnestly urge upon your committee, that in the furtherance of public interest, and as a principle of fair treatment in private investments and individual rights, no schedules of taxation be adopted that will hamper the orderly functioning of business enterprises that are needed so greatly at the present time to furnish employment in this country. We believe that an opportunity is given for your committee to restore the confidence that seems to be lacking at the moment. Nothing will contribute more to a rapid restoration of this confidence than a tax bill that will be clearly responsive to the business and individual requirements set forth in the recommendations outlined at the beginning of this brief.

WASHINGTON, D. C., *March 19, 1938.*

HON. PAT HARRISON,
Chairman, Senate Committee on Finance, Washington, D. C.

DEAR SENATOR HARRISON: As a lawyer who has devoted many years' study to the subject of stock and commodity market practice, I desire to comment briefly on the testimony of Mr. James P. Tumulty and of Mr. Lawrence J. Ryan in the House Ways and Means Committee hearings held last January. Your honorable committee is now, I understand, having under consideration the same subject matter, namely, revision of revenue laws, 1938, especially relating to a tax on sales of produce for future delivery.

Had it been convenient for me to do so, I should have sought an opportunity of appearing before you to testify in person. However, you may, if you wish, insert this letter in the record of your hearings.

There is a joker in section 707 (b) of the Revenue Act of 1938, as passed by the House on March 11, 1938. The purpose of the amendment you are now considering seems to be, by striking out the words "(not including so-called transferred or scratch sales)", to include such transferred or scratch sales within the taxable corpus. A reference, however, to subdivision 4 of schedule A of title VIII of the Revenue Act of 1926, as amended, will disclose that not only the above-quoted words but also the second proviso, relating to transfer sales, should be stricken.

Nearly all sales of commodity futures are transfer sales. Moreover, brokers charge their customers, both buyers and sellers, a commission on all sales, regardless of the vocabulary used in connection therewith, whether original sales, wash sales, bucket sales, scratch sales, match sales, set-off sales, or what nots.

Furthermore, the tax on such sales as are reached by the levy is always passed by the broker back to the seller. According to the last annual report of Dr. J. W. T. Duvel, Chief of the Commodity Exchange Administration, the volume of purchases and sales of commodity futures on contract markets amounts to $25,000,000,000 per annum. It would be interesting to know why the tax money derived by the Government from the sale of tax stamps to brokers, under the provisions of this act, at the existing rate of 3 cents per $100, was only $5,697,000 in 1937.

By the proposed amendment of section 707 (a) it is intended, effective July 1, 1938, to reduce the amount of the tax from 3 to 1 cent per $100 of value of produce sold for future delivery. That tax would amount to one one-hundredth part of 1 percent. It must be thought by any man of average learning and intelligence that any business that is not able to bear that much tax is not a very substantial business.

Mr. Tumulty has pleaded for magnanimity toward futures brokers. He has cited the cases of 20 brokers whose business, after payment of the tax, has shown a small profit. He has cited the cases of six brokers whose business, after payment of the tax, has shown a loss. In the case of William D. Hagerty, the gross profit on a particular day's trade was $37.50 and the tax was $47.55. In the case of Frank L. Schreiner, which he calls "a perfect example of a victim of the present tax," it appears that Mr. Schreiner's net loss, prior to payment of the tax, was $1,005.37, and that, after suffering that loss, he had to pay $22,967.58 in taxes. Mr. Schreiner seems to have been doubly unfortunate. One must marvel at his courage in carrying on.

The simple fact is that these poor men were not acting as brokers at all. A broker is an agent. These men were trying to buck the game on their own account and as their own principals. They call themselves "pit traders." It has been well said that a lawyer who acts in his own defense has a fool for a client. At any rate, for many years the propriety of a broker acting as his own principal in stock and commodity futures markets has been seriously questioned by students of the subject.

At some future time the Senate Committee on Finance may wish to consider the larger aspects of taxation on the business of buying and selling futures contracts. It is a subject, it seems to me, that merits more consideration than it seems to have as yet received.

Respectfully submitted.

ERNEST D. MACDOUGALL.

BRIEF SUBMITTED BY JULIAN W. CURTISS, CHAIRMAN, TAX COMMITTEE OF THE ATHLETIC GOODS INDUSTRY

EXCISE TAX ON SPORTING GOODS

By the Revenue Act of 1932 there became effective on June 2, 1932, the following tax, under section 609:

"There is hereby imposed upon the following articles, sold by the manufacturer, producer, or importer, a tax equivalent to 10 per centum of the price for which so sold: Tennis rackets, tennis racket frames and strings, nets, racket covers and presses, skates, snowshoes, skis, toboggans, canoe paddles, polo mallets, baseball bats, gloves, protectors, shoes, and uniforms, football helmets,

harness, and uniforms, basketball goals and uniforms, golf bags and clubs, lacrosse sticks, balls of all kinds, including baseballs, footballs, tennis, golf, lacrosse, billiard, and pool balls, fishing rods and reels, billiard and pool tables, chess and checker boards and pieces, dice, games and parts of games (except playing cards and children's toys and games); and all similar articles commonly or commercially known as sporting goods."

This tax was approved on June 16, 1933, for 2 years. In 1935 it was renewed for 1 year and in 1936 for still another year. Again in 1937 it was renewed for 2 more years.

It is most unfortunate that we are associated in that bracket with so many goods that our industry does not manufacture and with which we have no association. I refer particularly to billiard and pool balls, fishing rods and reels, billiard and pool tables, chess and checker boards and pieces, dice, games and parts of games.

The goods which our industry makes and desires to be tax-free is all the equipment used in the following sports: Tennis, golf, baseball, basketball, football, and uniforms for all sports.

The total amount of tax collected on these sports, in the most careful figuring, would not exceed $3,000,000, these quantities having been checked off by a complete record of all the important manufacturers and with the United States census of manufacturers.

Furthermore, this tax is extremely expensive to collect so that the net return is small, indeed. I do not think I need argue about the important part that these goods play in building up the health and strength of the youth of our country—that surely is an accepted fact. I would like to call particular attention to the difficulty in the collection of this tax on uniforms. I think the department itself realizes this fully, because they hardly know what instructions to give in connection with the collection of this tax.

Baseball uniforms that are sold to a boy of 6 to 9, inclusive, are not taxed; but when the kid reaches the mature age of 10, it is taxed 10 percent. Baseball caps are taxed; novelty caps are not. By novelty caps I refer to freshmen caps, class caps, or some distinctive cap adopted by a class, for instance.

The collectors are instructed that in determining when an article is a baseball cap or a novelty cap there should be taken into consideration particularly the place where sold, and that idea is carried out without fail in everything connected with uniform goods. Sporting-goods stores are under suspicion. Department stores are not.

Gym clothing is not subject to tax unless so constructed to be identified as part of the uniform. Sweat shirts not taxable unless sold as part, or in conjunction with, a uniform. How is this determined? No one knows. Gym-leader pants or instructor's pants not taxable regardless of whether they are striped or plain. Shorts for all outdoor use, not taxable unless sold as part or in conjunction with a uniform. Gym bloomers or girls' rompers not taxable unless lettered or marked so as to be identified as a uniform or part of a uniform.

Ski uniforms of all kinds—and these are sold largely in department stores and represent in many cases most elaborate costumes—are not taxed at all.

Shoe stores are selling shoes for golf with plain soles and the golf pegs are put in afterward. All tax this way is avoided.

And so I could go on almost interminably. I will venture to say it is the most mixed up mess with which the Tax Bureau has to deal. In fact, they themselves acknowledge it.

Also a ruling has been made that schools and colleges supported by States and municipalities, and performing an essential government function, should be relieved from this tax. In other words that they could charge it back to the manufacturer or, as is generally the case, to the distributor or dealer who supplies them. This ruling is also applied to Civilian Conservation Corps camps, cities, and counties in their purchases, which, of course, have multiplied many times the detail work necessary to handle such orders.

There is a further inequality to the ruling exempting schools and other governmental institutions, that while State and city schools are exempt from this tax, private, parochial schools, universities and colleges, Y. M. C. A.'s, boys' clubs, Lutheran, Methodist, and other denomination schools, American Legion athletic programs, and Turnvereins must pay it, thus forcing the manufacturer to deal with two classes of customers, one the privileged class that can charge the tax back, and the other the unfortunate group that has to pay it.

To sum up tersely, we place our claims on the following reasons:

First. The small amount of tax collected and the large expense in connection with it.

Second. Impossible situation in regard to uniforms.

Third. It taxes the implements of play which bring health and strength to our people. Also collected from the young who can least afford to pay it. Even in golf the number of players on public courses exceeds those on private club courses who, by the way, are reached by tax on their club dues.

Fourth. It has been a severe handicap to the industry, the present sales being not over 60 percent of what they were 8 years ago.

Of course, I do not claim that this tax was entirely responsible for this situation—that would be foolish—but it has been certainly a contributory effect.

Respectfully submitted.

JULIAN W. CURTISS,
Chairman, Tax Committee of Athletic Goods Industry.

BRIEF SUBMITTED BY L. K. ANDERSON, VICE PRESIDENT, SELCHOW & RIGHTER CO., NEW YORK CITY

It is respectfully urged that you and your committee approve the provisions of the House bill providing for the repeal of section 609 covering excise taxes on sporting goods for the following reasons:

1. As a manufacturer of home games we have found that there is no clear line of demarcation on taxable games. Treasury Department inspectors declare more and more border-line games taxable each year.

2. More fly-by-night concerns, who have no plants, enter the game business each year. These either ignore the tax, or are ignorant of it. They can, therefore, undersell us at least 10 percent, and can pocket their profit. If finally caught, the damage has been done, and we manufacturers, who keep our plants running all year, are the victims.

3. As game manufacturers, we are part of the toy industry, and must compete for the consumers' toy dollar, whether it be for mechanical toys, books, dolls, or any other item (none of which are taxed). To our knowledge, this is the only case of its kind where a portion only of an industry is so unfairly handicapped.

4. It is impossible to pass this tax on. Our customers will not stand it. The burden, therefore, increases for us yearly for, in 1937 alone, 100 percent of our hard-earned net profits went for payment of this excise tax. This was due to more games (home games not gambling ones) being construed as taxable by under deputies.

5. The records and experiences of representatives of the Bureau of Internal Revenue, charged with the administration of this tax, show that this has been one of the most difficult excise taxes to administer, and it is believed that, if called upon by your committee, they would express opinions in that regard. The total revenue from the tax on games, according to conservative estimates, does not exceed $250,000, which amount is not large by comparison but falls heavily upon a few manufacturers for reasons as explained in paragraph 3.

6. If for any reasons, because of need of additional revenue, section 609 be reinstated by your committee, we strongly urge that in such event it be amended at least to the extent of removing "Games and parts of games (except playing cards and children's toys and games)."

7. If this tax yielded any considerable net revenue to the Government, and if it were more equitably distributed to the manufacturers of competing products, we would not feel justified, at this time of much-needed revenue on the part of the Government, in so strongly urging its repeal.

MEMORANDUM OF H. H. NORDLINGER (NEW YORK CITY) WITH REGARD TO THE CAPITAL GAINS AND LOSSES PROVISION OF THE FEDERAL INCOME-TAX LAW

To the honorable Finance Committee of the Senate:

I

It is submitted that the soundest way to handle the matter of capital gains and losses would be to eliminate them altogether from consideration. In other words, capital gains should not be taxable as income, and, conversely, it would follow that capital losses would not be deductible for income-tax purposes.

It is submitted that capital gains and losses are in no true sense income items. This is made clear by a number of considerations.

No sensible person in the conduct of his affairs treats these items as income items. If he has a substantial capital gain in the course of a particular year, he undoubtedly has a feeling of prosperity, but he certainly would not think of spending the gain for his ordinary living expenses. On the other hand, if he has a capital loss which equals or exceeds his ordinary income, he would continue to pay his expenses out of his ordinary income just the same, without any feeling that he is spending his capital.

The point is reenforced by the way in which such items are handled in the case of trust funds. It is well settled, at least in New York and presumably elsewhere, that where a trust is created to pay the income to a beneficiary for life, capital gains of the trust are not payable to the beneficiary but added to the corpus of the trust and, conversely, capital losses are not deducted from the income payable to the beneficiary but deducted from the corpus of the trust (*Stewart* v. *Phelps*, 71 App. Div. 91, affd. 173 N. Y. 621; *Matter of Stevens*, 111 App. Div. 773, 778, modified on another point 187 N. Y. 471; *Matter of Schley*, 202 App. Div. 169, 178, affd. 234 N. Y. 616; *Matter of Eger*, 139 Misc. 59; *Matter of Sherman*, 154 Misc. 289).

Furthermore, if so-called capital gains are due to the operation of inflation, it is plainly unjust to impose a tax upon them, because in that case they are not truly gains at all but simply represent the complete or partial success of the efforts of the taxpayer to maintain his position unimpaired.

The harmful effect of a heavy capital-gains tax in preventing the free sale of assets in which there has been a market appreciation has often been pointed out and need not be elaborated.

II

If capital gains are to be considered for income-tax purposes at all, it is submitted that elementary justice requires that capital losses should be considered in the taxpayer's favor to exactly the same extent that capital gains are considered against him. This implies, of course, that the $2,000 limitation on deduction of capital losses should be eliminated.

III

If capital gains and losses are to be taken into account, it is submitted that the fairest and most satisfactory way to do so is substantially the way in which it was done approximately 10 years ago, viz, to tax capital gains (either absolutely or at the option of the taxpayer) at a moderate flat rate (say 12½ percent) and correspondingly to allow credit for capital losses (either absolutely or at the option of the taxpayer) at a corresponding rate. Such a disposition of the matter, while perhaps theoretically objectionable, would eliminate most of the practical objections to the present arrangement. The rate of tax on gains would not, as at present, be so high as to be prohibitively unjust to the taxpayer in the case of substantial gains; and the change suggested on the previous page would also eliminate the injustice which now exists as a result of taxing capital gains, whereas capital losses are allowed only to the very limited extent of $2,000.

Such provision, if made, should be supplemented with a carry-over provision in the event of a net loss.

IV

If Congress is unwilling to go to the extent of any of the foregoing suggestions, it is submitted that adopting the suggestion in subdivision III of this memorandum as to securities held more than a year, coupled with the total elimination of the $2,000 limitation on losses and the adoption of a reasonable carry-over provision for losses, would be a step in the right direction. There is some theoretical and practical justification for distinguishing between gains and losses upon the sale of securities held for a short time and those held for a longer term. If the distinction is to be drawn at all, an arbitrary line of demarcation must be selected and 1 year seems a good practical dividing line.

V

However, if the present restriction on the deduction of losses is to continue and is coupled with a segregation between sales of securities held over a year

and sales of securities held less than a year, the great injustice to the taxpayer, which already exists under the present provisions, is aggravated further. If, on the other hand, the restrictions from the deduction of capital losses are removed and provisions allowing the carry-over of losses from year to year are inserted, there seems to be no serious objection to the distinction between short-term and long-term transactions.

Dated, New York, March 18, 1938.

Respectfully submitted.

H. H NORDLINGER.

STATEMENT OF DAVID R. CLARKE, OF FYFFE & CLARKE, GENERAL COUNSEL FOR THE ILLINOIS MANUFACTURERS' ASSOCIATION

Gentlemen, I am David R. Clarke of the firm of Fyffe & Clarke, general counsel for the Illinois Manufacturers' Association, Chicago, Ill., and I am speaking for the Illinois Manufacturers' Association.

I am an attorney at law and my address is 120 South LaSalle Street, Chicago, Ill.

The manufacturing industries in Illinois are about as near to a standstill as they can be and yet continue to keep their doors open.

The situation is rapidly getting worse—and not better.

Backlogs of orders are rapidly becoming exhausted and new orders are of the small hand-to-mouth variety.

Losses are rapidly depleting the remaining working capital of most manufacturers.

Employment is continuously lower—and unemployment higher.

Why?

Because the mass of the public—the businessman public, the financial public, and, above all, the purchasing public—do not believe that the Congress is going to do anything to materially relieve business from the burdens, the strictures, and the harassment of Government impositions and Government agents.

They know that the retention of the principle of the undistributed-profits tax, the retention of the withering capital-gains tax, the retention of the high corporate-profits taxes, and the over-all determination to extract the same amount or more taxes from business by one tax scheme or another, whatever may come, means that business and industry are not to be freed to go forward.

Unless Congress will act now, at this time, to dispel this all-enveloping cloud over the future of business and industry, the outlook is calamitous.

Nothing Congress can do will so dispel this all-pervading and paralyzing fear as will the outright repeal of the undistributed-profits taxes, the outright repeal of the capital-gains tax, and the lowering of the corporate-profits taxes.

Such a clear-cut declaration and action by Congress will start the wheels of business and industry because it will release the purchasing power of the country, vast purchasing power that is frozen with the present outlook for hard times.

Where will Congress get the money to take the place of these taxes?

The answer to this question is: The only thing that can take the place of stifling tax burdens on business and industry is the resumption of business and industrial operations and the consequent resumption of business and industrial employment. That will come, and will only come, when the people of the country know that the business and industry of the country, upon whose prosperity we all depend, is going to be allowed to live and prosper.

The Government cannot employ and support the people; only business and industry can.

Business and industry must be made free to do so.

DAVID R. CLARKE.

SURVEY MADE BY ILLINOIS MANUFACTURERS' ASSOCIATION REGARDING EFFECT OF FEDERAL SURTAX ON UNDISTRIBUTED PROFITS UPON ILLINOIS INDUSTRY AND EMPLOYMENT

The Illinois Manufacturers' Association recently conducted a survey among 3,000 manufacturing industries of Illinois embracing practically every type of manufacturing and including manufacturers of all sizes with the purpose of securing information regarding the influence which the Federal surtax on undis-

tributed profits had had upon the business of individual manufacturers as well as upon the business situation in general during the years 1936 and 1937.

The principal questions embodied in this survey and a summary of the answers received thereto follow:

1. WHAT INFLUENCE DID THIS TAX HAVE UPON PLANT REHABILITATION OR EXPANSION? CAN YOU ESTIMATE THE AMOUNT OF CONTRACTS YOU WOULD HAVE LET BUT FOR THE RETARDING INFLUENCE OF THIS TAX?

Eighty-three percent of the replies indicated that the Federal surtax on undistributed profits was definitely detrimental to their program of plant rehabilitation.

In practically every instance the answers indicated that plant repairs, expension, and rehabilitation had been retarded or delayed indefinitely.

In 58 cases, however, member firms definitely estimated that the amount of contracts they would have let, but for the deterring influence of this tax, was $39,558,000. This was $8,716,739 more than the entire building record for Chicago during the first 9 months of 1937.

In a great majority of instances the manufacturers could not estimate definitely the amount involved in dollars and cents for such expansion, but in the aggregate, the amount would far exceed the specific sum stated.

2. WHAT EFFECT HAS THE TAX HAD UPON THE STABILITY OF EMPLOYMENT?

Nearly every letter referred to falling off in business, enforced lay-offs during the 1937 recession and consequent unemployment. During the heaviest years of the previous depression hundreds of manufacturers paid employees not actually required during diminishing production out of reserves which under the present revenue law, no longer are available for that purpose. This was brought out forcefully in many of the letters received by the association.

A manufacturer of machinery and tools stated:

"During 1936 and 1937 our additions to plant and equipment have averaged $125,000 annually less than the average additions over the 5 years, 1925 to 1929. The restriction has largely been caused by the use of our free working capital for handling a larger volume and higher priced inventory. The further influence was our disinclination to use a larger percentage of earnings for plant improvement under the necessity of paying immediately a heavier percentage of such earnings in this tax.

"We went into the depression in 1930 with very substantial reserves built up by retaining a large percentage of our 1928 and 1929 profits in our own industry. During the greater part of the 5 depression years following, we maintained a very active sales organization and secured a better than normal percentage of the going business in our lines.

"Consequently, through that period we carried a force that averaged about 65 percent of our normal, although generally this force was on record hours. However, there were a number of periods when we ran a portion of our working force on an overtime schedule. The prospects now are that we could not afford the expenditure to repeat this record, because we would not have as heavy reserves and the actual operations during the period of the depression were not profitable."

A large manufacturer of railroad supplies wrote on this point:

"Our attitude on labor costs has necessarily been changed on account of the tax law. We have decided our policy must be reduction in personnel as soon as a business lull is apparent, not waiting for conditions to improve and to employ workers on general maintenance or building up larger inventories. If you have guessed wrong, you have a charge to surplus account that under the present law cannot be regained without a heavy penalty. We had to reduce our force 25 percent 60 days ago."

A producer of building material with a deferred building program of $30,000 wrote:

"With curtailment of operation we are obliged to reduce our working force. At one of our plants which requires 40 men there are now but 6 on the job."

A machinery manufacturer who had abandoned a $100,000 building program commented:

"Employees reduced 50 percent due to decreased business brought about by tax."

A manufacturer of starches which had given up building plans estimated at $500,000 estimated that the Federal surtax had cut into the stability of its employment fully 50 percent.

A manufacturer of drills concludes:

"The surtax prevents stability of employment for the reason that it does not permit the retention of gains for investments in capital expenditures, which in turn increases employment and assists in stabilizing employment in all lines."

A manufacturer of excavators wrote:

"The Federal laws have caused stability of employment in our business, but negatively, for the reason that we do not have the courage or desire to enlarge our operating force if we can secure sufficient business to keep the existing force profitably employed."

3. WHAT EFFECT DOES THE SURTAX HAVE ON DEBT RETIREMENT?

Thirty-eight percent of the replies to this specifically indicated that the tax in question interfered materially with debt retirement. A typical letter from a machinery manufacturer said:

"This tax has been directly responsible for distribution to stockholders of earnings which could otherwise better have been applied to debt reduction."

Most of the letters, however, seemed to indicate that debt retirement is not a major problem with the companies replying.

4. HAS THE TAX INCREASED INDEBTEDNESS TO BANKS OR STOCKHOLDERS?

Forty-two percent of the replies indicated that such indebtedness had been increased. Six alone stated that such indebtedness had been increased by $1,220,000.

Some letters stated they had been compelled to obtain bank loans for the first time in many years. It was pointed out that if money could have been retained in the business it would not have been necessary to incur bank indebtedness.

5. WHAT DIFFICULTIES HAVE BEEN ENCOUNTERED IN ESTIMATING THE TAXABLE NET INCOME BEFORE THE CLOSE OF THE YEAR TO BE USED AS A BASIS FOR ACTION ON DIVIDENDS?

This question of the difficulty encountered in estimating the taxable net income before the close of the year to be used as a basis for action on dividends brought forth great unanimity of opinion.

Eighty-three percent of the replies stated that they felt the tax to be unfair in this respect. Some of the difficulties encountered in the estimate of taxable net income were as follows:

(*a*) Earnings cannot be accurately determined until a value has been placed on the year-end inventory.

(*b*) Year-end adjustments often change the taxable net-income figure.

(*c*) Taxable net income determined at the close of any year is subject to review and change by the Treasury Department.

A large manufacturer of railroad supplies stated:

"The feature of the law requiring that in order to have credit for dividends paid they must be in the hands of stockholders before the end of the year is very unfair. It was necessary that this company estimate its profit for the last month in the year; also try to figure what shrinkage might develop in our inventories due to markets and other causes. Our firm has a very diversified line of products. Also with the varied line our inventories are large. If you guess too great a profit and pay your dividends on that basis, your capital may be impaired; too low estimate of profits, you are penalized."

A manufacturer of drills said:

"Difficulties encountered in estimating taxable net income before the close of the year has forced us to take a physical inventory on October 31 which practically will have to be repeated on December 31 resulting in unnecessary overhead."

A company manufacturing engraving supplies replied:

"Plenty! You have to be a juggler, a psychic, and an Indian yogi."

6. WHAT EFFECT DOES THE TAX HAVE ON RESTORATION OF DEPLETED WORKING CAPITAL?

About 69 percent of the replies received in answer to this question indicated that the tax resulted in a detriment to the restoration of depleted working capital. Many of them replied that they could not restore this working capital except by paying a heavy tax.

A manufacturer of wheels replied:

"Expanding industry, which may require a substantial part of its profits to take care of the necessary increase of working capital and plant expansion, practically faces confiscation."

A biscuit corporation replied:

"After paying large dividend our working capital was depleted and it was our thought to acquire additional funds through the sale of stock. Due to the collapse of the stock market, however, this was not possible and we are now finding ourselves unable to obtain further sums from this source and it is too late to do anything about the dividend which has been declared and paid."

A large manufacturer of agricultural implements replied:

"We do not have any depleted working capital to be restored."

7. DESCRIBE THE FORM IN WHICH YOU PAY DIVIDENDS

Seventy-three percent replied that they paid in cash; 13 percent in cash and notes; 6 percent in cash and stock; 2 percent in stock; 6 percent reported that they paid no dividends; and a large number failed to answer the question.

8. DESCRIBE THE DIFFICULTIES ENCOUNTERED IN FINANCING INCREASED INVENTORIES AND ACCOUNTS RECEIVABLE

The respondents did not specify the difficulties encountered in financing increased inventories and accounts receivable although 45 percent of the total replies expressed objection to the tax in this respect.

A power implement company said that during the depression from 1929 to 1935, it lost about $7,000,000 in working capital and added that under present income tax laws, Federal and State, including normal excess-profits and undistributed profits, it did not look like they would again be able to restore reserves.

A manufacturer of brushes said:

"In order to overcome the difficulties of financial increased inventories and accounts receivable, we have continually decreased the amount of inventory on hand and endeavored to get a much quicker turn-over of same."

9. WHAT DIFFICULTIES WERE ENCOUNTERED IN MAKING CAPITAL GOODS PURCHASES OR SALES?

Fifty-six percent indicated difficulty in varying degrees.

An engineering concern said:

"Credit is being more rigidly restricted on capital goods and time payments extended only on adequate security."

A job-printing establishment replied:

"Capital goods purchases were limited to the amounts of yearly depreciation in order to escape taxation whereas larger amounts could have been expended on the basis of long-term profits."

A manufacturer of springs replied:

"In order to conserve our cash, we have refrained from purchasing any capital goods."

A forging company supplying automobiles, trucks, and railroad cars replied:

"We do not purchase capital goods unless we have money on hand to pay for them."

A manufacturer of drilling tools replied:

"We faced many difficulties in making capital goods purchases for obvious reasons, one being that where we would invest in capital goods it would represent in value or surplus, and therefore, we would be taxed what we think unreasonably high for it."

10. WHAT WAS THE TENDENCY TOWARD INCREASING SALARIES, WAGES, AND EXPENDITURES, SUCH AS ADVERTISING, BECAUSE THE GOVERNMENT WOULD SHARE SUBSTANTIALLY IN DEFRAYING THE EXPENSE THROUGH DECREASED TAXES?

About 41 percent of those replying stated that they had followed this tendency to the extent of increasing bonuses, salaries, wages, and advertising.

A large number of the companies indicated that they would or had already communicated with their Representatives in Congress in opposition to the tax. Many of them included copies of letter which they had sent to the Senator and Representatives.

It is apparent from the text of the letters received that the opposition by industry to the Federal surtax on undistributed profits is strong and, while few concrete remedies were offered other than complete repeal, all of the companies seem united in a feeling that this tax is an onerous burden on their current operations and a retarding influence on their future progress and development.

A manufacturer of drilling tools who had deferred $210,000 for plant and office expansion favored the Celler bill as a constructive measure, stating:

"Stability of employment. The Federal surtax on undistributed profits deters stability of employment for the reason that it does not permit the retention of gains for investments in capital expenditures, which, in turn, increases employment and assists in stabilizing employment in all lines.

"We wish to go on record as highly supporting the bill introduced by Congressman Celler, known as H. R. 7550. In the face of a new depression, and with no relief in Government expenditures, repeal of the undistributed-profits tax seems improbable. Hence about all we can seek is an amendment to the said tax. The three points proposed by Congressman Celler, namely: (1) Discharge of indebtedness; (2) expenditures for improvement; (3) general relief credit are highly pertinent to industry, particularly to the capital-goods industries."

Not a few of the replies indicated that the tax burden fall most heavily upon new and struggling companies.

A manufacturer of workmen's clothing says:

"It seems to us that the present tax gives quite a decided advantage to the older and more strongly entrenched companies and thus is unfair legislation.

"With the new businesses, however, such is not the case. Many have passed through a number of disastrous years, when dividends had to be omitted completely and where the capital may have become more or less impaired. In the normal business cycle they will encounter years in which good earnings will be made. The prudent course is to repair the losses incurred by leaving the money in the business and, if business is good, to use a substantial portion of the profits in increasing the facilities for producing a larger volume of business. At the present time we cannot do this without paying a very large tax to the Federal Government."

An officer of a large company manufacturing food products which canceled new developments amounting to $100,000, says:

"Just speaking personally, I feel that this undistributed-profits tax is about the most insane type of legislation that Congress has placed upon us. It is certainly fine for us as an old company with a pretty fairly substantial surplus because it handicaps our smaller new competitor, despite which fact I still believe it is insane legislation."

A manufacturer of novelties states:

"Under this tax law it cannot be expected that any new or small business can ever grow as it should when such a penalty is imposed on putting profits back into the business."

MEMORANDUM SUBMITTED BY THE NATIONAL MALT PRODUCERS MANUFACTURER'S ASSOCIATION TO SUPPORT A PROPOSED REPEAL OF SECTION 601 (C) (2) OF THE REVENUE ACT OF 1932, WHICH IMPOSES A TAX ON MALT SIRUP

The above-mentioned act imposing a tax of 3 cents a pound on malt sirup was approved June 6, 1932. At that time there was a relatively large volume of sales to which the tax was applicable, but since that time the sales of this product have declined to such an extent that the tax is now a burden and restriction upon the industry rather than a source of revenue to the Government.

The revenue derived from this source during the last 7 months of 1932 amounted to $2,146,987.79; for the calendar year 1933, $4,134,968.40; for the calendar year 1934, $1,670,366.16; for the calendar year 1937, $558,751.90.

A subcommittee of the Committee on Ways and Means of the House of Representatives in its report submitted January 14, 1938, with reference to the proposed revision of the revenue laws, after a careful study and, with the approval of the Treasury Department, recommended that this tax on malt sirup be not effective after June 30, 1938. (Recommendation No. 60.)

At the hearing before the Committee on Ways and Means of the House of Representatives on the revenue revision, it was contended by interests appearing in opposition to the repeal of the tax that large amounts of malt sirup are being used in the illicit commercial manufacture of beer. Anyone familiar with the situation knows that there is no such illicit manufacture of beer in the United States.

Mr. W. S. Alexander, Federal Alcohol Administrator, in his report filed with Congress January 5, 1938, discussed the problems connected with the enforcement of the liquor laws, but made no mention of illicit manufacture of beer as one of these problems.

Mr. Berkshire, head of the Alcohol Division, who has charge of the collection of the tax on beer, has stated that they have not encountered any cases of illicit manufacture of beer, and the charge that malt sirup is used in such connection therefore finds no support in the Treasury Department.

The Treasury Department recommended the removal of this tax on the ground that it is a nuisance and brings but little revenue while the cost of collection and administration is very high. The tax is a nuisance and a burden not only to the Treasury Department but to the industry. Bakers are the largest single consumers of malt sirup. The product is used by them in the manufacture of bread and similar food products. Sales to bakers, to manufacturing pharmacists, manufacturers of malted milk, breakfast foods and food beverages, such as cocoa and similar malt preparations, and to textile manufacturers are, by the provisions of the act, exempt from the tax.

To obtain this exemption, however, the user who purchases the malt sirup from the manufacturer must furnish the manufacturer with a certificate on a form prescribed by the Secretary of the Treasury for the purpose of showing that the malt sirup will be used for a tax exempt purpose. Should the purchaser resell any of the malt sirup, he must procure a similar certificate from his vendee. Such certificate provides that a fraudulent use thereof will subject the user to a fine of not to exceed $10,000 or to imprisonment for not more than 5 years, or both. A separate certificate where practicable is required for each order. Records of invoices, orders, etc., must be kept for a period of 4 years.

The use of malt sirup by bakeries alone brings it into thousands of shops. The burden on the manufacturer, wholesaler, and user in connection with complying with the requirements of the Treasury Department to establish proof of the nature of its use, and thus secure exemption from the tax, is necessarily considerable. Because of the work necessary to secure the exemption and the risk many users fear of possible assessment of tax for failure to comply strictly with some requirement, the use of malt sirup for tax-exempt purposes is curtailed to some extent.

The use of malt sirup for tax-exempt purposes accounts for by far the greater part of the sales of such product. During the year 1937 sales of malt sirup taxable under the act amounted to only about 20 percent of the total volume of malt sirup produced and marketed. It is thus seen that the restrictions imposed by the section of the act in question apply principally to sirup which is used in food and kindred industries and is exempt from the tax.

Although it was obviously the intention when the law was enacted to exempt from the tax malt sirup used for industrial purposes, the language of the act does not cover all such cases, and there have been developed new uses for the sirup where the tax applies. For instance, during the past few years, malt sirup has been found to have a value for the propagation of yeast in some industries but the possibilities of expanding its use in this and other instances have been limited because the tax must be paid when sold for these purposes.

The tax at present applies only to sales for such uses as are not exempt and to sirup sold in small packages for household use. As has been pointed out above, such sales constitute a minor and declining percentage of the business. Thus the formalities connected with obtaining tax exemptions burden the major part of the business in order to collect the tax on a very minor portion of it and places the tax on malt sirup definitely in a nuisance category.

The contention that the product is being used in the illicit manufacture of beer is groundless. The Treasury Department will substantiate this. That the

tax is a burden and a nuisance to the industry and to the Treasury Department has been shown above. As a revenue producer, it is becoming increasingly valueless, but the cost of collection remains the same.

The tax has outlived its usefulness to the Government and is now merely a burden and handicap to the industry.

It is respectfully urged that this tax be eliminated.

Respectfully submitted.

S. L. GOLDMAN, *Secretary*.

BRIEF SUBMITTED TO THE FINANCE COMMITTEE, UNITED STATES SENATE, REGARDING REVISION OR REPEAL OF CERTAIN SECTIONS OF THE REVENUE ACT OF 1936

SPARTANBURG, S. C., *March 17, 1938*.

COMMITTEE ON FINANCE,
United States Senate, Washington, D. C.

GENTLEMEN: In reply to your telegram in which you notify me that I am listed to appear before your honorable committee Thursday, March 17, I regret that I shall not be able to avail myself of the opportunity which you so kindly extend me.

As the time for testimony is limited to such a short time, I do not believe that the possible results that might be accomplished would warrant a trip to Washington.

I am, however, at your request submitting the following brief, which supplements the enclosed brief, Tax Comments, to Mr. S. M. Beattie, president of the Cotton Manufacturers Association of South Carolina, both of which pertain to the Revenue Act of 1936, particularly to the undistributed-profits tax.

Tax Comments was written on March 17, 1937, at the request of Mr. Beattie, president of the Cotton Manufacturers' Association of South Carolina, for whom I am tax adviser. This association is comprised of all textile plants in the State and represents leading textile plants in the United States. These comments are largely general, analyzing certain provisions of the Revenue Act of 1936, showing the inequities of these provisions and predicting their harmful effects.

In response to your telegram I have supplemented these comments with several specific cases of mills in this vicinity adversely affected by the Revenue Act of 1936, which prove beyond a doubt that the undistributed-profits tax is a most vicious form of legislation, unfair in application, disastrous in effect, and unsound in policy.

As I cannot attend the hearing, may I ask that the clerk of your honorable committee read both briefs if time permits; if not, will you be so kind as to allow this supplementary brief, with this letter, to be read, as I believe, since it cites definite cases, it will be of interest to you?

Respectfully submitted.

L. C. DODGE.

SUPPLEMENTARY COMMENTS ON EFFECT OF CERTAIN PROVISIONS OF THE REVENUE ACT OF 1936

In response to your telegram I am illustrating with specific cases some of the ill effects of the undistributed-profits tax as it applies to the textile mills in the South. As representative of some 30 or 40 textile plants in the South in tax matters, and as tax adviser to the South Carolina Manufacturers' Association, this act has received serious study from me, both as to theory and application, and I submit herewith a few comments the reading of which, I believe, will not require more than the allotted 10 minutes of your time.

The Drayton Mills, Drayton, S. C.; the Darlington Manufacturing Co., Darlington, S. C.; and the Abbeville Mills, Abbeville, S. C., were forced into bankruptcy under section 77B due to the fact that their creditors were unwilling to continue financing them unless a reasonable amount of their profits should be used to liquidate their accounts without severe penalty.

One of the most interesting illustrations of the hardship caused by the operation of the undistributed-profits tax is that of the Whitney Manufacturing Co., Whitney, S. C.

This company had been in financial difficulties for the past several years, and their main creditor to whom they were indebted in an amount of some $1,800,000 agreed to cancel $700,000 of same in order that they might not be forced into bankruptcy and cause further unemployment.

This creditor was willing to carry the indebtedness of the company in hopes that the stockholders might eventually realize something from their investment, but he could not be expected to continue this credit if the company was compelled to distribute future earnings to its stockholders or pay 20½ percent extra to the Treasury Department for not doing that which would be, in effect, a fraud upon the creditors. Furthermore, having a deficit, it would be violating a State law to declare a dividend.

If this company had made any money in the fiscal year 1937, the creditor would have been compelled to institute bankruptcy proceedings to save the 20½ percent of the profits so that it could be applied upon his account.

This was not done because the company's records disclosed a net loss for the year, but the irony of the situation is that the operating profits of some $60,000 were offset by a loss of $70,000 incurred through the company's desire to satisfy its employees by selling the company's houses to them far below cost, feeling that the pride of ownership would make better citizens of the employees and would create a more satisfactory relation between the management and its employees.

The employees were pleased, but the transaction caused a net loss of some $10,000 for the year. According to the 1936 Revenue Act, however, they have a taxable net income of $58,000 which is subject to normal tax and a further penalty for not distributing same even though the profit was not available or even realized. This situation is due to the fact that the sale of the houses constitutes a loss on the sale of a capital asset, and is deductible only to the extent of $2,000. This case presents the question, How is it possible to distribute a profit that you have not realized?

To illustrate the unfairness of the present tax structure, as regards the comparative taxes on corporations and their stockholders with the taxes paid by individual owners or partnerships, attention is directed to the following case, which clearly illustrates that a corporation closely held is severely penalized under the present law as compared to similar enterprises operated as individuals or partnerships. This discrimination will undoubtedly result in the liquidation of many corporations under the present law without taking into consideration the proposed law of attaching additional penalties on closely held corporations.

One of the recent illustrations of the results of these additional taxes on a corporation is the case of the Jackson Mills, Wellford, S. C. This company operates textile mills in North and South Carolina, and is capitalized at a very nominal figure. For years they have been expanding on borrowed capital, and they sustained substantial losses during the depression of 1930 to 1933. By 1936 they were in a position to expand further by renewing their indebtedness and refraining from declaring any dividends.

They purchased a plant in North Carolina, spent several hundred thousand dollars to put the plant in an efficient operating condition, and employed several hundred workers.

After these plans were formulated, and partially executed, the Revenue Act of 1936 was passed penalizing them some 20½ percent additional tax for not distributing the income earned in 1937. The stock of this company was 85 percent held by the treasurer and general manager and the indebtedness of about 200 percent of the stock was being carried by him and his relatives.

The treasurer called at my office for advice prior to the close of his taxable year 1937 and estimated the corporate profits to be about $500,000, which would not replenish the surplus if added to it and which would not place the company in any better financial condition than it was prior to the depression of 1930. This company's indebtedness would remain without change as the profit was to be used for the purpose of acquiring and reconditioning the North Carolina plant.

Due to the depression during the latter part of 1937, the estimate of $500,000 profit for the year proved too optimistic to the extent of about $200,000. Moreover, figuring the tax based upon the $500,000 estimated income, it was disclosed that if same were distributed to avoid the 20½-percent tax on undistributed profits, the corporation and its major stockholders would pay to the Federal and State Governments $406,000 of same leaving only $94,000 to be placed back in the business. If no distribution was made in the fiscal year 1937 a saving of some $125,000 would be effected, but eventually, when the income was distributed, the stockholder owner would be taxed far more than this saving.

This brings up the inequity of cases of this kind where the corporation could not distribute the income in the taxable year 1937 and, therefore, paid the penalty of 20½ percent for not doing so. If, however, in future years this income is distributed, no recognition will be given to the fact that the corporation paid the penalty and the stockholder recipient will be taxed just the same as if the distribution were made in 1937, that is if there is no change in the rates.

The normal tax placed upon dividends by the 1936 act was undoubtedly to increase revenue, and the undistributed-profits tax was designed to compel distributions so that additional revenue would accrue by means of the new normal tax and the surtaxes upon dividends that may not have been declared but for the penalty to the corporation; but certainly, where the corporation has been compelled by circumstances to accept the penalty, the stockholders, who are in effect the owners, should not be charged the same normal and surtaxes upon profits, when received, which profits have already stood the penalty.

We are now seriously considering liquidating this corporation.

There can be little doubt that the law is unconstitutional. I do not wish, however, to discuss that phase of the act. The law is impossible of administration for numerous reasons. In addition to the above I wish to call attention to one of the other numerous applications of the act that is very unfair, namely, in instances where taxable gain is computed under the Treasury Department's regulations, due to the fact that excessive depreciation was taken in past years.

It is a common occurrence where corporations have no actual undistributed profits but, due to the fact that they took more depreciation in past years than was actually sustained, they are not allowed deductions for depreciation purposes in the current year, or are only allowed a nominal amount. Frequently, for this reason, an actual loss is converted into a taxable profit, which, in reality, is a profit obtained in some prior year and may already be distributed. Certainly, you cannot be penalized for not again distributing the same profit. There are many other instances where the law compels distribution of profits that are not available for distribution.

It is doubtful whether any amendments could be written into the section of the Revenue Act of 1936 imposing the undistributed-profits tax that would operate to remedy the evil effects of this tax. Certainly nothing can be elastic enough to cover all the inequities of a tax of this nature and leave sufficient force in the act to penalize the few who intentionally accumulate an unwarranted surplus to avoid taxes to the stockholders. Certainly a small exemption from the undistributed-profits tax is of little value. Speaking for the textile mills in my vicinity, I can state that even the smaller textile plants can earn a profit or sutain a loss of several hundred thousand per annum and their requirements for working capital, plant debts, plant replacement, and plant expansion often exceed several years' profits.

It is the larger industries that have to prosper and expand to absorb the unemployed, and minor exemptions will not be of any value in creating employment or establishing confidence in industrial investments.

I have had occasion to audit or investigate most of the large textile plants in the Piedmont section of South Carolina, and I can honestly state that I do not know of one instance where dividends have been withheld for the purpose of enabling the stockholders to avoid surtaxes.

Some cases have come to my attention where executives have pursued a conservative policy in the past and have accumulated what would appear to less conservative executives an unwarranted surplus; but, in these instances, their judgment has proved wise and they have been able to continue through the depression operating as nearly normal as was consistent with the market demands and keeping their plant and equipment in an efficient and up-to-date operating condition. Their stockholders can depend on annual or semiannual dividends. Those less conservative, who distribute all income as it accrues, incurred large indebtedness during the depression, and have paid no dividends recently and will not be in a position to pay any until sufficient earnings accrue to replace and efficiently equip their plants to compete with the plants operated under a conservative management.

TAX COMMENTS BY MR. DODGE TO MR. S. M. BEATTIE, PRESIDENT THE COTTON MANUFACTURERS' ASSOCIATION OF SOUTH CAROLINA

SPARTANBURG, *March 4, 1937.*

Mr. S. M. BEATTIE,
President, The Cotton Manufacturers' Association of South Carolina, Greenville, S. C.

DEAR SIR: From time to time, various investigations are instituted by Congressional Committees, with a view of amending the taxing statutes to eliminate the legal avoidance of tax and to remedy any possibilities that exist in the laws by which clever tax advice will enable taxpayers to decrease their tax liability in a manner not contemplated by the legislators; in short, to eliminate all possibility of the taxpayers taking an inequitable advantage of the Treasury Department.

These committees secure data and information from the Treasury Department, all of which pertains solely to the instances where some advantage has been taken by the taxpayer, which causes a loss of revenue to the Treasury Department.

Seldom is the taxpayer given an opportunity to present the inequitable effect that the laws and their administration have upon the taxpayer. Frequently, in fact as often as otherwise, the laws and amendments promulgated with a view of eliminating any unwarranted advantages a taxpayer may have, work an unwarranted hardship upon the taxpayers not contemplated or intended by Congress.

This naturally follows, for it is impossible for these legislative committees to realize the effect that the changes in the taxing statutes have upon all taxpayers, and they are no doubt subject to the recommendations of the Treasury Department's experts whose training is confined mostly to a viewpoint of obtaining revenue and the eliminating of means by which the taxes are avoided. Their experience is not such as would qualify them to recommend changes to eliminate inequalities and unwarranted features in the acts which penalize a taxpayer beyond the intent of the legislators. It does not appear to be their duty to recommend changes of this nature even though they were qualified, therefore, certain hearings should be held enabling the taxpayer to present annually to the various legislative committees their views regarding the necessary changes not only in the respective taxing statutes but in their administration by the Treasury Department.

In order that this may be considered constructive criticism, a few of the present inequalities are cited, and it is hoped that the legislators representing the people will be as interested in the correction of these defects in the taxing statutes and its administration as they are to remove the unfair advantages allowed the taxpayers.

(*a*) Disregard of the statute of limitations.

(*b*) Methods employed by which income is transferred from one year to another.

(*c*) Methods employed by which past years' adjustments can be made if advantageous to the Treasury Department.

(*d*) Refusal of the Treasury Department to allow obsolescence of equipment discarded.

While some of the above items have not been tested by the courts, they are claimed as being supported by the statutes, and, if they are, the inequalities should be remedied, and, if not, the administration of the act should be altered. There are undoubtedly other substantial items of this nature, but they could not be commented upon in detail in this memorandum. Therefore, the above items with the following comments thereon will illustrate the advisability, from an equitable viewpoint, of the legislators' hearing of the hardships encountered by the taxpayers.

(*a–c*, inclusive) The taxing statutes set forth a period during which the Treasury Department may examine the returns and assess an additional tax. There are certain elements of cost, such as depreciation, and the reserve for bad debts, that are constantly being changed by the Treasury Department. These changes should actually affect the respective years, but, where it is found that the allowance in past years was excessive, the excess is deducted from the current-year allowance, rather than that an attempt be made to correct errors of the past years. This defeats the object of the statute of limitations and enables the Treasury Department to correct errors of prior years, even though the statute of limitations has applied. It distorts the income from year to year. On the contrary, if a taxpayer has taken too little depreciation in a year that is outlawed, he has no remedy but is compelled to lose the deduction. The basis of this ruling by the Treasury Department is that the law allows

the Treasury Department to charge a taxpayer with the depreciation sustained in past years, or the amount allowed, whichever is greater. Is it equitable to reduce a taxpayer's depreciation allowance in a current year because he took too much in the past, and refuse to increase same in a current year because he took too little depreciation in the past? When past years' earnings can be adjusted by increasing current years' earnings with the adjustment, then the statute of limitations is valueless. But surely it should work both ways, and current years' earnings should be reduced when an adjustment to past years' earnings warrants it.

To illustrate: A company is allowed 5-percent depreciation on machinery from 1920 to 1935, inclusive. Subsequently, it is disclosed that 3 percent is nearer the proper rate; and, as a result, the A company is only allowed 1⅙ percent in subsequent years to offset the excessive allowance for the 15 prior years. On the other hand, were the circumstances reversed and the A company had taken only 1⅙ percent in the 15 prior years, they would be charged with the full 3 percent and allowed only the same for future years. This inequality was derived and claimed legal from the following extracts from section 114 of the Revenue Act of 1936, also in some of the prior acts:

"Section 114-a. Basis for depreciation: The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 B, for the purpose of determining the gain upon the sale or other disposition of such property."

Section 113 B: Adjusted basis for determining gains and loss states, as regards depreciation, that the costs shall be adjusted "for exhaustion, wear and tear, obsolescence, amortization, and depletion to the extent allowed (but not less than the amount allowable) under this act or prior income-tax laws."

The "joker" in the above act is the part of section 113 B, in parentheses, which allows the charging of the greater of the amount allowed or the amount allowable in the years outlawed by the statute of limitations, and provides for the correction in the subsequent years as far as it is advantageous to the Treasury Department.

It is the writer's opinion that the above provisions of the act refer to depreciation only as it pertains to the computation of a loss or gain on the disposition of assets, and contends that section 23 L governs the basis for depreciation allowances on property held and used in the trade or business.

Section 23 L: "In computing net income there shall be allowed as deductions:

"A reasonable allowance for the exhaustion, wear and tear of property used in a trade or business, including a reasonable allowance for obsolescence," etc. * * *

Certainly if section 113 B has reference to the normal depreciation allowance on equipment not sold or otherwise disposed of, it is ambiguously worded and entirely unfair to the taxpayers.

(*d*) While the respective revenue acts provide for losses due to obsolescence, the administration of the acts made it practically impossible to take advantage of this provision for the following reasons:

1. Unless a detailed cost and depreciation account is kept for each individual machine or unit of equipment, no obsolescence is allowed until all the units purchased at the same time are retired or disposed of.

2. Where a composite machinery rate is used rather than a separate rate for each unit, it is contended that all the machinery or equipment has to be disposed of, or retired, before obsolescence can be claimed. Many taxpayers had set up their records long before taxes were of any consequence, and the detailed costs are not available for each unit; furthermore, in the administration of the revenue laws from 1917 to 1932 these contentions were asserted, and in fact the composite rate of depreciation was in most instances installed by the Treasury Department.

It is now claimed that a composite rate on equipment does not mean that every item is depreciated at the exact rate allowed, but that the respective units may vary from 1 percent to 8 percent, but the average would constitute a 4 percent rate. This is used as the logic upon which it is claimed that the exact depreciation allowed or sustained on a respective unit is indeterminate when a composite rate is used, therefore, obsolescence cannot be allowed until all units are retired or disposed of.

Inasmuch as is practical, all of the composite rates were established by the Engineering Department of the Bureau of Internal Revenue, and if these rates are a general average of the different rates allowed on the respective classes of equipment, this information should be given to the taxpayers in order that they may be allowed the correct obsolescence on equipment as it is disposed of. To

promulgate rates, or change the taxpayers' rate in a manner that subsequently results in the disallowance of a deduction heretofore permitted, and now permitted by the law, but disallowed in the administration of the law, due to the fact that the taxpayers have used a composite rate promulgated and in many instances, insisted upon by the Treasury Department, who will not disclose the derivation of the rates, is certainly unfair and unwarranted.

The 1936 Revenue Act illustrates the unfair results of legislation based upon investigations made solely from the Treasury Department's viewpoint, without considering the questions involved from a taxpayer's standpoint.

Comments regarding some of the questionable portions of the 1936 Revenue Act are follows:

The most important provision of the 1936 Revenue Act needing immediate revision is the undistributed-profits tax.

There are many causes why this act should be amended, but the most important of them are as follows:

1. Penalties inflicted upon debtor corporations if current profits are used to liquidate their indebtedness.
2. Corporations with impaired capital penalized unless directors violate State laws by declaring dividends of current profits.
3. Decided set-back in the attempt to decrease unemployment.
4. Resulting decreased profits will greatly reduce the Federal revenue in future years.
5. In many instances, penalties will be asserted unless distributions of capital or surplus are made by the taxpayer corporation.
6. Unallowable deductions as applied to cash outlays.

The inequities mentioned above necessitating the amending of the undistributed-profits tax are too numerous to comment upon in detail. Nevertheless, a few comments regarding them will illustrate the necessity of amending the act at an early date.

1. In many instances corporations were organized with a nominal capital, and as profits were earned they were invested in additional manufacturing facilities, and as a result the property and plant investment greatly exceeds the nominal capital invested. This, of course, makes a surplus, but not one that can be distributed in taxable dividends. These companies were only able to withstand the depression by substantial loans, all of which should be liquidated from the first available profits. This cannot be done under the 1936 revenue act unless a penalty of 20½ percent is paid as undistributed-profits tax.

The creditors of these companies in many instances are unwilling to carry the loans when the prospective profits, upon which they expect to realize, are taxable to the Federal and State Governments in a minimum amount of 40 percent. Very few loans can be obtained on account of plant and very little can be realized from the forced sale of plant and property; therefore, unless some provisions are made in the act to relieve corporations in debt, numerous companies will be forced into bankruptcy, and stockholders throughout the country will lose their savings invested in these corporations; furthermore, a large increase in unemployment will result.

2. Corporations with impaired capital are subject to the same difficulties as set forth in the above comments, together with the fact that they are prohibited in most instances by State laws from declaring dividends. Therefore, if it were possible for them to obtain loans which provided funds for a distribution, they would be violating State laws and subjecting the directors to personal responsibility to the creditors.

3. As regards the unemployment situation, the decreased employment due to the necessary liquidations mentioned in the foregoing comments will seriously affect this situation; but, in addition, the act practically prohibits any possibility of increased employment due to the fact that many taxpayer corporations, particularly the smaller ones, have planned in prosperous times to erect and operate additional buildings and equipment, financing same from current profits. This can be hardly expected when, as a result, the total cost of the additions will be 20½ percent more than if they were constructed at a time prior to the enactment of the 1936 Revenue Act. This is particularly true at the present time, when normal costs are increasing.

In addition to the above, many corporations at present find it necessary to replace or recondition their equipment, which has for the past 5 years been operated while in an inefficient condition due to the lack of finances during the depression. The increased normal cost, together with the 20½ percent penalty for using current profits for this purpose makes this possibility very remote. As a result, it is only a question of how long these taxpayers can

compete with those whose finances allowed them to be equipped with modern machinery, and so forth.

The effects of the decrease in additional facilities, and the closing down of those plants unable to replace their equipment, will greatly increase unemployment in the immediate future.

4. It is extremely doubtful, whether or not this provision of the 1936 Revenue Act will produce more revenue than it will lose for the Treasury Department.

No doubt this provision was intended for large corporations closely held, which were accumulating profits and saving the surtaxes heretofore chargeable to the stockholders on dividends received.

By compelling these corporations to distribute their earnings in dividends, undoubtedly increased revenue will be received, although probably not in proportion to the amount anticipated, for it is a known fact that individuals in the higher tax brackets have more ways of legally avoiding income taxes than corporations or the average individual.

On the other hand, will the increased taxes from this source offset the loss of income taxes on the corporations forced to liquidate, or those unable to make profits on account of their financial inability to equip their plants with modern machinery, and so forth? When the losses to stockholders and the creditors of these corporations are taken into consideration, there is serious doubt whether or not this provision of the act will prove revenue producing. Even though there were some balance in favor of increased revenue, its detrimental effect on the smaller corporations or those in financial difficulties is sufficient to warrant an effort along other lines to penalize those few who attempt to avoid taxes by accumulating an unwarranted surplus.

5. In many instances, corporations will be penalized unless capital or surplus distributions are made. In regard to those corporations having a deficit, they are commented upon in item No. 2, but, in addition to these, there are many corporations with adequate surplus to declare dividends, which have no finances to pay same and which have made no actual profit for the year from which they could be paid. Yet, under the act, they will be subject to the tax.

To illustrate this contention, many examples could be used, but same applies in all instances where, under Treasury rulings promulgated from the respective revenue acts, income from one year is held taxable in another, due to abnormal conditions. The most important of these items is depreciation.

In an instance where the normal depreciation of a corporation is agreed upon at $300,000 per annum, but, due to the fact that the corporation had been allowed $400,000 for all the past year in error, they are only allowed $100,000 per annum for the current and future years. In substance this means that the corporation has to pay taxes for the current year on $200,000 that it did not make; but, inasmuch as it did not pay tax on the same in prior years, it now becomes taxable. This is the Treasury Department's construction of the revenue acts, and has not as yet been tested in the courts. If it is sound, under the undistributed-profits tax a corporation under like circumstances will be compelled to distribute $200,000 it did not make during the year, and which was very probably distributed in some past year, or else pay a penalty of 20½ percent of same. Under these circumstances a corporation losing $50,000, presuming they had no funds available for dividends, would be compelled to borrow $150,000 to distribute to its stockholders or suffer a penalty of $30,750. Had it no surplus the directors of the company would be personally liable for the $150,000.

6. Unallowable deductions, particularly as applied to cash outlays, should be considered in the computation of the adjusted net income as provided by the law on undistributed-profits tax.

The 1936 Revenue Act provides that the adjusted net income is the taxable income for normal tax purposes, less normal tax and interest on tax-exempt United States obligations. Corporations invariably have expenditures which constitute unallowable deductions, even though they are not capital expenditures, and in many instances these expenditures constitute taxable income in the hands of the recipients, although they are not considered distributions of income under the Revenue Act of 1936. These funds are already disbursed and it is hardly equitable to penalize the corporations for not distributing to its stockholders funds which are not available but have been disbursed. The most frequent expenditures of this nature are as follows:

(*a*) Salaries, disallowed as a deduction as being excessive, but paid to officers who have paid normal and surtaxes on same.

(*b*) Policy expenditures, classified by the Treasury Department as not being ordinary and necessary expenses.

(*c*) Replacements made in excess of the depreciation allowance for the year, due to excessive depreciation being taken in the past.

(*d*) Deferred charges covering expenditures made but chargeable over a series of years, the most important of which are—

1. Organization expenses.
2. Prepaid insurance premiums.
3. Interest and discount.

To illustrate, a corporation organized at an expense of $50,000 may make $40,000 income the first year; therefore, if this sum is paid to their creditors, they will be $10,000 in debt. To require them to distribute this $40,000 income continues their indebtedness at $50,000, and were the other deferred charges, mentioned above, consequential in the instant case, a serious drawback to future earnings would be caused by the initial indebtedness, even though the first year's earnings were substantial. In other words, the Revenue Act of 1936 provides no relief for those required to retain their profits as working capital. Small corporations frequently are compelled to borrow funds for working capital and expect to liquidate the loans from earnings. The act compels them to be perpetually in debt.

As regards the general application of the 1936 Revenue Act and those immediately preceding it, attention is directed to a statement of one of the able Senators, as set forth in the Congressional Record of February 17, 1937, in reference to the power of the legislative branch to enact taxing statutes:

"It was given the power to tax, but all taxes had to be uniform."

Undoubtedly this is a correct interpretation of the Constitution of the United States; nevertheless, the word "uniform" no doubt means all taxpayers under like circumstances are to be treated equitably and taxed equally. In enacting taxing statutes this is not done when the act reads the law is effective for the first taxable year beginning after December 31, 1935, for in some instances the new rates are applicable as of January 1, 1936, and in some instances they do not apply until December 1, 1936—11 months later. To increase the taxpayers' rate of normal tax and assert an additional undistributed-profits tax on one taxpayer for the 11 months' profits and allow another taxpayer under like circumstances the privilege of not paying these increased taxes is certainly not uniform, and, therefore, not constitutional. It places no means for them to change their basis of reporting.

As a result, two corporations operating under the same conditions, and with the same profits for the 11 months of 1936, can vary in tax liability from $13,750 to $35,000 on each $100,000 earned.

In conclusion, there has been some discussion of the capital gain or loss provision of the revenue acts. It is not my intention to go into this phase of the act other than to call attention to the following, which emphasizes the fact that some revision should be made to this portion of the revenue act:

An officer of a company, liquidating its assets, was in some instances able to realize only 5 cents on the dollar. The corporation he represented was realizing substantial profits on its operations. Therefore, the loss on its capital assets would save far more in taxes than the proceeds of its sale would realize, inasmuch as, if the assets are sold the loss could not exceed $2,000, whereas, if marked down as valueless, the total loss was deductible. With the law as it now stands, a taxpayer is losing money if he tries to obtain any value for assets of a very doubtful nature.

In view of the above comments, would it not be advisable for some of the leading industries and other taxpayers to take more interest in the promulgation of the taxing statutes and the administration of same, and from time to time present these questions to the proper committees for consideration.

Respectfully yours,

L. C. Dodge.

The Chairman. The committee will now recess until tomorrow morning at 10 o'clock. Mr. Magill will be before us at a public hearing.

(Whereupon at 6:10 p. m., the hearing was recessed until Tuesday, March 22, 1938, at 10 a. m.)

REVENUE ACT OF 1938

TUESDAY, MARCH 22, 1938

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

The committee met, pursuant to recess, at 10:15 a. m. in the Finance Committee room, Senate Office Building, Senator Pat Harrison (chairman) presiding.

The CHAIRMAN. The committee will be in order.

Mr. Magill, we have heard a great number of witnesses and now we will hear you on the estimates and anything else you wish to state.

Mr. MAGILL. I think you are very patient to hear me after all you have been through already.

STATEMENT OF ROSWELL MAGILL, UNDER SECRETARY OF THE TREASURY

Mr. MAGILL. The chairman of the committee has asked me to present at this time, first, the views of the Treasury regarding the revenue bill now pending before the committee; and second, Treasury estimates on various proposals which have been made for the revision of our revenue laws. Since the provisions of the bill have already been discussed in detail in executive sessions before the committee, I shall not make an extended statement at this time regarding them.

Nearly a year ago the President recommended that the tax structure should be surveyed and legislation enacted to remedy defects which experience disclosed. The President repeated his recommendation in his budget message of January 3, 1938, saying, "I hope that there may be enacted at an early date such amendments to the revenue law as will maintain the revenue producing power of the present tax structure while correcting at the same time existing proven inequities."

Consequently, the Treasury conducted its study of the tax system last year with two ends primarily in view: (1) That proven inequities in the revenue laws should be eliminated, including both provisions which created hardships to particular classes of taxpayers and provisions which granted unjustifiable exemptions from tax; and (2) that the productivity of the internal revenue laws, as amended, should be equivalent to that of the existing laws. The recommendations of the Ways and Means subcommittee on tax revision which were later embodied in the revenue bill introduced in the House were formulated with these two basic objectives in mind.

All persons agree that tax laws should be equitable, but there is great diversity of opinion as to what constitutes equity in particular cases. No one enjoys paying taxes. Any taxpayer is apt to consider

the tax which he has to pay as more oppressive than it should be and more oppressive than his neighbor's tax. Appeals for relief are always persuasive, since the particular taxpayer can readily show the weight of the burden he is bearing, and, unlike the Congress and the Treasury, he is not concerned with alternative imposts.

Framing tax laws in these times is one of the most complex and difficult and technical procedures with which the Congress and the Treasury is charged. Granted that a given total of revenue is to be raised, relief to one class of taxpayers usually means increased burdens on other taxpayers. Consequently, a determination of the merits of any proposal for tax reductions or tax increases involves not merely the immediate operation or revenue significance of the particular suggestion; but also the relative desirability of the relief or additional tax proposed as compared with the burdens, whether increased or merely maintained, which must be borne by others. The size of our tax bill and the significance of taxation in our economic life both require that proposals for shifts in tax burden from one group of taxpayers to another should be studied with great care.

The committee has expressed its interest, not only in the various amendments of the revenue laws which are embodied in the House bill but also in several alternatives as to which estimates have been requested. Consequently, the committee may wish a brief summary of the propositions which the Treasury regards as fundamental in the formulation of a sound revenue system for the United States. Some of these propositions are set forth at greater length in the statement which I made before the Ways and Means Committee on January 14, 1938.

1. Income taxes and estate taxes are a better measure of capacity to pay than consumption taxes.

Senator KING. May I interrupt there a moment, Dr. Magill?

Mr. MAGILL. Certainly.

Senator KING. You are now summarizing your statement, are you, Doctor?

Mr. MAGILL. It is to some degree a summary; yes.

(Resumes reading:)

Consumption taxes in general take little account of the income or wealth of the taxpayer. Yet at present taxes of this character account for about one-third of our total internal revenue. Consequently, the Treasury has held the view, expressed by the Secretary last fall, that the number of consumption taxes should be reduced as the state of the revenues permits. In view of the necessity for maintaining the total revenue yield, it is evident that not many consumption taxes can be repealed at this time, unless the Congress is prepared to make up for decreases in revenue so caused by increases in other levies. The first consumption taxes to be repealed should be those which are difficult of administration, which produce relatively small sums, and which are imposed upon articles in common use. The bill as introduced in the House made a start upon this revision by eliminating a number of consumption taxes aggregating about $30,000,000. On the floor of the House, however, the tax on distilled spirits was increased to yield an estimated $19,000,000 additional; and the import tax on pork products was almost trebled in amount, a change which, however, appears unlikely to yield any additional revenue. Both of these changes the Treasury regards as undesirable.

The CHAIRMAN. By consumption taxes do you mean liquor taxes?

Mr. MAGILL. And the tax on pork products.

Senator VANDENBERG. Do you mean, Mr. Magill, under any circumstances, if we found it necessary to find additional revenue, you still would oppose the additional tax on spirits?

Mr. MAGILL. We are basing our view on the particular conditions that now obtain. Whether or not the tax should be increased under other conditions, is a matter which would have to be considered when those conditions arose.

(Resumes reading:)

The most important changes in the House bill concern the income tax and in particular the taxes on corporation income and on capital gains. I shall discuss these briefly under the two following heads:

2. The income tax should rest equally on incomes of similar size. It is on this basis that the Treasury has urged for many years that existing exemptions from Federal income taxes, now extended to the interest on State and local bonds and to State and local official salaries, should be eliminated for the future; and that capital gains should continue to be subject to the income tax. Neither of these recommendations is peculiar to this administration.

So long as a vast reservoir of tax-exempt securities exists, it is difficult or impossible to make any system of progressive surtax rates operate effectively. Possibly the problem can be partially solved by a statutory provision, such, for example, as that which was urged by Senator Glass when Secretary of the Treasury; possibly a constitutional amendment should be proposed as the most effective means of ending these tax exemptions for the future. The Treasury strongly recommends that effective action be taken as promptly as possible in one or both forms.

Senator VANDENBERG. Do you suggest it is possible to reach the local officials' salaries without a constitutional amendment?

Mr. MAGILL. I think it is constitutionally possible. It is a question of constitutional law, of course, to be decided on the basis of the court decisions in recent years. There is no provision exempting such salaries from tax in the revenue law, and the Supreme Court has been concerned with a series of cases on that question. The justices have expressed divergent views on the subject, but it appears that there is a growing support on their part of the idea the Federal income tax should apply to salaries paid by States and local units of government.

Senator VANDENBERG. What was the suggestion of Senator Glass on that?

Mr. MAGILL. His suggestion was that in setting the rates applicable to the individual's taxable income, his other income should be taken into account.

Senator KING. You differentiate between the taxing of salaries of officials and the interest on State and local bonds?

Mr. MAGILL. The Glass suggestion would be useful with respect to bond interest, but not so useful with respect to salaries of State officials. It would not have any tax effect on exempt State officials unless they had income from outside sources.

Senator VANDENBERG. Are you prepared to suggest an amendment which in your judgment would reach the local officials' salaries?

Mr. MAGILL. I do not have one here, but I think there is no particular difficulty in formulating such an amendment.

Senator VANDENBERG. I should very much like to see one.

Senator GEORGE. You do not mean to reach them under a direct tax?

Mr. MAGILL. I understood the question of Senator Vandenberg to be whether under a constitutional amendment it would be possible to tax State and local officers' salaries.

Senator VANDENBERG. No, the converse; I want to know whether it is possible to do it without a constitutional amendment.

Mr. MAGILL. You can do it by statute and then the question is whether the Supreme Court would sustain the statute, and my impression is that they would at the present time although I do not think they would have done so some years ago.

(Resumes reading:)

Gains from sales of property have been subjected to income taxation from 1913, when the Sixteenth Amendment was adopted, to the present time. The basic reason, no doubt, has been that such gains represent a capacity to pay quite as great as that represented by income from salaries, interest, dividends, or the like, at least in the absence of great changes in the general level of prices. It is agreed on all sides that the gains realized by a merchant from repeated sales of property should be taxed like ordinary income. It is hard to see why an individual who makes a profit of $25,000 from a single sale of securities or other property has less capacity to pay an income tax than a merchant with a profit of a similar amount from repeated sales.

Nor is it easy to see why either of these individuals has less capacity to pay than an individual who earns a salary of like amount. To put the matter in another way, would it be just to repeal the present tax on capital gains entirely, a tax which has yielded a net of $1,415,000,000 in the 10-year period of 1927 to 1936, inclusive, after allowable deductions and credits for losses; and to make up the lost revenue, an average of over $140,000,000 per year, by increased income-tax rates on salaries and other forms of ordinary income? To do so would be to exempt one type of income at the expense of other types of income.

Most proposals do not go so far, but rather suggest that income taxes on capital gains should be modified to preferential rates particularly advantageous to taxpayers in the upper brackets. Simply on the score of fairness, gains from sales of property held less than 1 year do not appear to be entitled to any different treatment from ordinary income which has accrued in a similar period. In fact, the Revenue Acts from the beginning have treated 1-year capital gains like ordinary income. On the other hand, in taxing gains of individuals which have accrued over a longer period, fairness requires that consideration be given to the length of time during which the gains have accrued. In other words, a profit on the sale of property held 10 years ought not to be taxed in the same way as a profit which accrued in a single year. Rather, the ideal treatment would seem to be to tax the 10-year gain at the rates which would have been applied to it if it had been realized in 10 equal annual installments.

The present law contains a method of taxation designed to give effect to this philosophy, although in fact the tax produced is ordinarily considerably less than it would have been had the total gain been taxed evenly in the various years in which it accrued. It is perhaps not generally realized how favorably the percentage scale in the present law treats the capital gains of individuals. We may compare, for example, two individuals, each of whom receives, from salary and interest, a surtax net income of $50,000 a year. The first individual receives an additional income of $25,000 a year in dividends for two years—a total of $50,000 in dividends. The second individual

receives, instead, additional income as capital gain on stock held slightly less than 2 years, and sold at a profit of $50,000—an average gain of $25,000 a year. For the 2-year period he pays 11 percent less tax on his $50,000 capital gain than the first individual pays on his $50,000 of dividends. That is, the taxpayer in such a case is given a 11 percent discount on the tax on his capital gain, as compared to the rate of tax on other types of income that develop in the same length of time and that reach the same amount. This instance is one of the more moderate. If we use the same total amounts, but spread the gain and the dividends over 6 years, we find that for the 6-year period the capital gain pays 56 percent less tax than the dividends. Still greater differentials exist in other instances. In practically every conceivable case there will be found some differential in favor of capital gains.

The House bill gives further relief to the taxpayer and increases the liquidity of the capital market by a series of changes that (1) affect the percentage governing the amount of gain or loss to be taken into account, (2) fix a minimum tax rate applicable to the gains after they have been reduced by the percentages, (3) allow a carry-over of losses of one year to reduce gains of a subsequent year, (4) improve the definition of a capital asset. On the other hand, the bill tends to increase the revenue from this source by restricting deductions of short-term losses to short-term gains, and of long-term losses to long-term gains. Requiring deductions on account of worthless securities to be treated as capital losses also tends to increase the revenue.

In general, the treatment of capital gains and losses under the House bill, as under the existing laws, has the following important characteristics: (1) Capital gains on assets held more than 1 year are given decidedly preferential treatment compared with income from other sources such as interest, dividends, rents, salaries, fees, and wages; (2) capital losses, on the other hand, are treated less favorably than business losses, losses by fire, theft, and so forth, and other deductible items allowed in the individual return; (3) capital gains, like other income, are affected, though not to the same extent, by the various levels of surtax rates.

To summarize, capital gains—other than 1-year gains—are already given much lower income-tax rates than ordinary income. They will receive still more favorable treatment under the House bill. Capital losses are allowed as deductions only to a limited extent under existing laws; and under the House bill the treatment of losses is liberalized somewhat by a provision whereby a net capital loss may be carried over to the following year and offset that year's capital gains. There is a strong case for a further liberalization of the provisions for the deduction of losses. A prospective investor in a hazardous enterprise must count on a tax on his gain if he is successful—though the tax will be lighter than if he got the same amount in a salary—and a very small deduction if he is completely unsuccessful. Exactly how far an extension of the capital loss provisions should go depends in large part on the revenue aspects of the problem. In any event, application of the proposition that the income tax should rest equally on incomes of similar size calls for more generous treatment for capital losses, but not, it seems, for more generous treatment for capital gains.

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3. The income tax should rest equally upon different classes of taxpayers with similar incomes. The problem of providing a fair mode of taxation for corporations and their shareholders, as compared to individuals and partnerships with similar incomes, has given the Congress and the Treasury concern for many years. Individuals are subjected not only to a normal tax but to progressive surtaxes which now reach a maximum of 75 percent. The corporation normal tax has varied in rate and at present runs from 8 to 15 percent. Consequently, if the corporate stock is owned by individuals with large incomes, there is a strong tax incentive for the accumulation of earnings by the corporation, if these earnings are subjected only to these normal taxes.

On the other hand, a flat tax rate of 15 percent is the equivalent of the effective rate applicable to a married person with an income of approximately $40,000. Corporations with small incomes are commonly owned by individuals whose personal incomes do not approach this figure. Hence, it seems that a lower tax rate should be applied to such corporations than to corporations with large incomes.

Senator KING. Do you mean by that that the amount of capital invested and which is risked in the enterprise should not be a factor in determining the rate of taxes?

Mr. MAGILL. Ideally, I think it should. As you realize, there are great difficulties in determining what capital is invested in the enterprise, and those were the difficulties which we had in connection with the excess-profits tax. The excess-profits tax has a great deal to be said for it, but practically it is difficult of administration because of the necessity of valuing tangible assets, goodwill, and so forth.

Senator KING. I know of small corporations where the earnings permitted a dividend of 20 percent, and on the other hand I know of large corporations, that is, large in the sense of having considerable capital, and their earnings did not justify a dividend of 2 percent.

Mr. MAGILL. That is quite possible.

(Resumes reading.)

Although the undistributed-profits tax adopted in 1936 has been the subject of much public discussion, the fundamental basis for it has not always been clearly recognized. Individual proprietors and members of partnerships are subject both to normal taxes and surtaxes upon the entire net incomes of their businesses whether distributed or not. This means, among other things, that there is no deduction for amounts of income used for the payment of debts or for plant expansion, since such expenditures do not affect current operating income as the businessman and his accountant compute it, and it is current operating income which is being subjected to the tax.

The question then is: Is it fair to tax an individual proprietor and to tax partners upon the entire net incomes of their businesses at the full normal tax and surtax rates, whether the income of the business is distributed to them or not; and at the same time, to tax corporations simply at a flat normal tax rate? Before the question can be answered, an additional factor must be added; namely, that stockholders of the corporation will pay normal taxes and surtaxes upon any dividends distributed to them. It then appears that the distributed income of the corporation enjoys no tax preference as compared to the income of the individual or partnership business. Both are subjected to the applicable normal taxes and to the surtaxes. Indeed, the distributed corporation income is somewhat more heavily taxed, since the corpo-

ration has paid a normal tax of 8 to 15 percent on it before distribution, and the stockholder is subject to a second normal tax of 4 percent, as well as to any applicable surtaxes, when he receives the dividend. In fairness, he might properly be given a credit against his own normal tax for the normal tax already paid by the corporation.

Senator KING. Is that not done in England?

Mr. MAGILL. Yes, sir; and we did it here until 1936.

(Resumes reading.)

The undistributed corporate income, however, stands on a different and more favorable basis. In the absence of an undistributed-profits tax, the corporation pays a flat normal tax upon its total net income, whether distributed or not; but unlike the cases of the individual proprietor or partnership, no surtaxes of any kind are collectible on the undistributed portion of its net income.

Under this system, then, the Treasury collects less taxes from undistributed corporate income than from income distributed in dividends. Moreover, the corporation then enjoys this tax advantage over the partnership or individual proprietorship, that its earnings may be retained without surtax liability. The case for an additional tax on the undistributed portion of corporation incomes rests primarily on the basis of subjecting like incomes to like taxes.

Senator KING. Is it not true the corporation does not pay any tax on that portion of the income that is not distributed because it pays a capital-stock tax and an excess-profits tax; it necessarily must come out of the general profits of the corporation?

Mr. MAGILL. That is true. I am seeking to distinguish between the case of the corporation which distributes and the corporation which does not. As you know, both corporations are subject to the capital-stock tax and the excess-profits tax.

Senator KING. But your comparison is also between the individual and the partnership in one case and the corporation in another?

Mr. MAGILL. That is true. I think, as I said to the committee in executive session, the capital-stock tax which is collected from all corporations can be regarded as amounting to an additional income tax of approximately 2 percent on the net income corporations. Perhaps I should emphasize, in view of your question, the normal taxes on corporations are higher than those on individuals and partnerships; so there is a tax differential against a corporation in those respects, as you say.

Senator VANDENBERG. You base your defense of the excess-profits tax chiefly, today, on the alleged relatively greater burden which rests upon the individuals and the partnership; are there any figures to indicate what proportion of American business rests in individuals and partnerships as compared to corporations?

Mr. MAGILL. I do not know how much detail we have on that. At the present time, the income taxes which we are receiving from individuals, which includes the partnerships, are roughly the same in total amount as the income taxes which we are receiving from corporations, and that would doubtless lead you to believe, so far as income is concerned, there are more incorporated enterprises than unincorporated enterprises, because the receipts of corporations do not include receipts from salaries and the like which are business in character.

Senator VANDENBERG. Is it not obvious that the vast proportion of American business is done in the corporate form?

Mr. MAGILL. Certainly that is true, particularly so far as the larger enterprises are concerned.

The CHAIRMAN. Where can we get a record of the proportion of partnerships and of corporations in this country; I am not talking about professional partnerships.

Mr. MAGILL. Mr. O'Donnell tells me we can give you a breakdown showing the amount of partnership income reported by individuals as compared with corporate income. I presume we can give you the number of partnerships which file information returns as compared to the taxable corporations. My recollection is we get something like 450,000 corporation returns of which about 200,000 are taxable; I do not know how many partnership returns there are, but we can obtain the data.

Senator BROWN. About the only large business enterprises carried on by partnerships are in the private banking business; there you have partnerships carrying on very large business operations.

Mr. MAGILL. Yes; that is the principal one that occurs to me, the brokerage and banking business.

Senator BROWN. Private banking business, like J. P. Morgan and Kuhn Loeb.

Mr. MAGILL. You also have the various professional partnerships, but those are not strictly comparable.

The CHAIRMAN. You do not know where you can get it?

Mr. MAGILL. We can obtain the information and put it in the record.

(Subsequently Mr. Magill submitted the following tables.)

TABLE 1.—*Number of returns of corporations, of partnerships, and of individuals with net incomes of $5,000 and over reporting partnership and business net income or net loss, 1926–36.*

Year	Corporation returns				Partnership information returns	Individual returns with net incomes of $5,000 and over [1] reporting:				
	Inactive corporations (no income data)	Net income returns	Net loss returns	Total		Partnership net income	Business net income	Partnership net loss	Business net loss	Total
1926	([2])	258,134	197,186	455,320	295,425	....	218,148	....	....	....
1927	49,356	259,849	165,826	475,031	282,841	....	212,919	....	....	....
1928	52,281	268,783	174,828	495,892	272,127	....	220,159	....	....	....
1929	53,415	269,430	186,591	509,436	263,519	....	228,475	....	....	....
1930	55,700	221,420	241,616	518,736	244,670	....	154,610	....	....	....
1931	56,700	175,898	283,806	516,404	230,407	....	97,779	....	....	....
1932	56,752	82,646	369,238	508,636	216,712	....	45,547	....	....	....
1933	57,238	109,786	337,056	504,080	214,881	....	49,740	....	7,970	....
1934	59,094	145,101	324,703	528,898	221,740	49,066	73,889	6,434	9,969	139,358
1935	56,518	164,231	312,882	533,631	222,293	55,782	89,714	6,186	11,323	163,005
1936	....	....	....	....	237,367	....	....	....	....	....

Source: Treasury Department, Division of Research and Statistics, Mar. 28, 1938.

[1] Corresponding data for returns with net incomes under $5,000, and for returns with net losses, are not available.

[2] Included with net loss returns in 1926.

TABLE 2.—*Aggregate net income and net loss of corporations compared with aggregate net income and net loss from business and partnership sources reported by individuals, 1926–36*

[In thousands of dollars]

Year	Corporations[1]			Individuals[2]						
	Net income	Net loss	Net income less net loss	Business net income	Partnership net income[4]	Total business and partnership net income	Business net loss	Partnership net loss[4]	Total business and partnership net loss	Business and partnership net income less net loss
1926	9,673,403	2,168,710	7,504,693	3,572,895	1,732,581	5,305,476				
1927	8,981,884	2,471,739	6,510,145	3,287,421	1,755,145	5,042,566				
1928	10,617,741	2,391,124	8,226,617	3,213,955	1,929,520	5,173,475				
1929	11,653,886	2,914,128	8,739,758	3,386,402	1,895,964	5,282,366				
1930	6,428,813	4,877,595	1,551,218	2,697,754	1,146,906	3,844,660			742,561	3,102,099
1931	3,683,368	6,970,913	−3,287,545	1,962,945	777,277	2,740,222			724,808	2,015,414
1932	2,153,113	7,796,687	−5,643,574	1,349,832	511,475	1,861,307			631,999	1,229,308
1933	2,985,072	5,533,339	−2,547,367	1,454,060	634,725	2,088,785	243,084	99,285	342,369	1,746,416
1934	4,275,197	4,181,027	94,170	1,747,650	644,052	2,391,702	194,407	71,947	266,354	2,125,348
1935	5,164,723	3,468,774	1,695,949	1,880,707	749,336	2,630,043	183,521	59,477	242,998	2,387,045
1936[3]				2,425,839	987,340	3,413,179	77,919	21,713	99,632	3,313,547

[1] Excluding dividends received and tax-exempt interest.
[2] Individuals with net incomes, 1926-28, inclusive, and 1936. All individuals filing returns (including individuals with no net incomes), 1929-35, inclusive.
[3] Returns filed through Aug. 31, 1937.
[4] The statutory requirements for the reporting of partnership net income and net loss by individuals have varied during the period covered by the table, so that these items are not strictly comparable throughout the period.

Source: Treasury Department, Division of Research and Statistics, Mar. 28, 1938.

The CHAIRMAN. Brokerage houses have to be partnerships, do they not?

Mr. O'DONNELL. Not necessarily. Restrictions on form of business organization come about when the brokerage house desires to own a seat on a registered exchange which has rules about such ownership. Thus the New York Stock Exchange and the New York Curb Exchange do not permit memberships to be held by corporations or partnerships, although the bulk of trading in stocks on these exchanges is done through such partnerships, where a partner as an individual holds such membership.

Senator VANDENBERG. It seems to me those figures are important if you are going to argue you must retain the undistributed profits tax as a matter of equity to the partnerships and individuals.

Mr. MAGILL. I think the figures would be illuminating.

Senator VANDENBERG. If it is 10 to 1, it is only a 10 to 1 argument.

Senator CONNALLY. As far as that is concerned, I do not see why one man is not entitled to just treatment.

Senator VANDENBERG. My observation stands, as far as I am concerned.

Senator CONNALLY. I do not see that the proportion or number makes any difference; the question of equity makes no difference whether it is 3 or 3,000,000.

Senator VANDENBERG. It makes a difference to me.

Senator CONNALLY. I am just expressing my view.

The CHAIRMAN. Tell us how many corporations there are in the country and how many partnerships, excepting professional partnerships, such as doctors, lawyers and things like that.

Mr. MAGILL. I will see whether such information is available.

Senator KING. The mortality of corporations is very great, is it not?

Mr. MAGILL. I do not know how it would compare with partnerships. I think the question was asked the other day whether there was a higher mortality of corporations than of unincorporated enterprises, but I doubt if we have any very good figures on that. We will have somewhat better figures if the bill goes through which calls for additional returns in the case of liquidating enterprises.

Senator KING. As I understand it, out of the 400,000 corporations, only 200,000 pay taxes?

Mr. MAGILL. There were about 200,000 taxable corporations in 1936, and I think 450,000 is correct for the total number. Are those figures correct Mr. O'Donnell?

Mr. O'DONNELL. Yes, sir. The tabulations of these returns to date indicate that your estimate is substantially correct.

Mr. MAGILL. We have a very large number of completely exempt corporations, as you know, and I do not mean to urge you to change that situation, but that is the fact.

Senator KING. You mean eleemosynary and farm cooperatives, and so forth?

Mr. MAGILL. Yes, and mutual savings banks, and so forth.

Senator CONNALLY. If we had the figures, and I have no objection to having them, and they showed that a great volume, the preponderating volume of the business of the United States was carried on by corporations rather than individuals and partnerships, would that not indicate that the reason they are doing it under the corporate set-up is because it is more favorable to do it under that set-up than the other way?

Mr. MAGILL. Yes.

Senator CONNALLY. Businessmen are not fools; they do it in the way the laws are better fitted, the best protection, the least factors, and all of that.

Mr. MAGILL. Yes. There are various advantages in doing business in the corporate form as compared with the partnership form, and limitation of liability is one that immediately occurs to me.

Senator CONNALLY. That is the primary one, but there may be others.

Mr. MAGILL. Tax advantages may be very important.

Senator GEORGE. Almost any partnership can go into the corporate form if it wants to do so.

Mr. MAGILL. Yes, sir.

Senator KING. Is the fact they do not, due to the partners living in different States, and to handle the business as a partnership would be rather difficult, and it can be handled much more easily by having it in the corporate form?

Mr. MAGILL. It is easier to raise money in the corporate form.

Senator KING. I understood you to say the capital stock tax and excess-profits tax totaled about $160,000,000.

Mr. MAGILL. That is right.

Senator KING. And that an increase of 1 percent in normal tax would be equivalent to that amount; that a 1 percent tax would produce that amount?

Mr. MAGILL. Approximately 2 percent. Of course it all depends on how much the corporate income is in a particular year. The corporate income for 1936 ran something like $7,000,000,000——

Senator KING. That is gross income?

Mr. MAGILL. Statutory net income.

(Resumes reading.)

It is evident that retained corporate earnings may be used for desirable purposes. So likewise corporate dividends may be usefully employed by their recipients. Partnership incomes may be retained to advantage, or spent to advantage by the partners. The question here, however, is not the desirability of particular forms of expenditures, but the formulation of taxes which will rest as nearly equally as is possible upon individuals, partnerships or corporations with similar net incomes.

For these reasons, the Treasury favors the retention of a tax upon undistributed corporate earnings, as a means of equalizing the distribution of the total tax burden. Since the corporate form does not act as a shield against the personal surtax if the corporate profits are small and the stockholder's own income is small, it is reasonable to exclude corporations with small incomes from the operation of the undistributed profits tax. Although some corporations with small incomes may be owned by wealthy stockholders, the majority of shares in such companies ordinarily are owned by investors of modest means. Approximately 88 percent of the 200,000 corporations taxable in 1936 had incomes of less than $25,000; and under the House bill would not be subjected to any undistributed profits tax. They can retain all or a substantial part of their earnings, and pay less tax than under the existing law.

Senator VANDENBERG. At that point, may I ask if it is correct that while 88 percent had incomes of less than $25,000, they did only about 10 percent of the business of the country?

Mr. MAGILL. They had about 10 percent of the income, as I recall, and that is shown in the big table which appears in the Ways and Means subcommittee report. It is on page 14 of the Ways and Means Committee hearings. It comes here in several columns; you have it before you?

Senator VANDENBERG. My statement is generally true; is it not?

Mr. MAGILL. I believe so; yes, sir.

Senator GERRY. Those small corporations, the 88 percent which you speak of, does that refer to corporations that are paying no incom tax at all, or does it cover those that only make a small income?

Mr. MAGILL. Those are the tax-paying corporations. This table to which I refer, on which some of these statements are based, was a compilation of data with respect to tax-paying corporations for 1936. The table aggregates the information as to about 145,000 corporations.

Senator GERRY. You are taking it from that table?

Mr. MAGILL. That is right.

Senator GERRY. That is what I wanted to know.

Senator VANDENBERG. I think it would be helpful to have this in the record, Mr. Chairman.

Senator GEORGE. It is in the Ways and Means Committee record.

Senator VANDENBERG. I think it should be in our record also.

(The table referred to is as follows:)

TABLE B.—*Corporation income-tax returns for 1936 filed through Aug. 31, 1937,*[1] *by size classes of "Net income for income-tax computation," showing number of returns, number of balance sheets, certain items of assets and liabilities, income, deductions, and taxes, and effective rate of tax*

[Size classes and money figures in thousands of dollars]

	Size classes, "Net income for income-tax computation												
	Aggregate	Under 5	5–10	10–15	15–20	20–25	25–50	50–100	100–250	250–500	500–1,000	1,000–5,000	5,000 and over
1. Number of returns	144,914	97,955	14,802	7,476	4,330	2,966	7,162	4,453	3,140	1,240	678	584	128
2. Number of balance sheets	134,695	89,268	14,268	7,267	4,212	2,888	6,951	4,299	3,020	1,183	653	559	127
3. Total assets	90,684,223	6,576,049	3,902,867	2,424,137	1,694,112	1,484,124	4,921,420	5,121,099	8,137,596	6,170,835	6,859,306	19,052,229	25,150,450
4. Bonded debt and mortgages	11,721,600	766,147	234,131	187,534	120,640	90,115	362,269	495,722	991,487	677,144	847,195	3,207,616	3,741,600
5. Capital stock: Common	31,313,183	2,690,816	949,175	687,908	478,983	425,083	1,436,844	1,504,331	2,491,966	2,055,853	1,945,852	5,922,320	10,724,053
6. Preferred	7,006,328	260,318	153,151	127,263	85,987	75,266	286,381	338,210	863,832	473,228	590,469	1,780,921	1,971,304
7. Total capital stock	38,319,512	2,951,134	1,102,325	815,171	564,970	500,349	1,723,224	1,842,541	3,355,798	2,529,081	2,536,321	7,703,241	12,695,357
8. Surplus	19,115,234	905,136	490,285	407,563	315,195	279,276	980,212	1,121,066	1,705,962	1,421,193	1,547,299	4,639,597	5,302,451
9. Deficit	1,132,035	462,124	100,833	50,162	30,474	27,259	95,355	111,272	98,523	95,105	43,313	17,492	122
10. Surplus less deficit	17,983,199	443,012	389,452	357,401	284,721	252,017	884,857	1,009,794	1,607,439	1,326,088	1,503,986	4,622,105	5,302,329
11. Net income for income-tax computation (line 29, p. 2)	5,428,109	122,867	105,102	91,728	75,103	66,337	251,816	312,988	484,177	432,646	472,604	1,169,654	1,843,088
12. Net income for income-tax computation before excess-profits tax deduction (line 27, p. 2)	5,442,069	123,886	106,100	92,523	75,703	66,843	253,398	314,662	486,045	433,738	473,799	1,171,355	1,844,017
13. Adjusted net income	4,689,202	107,299	88,465	76,637	62,537	54,495	209,368	262,346	408,363	369,095	397,971	1,009,927	1,642,700
14. Undistributed net income	785,155	67,406	36,577	23,769	16,719	13,183	48,894	58,084	88,582	72,078	71,708	141,412	146,744
15. Dividends received	1,167,577	5,495	4,250	3,739	2,954	3,251	14,446	25,454	50,673	50,199	59,001	268,398	679,712
16. Dividends paid credit	3,807,401	38,573	50,237	51,335	44,078	39,722	152,954	195,583	305,350	286,181	313,957	845,477	1,482,932
17. Depreciation	1,456,25[illegible]	120,359	46,174	36,528	25,203	22,515	76,209	84,276	122,287	102,870	108,892	306,276	404,704
18. Depletion	172,6[illegible]	4,733	3,018	2,481	2,429	2,082	8,822	10,113	16,219	11,800	18,456	23,801	65,654
19. Officers' salaries	1,323,073	480,875	137,087	85,338	57,789	43,482	127,218	103,692	103,493	58,210	45,135	57,933	22,790
20. Interest paid	793,845	80,447	33,255	23,951	16,296	13,076	41,798	48,058	62,985	49,360	53,900	181,627	191,052
21. Rent paid	592,622	143,543	39,785	26,696	18,491	15,355	42,790	38,615	45,747	39,675	30,199	52,970	98,788
22. Taxes: Excess-profits tax	13,930	1,019	998	795	600	506	1,582	1,671	1,868	1,092	1,195	1,701	929
23. Normal tax	621,568	10,657	10,340	9,300	7,845	7,135	28,487	38,434	62,583	56,335	61,712	139,308	189,432
24. Surtax on undistributed profits	98,305	4,727	2,993	2,574	2,037	1,748	7,061	8,919	13,417	10,120	10,018	19,005	15,327
25. Total tax	733,833	16,403	14,331	12,669	10,482	9,389	37,139	49,057	77,898	67,847	72,925	130,014	205,688
26. Effective rate of total tax to net income for income-tax computation	13.52	13.35	13.61	13.81	13.98	14.15	14.74	15.67	16.09	15.68	15.43	13.65	11.16
27. Effective rate of total tax to net income for income-tax computation before excess-profits tax deduction	13.48	13.24	13.51	13.69	13.85	14.05	14.65	15.59	16.03	15.64	15.39	13.66	11.15

28. Total normal tax and surtax	719,873	15,394	13,333	11,874	9,882	6,883	35,548	47,383	76,030	66,765	71,730	158,313	204,759
29. Effective rate of normal tax to net income for income-tax computation	11.45	8.67	9.84	10.14	10.45	10.76	11.31	12.28	12.93	13.02	13.06	11.91	10.28
30. Effective rate of surtax on undivided profits to net income for income-tax computation	1.81	3.85	2.85	2.81	2.71	2.64	2.80	2.86	2.78	2.41	2.12	1.62	.83
31. Effective rate of total normal tax and surtax to net income for income-tax computation	13.26	12.52	12.69	12.94	13.16	13.39	14.12	15.14	15.70	15.43	15.18	13.54	11.11
32. Percent of dividends paid credit to adjusted net income	81.20	35.95	56.79	66.99	70.48	72.89	73.06	74.55	75.02	77.54	78.89	83.72	90.27

[1] Taxable returns that have passed through the Statistical Section through Oct. 1, 1937.

Source: Treasury Department, Bureau of Internal Revenue, Statistical Section, Income Tax Unit.

Mr. MAGILL. It represents our best compilation on this subject. (Resumes reading.)

Cases of hardship can be cited in the operation of any tax. They can be cared for either by a series of specific exceptions or by a relatively low tax rate. The House bill utilizes both methods. In the first place, the bill fixes the rate of tax on undistributed corporate earnings at 4 percent, the rate of the normal tax on individuals. It is evident that the Treasury would receive less revenue at this rate, if corporations were to retain all their earnings, than it would if the earnings were all distributed in dividends. In other words, the rate is decidedly moderate. However, with no undistributed-profits tax, corporations distributed an average of three-fourths of their net incomes over the 10-year period 1926 to 1935, inclusive. Normal corporate practice plus the proposed undistributed-profits tax will result in adequate tax revenues from corporate earnings under present business conditions, in the cases of the bulk of business corporations whose stock is widely held There is no similar assurance in the cases of large, closely held corporations whose shareholders pay individual income taxes in the higher brackets. In the absence of such higher graduated undistributed-profits-tax rates as were generally applicable in 1936–37, some special treatment to eliminate this tax differential in favor of accumulations by closely held corporations appears essential. The recommendation of the House Ways and Means Committee in the proposed title 1B was designed as a safeguard of the revenues in this respect.

Secondly, the bill contains some notable relief features for special cases. Corporations that are bankrupt or that are insolvent and in receivership are exempt from the undistributed profits tax. So too are all banks, insurance companies, mutual investment companies, rental housing corporations, China Trade Act corporations, and corporations doing business chiefly in possessions of the United States.

All corporations are relieved of the undistributed profits tax to the extent that any of their stockholders agree to include in their personal returns any part of their shares in the corporation's current earnings (this is the "consent dividend" provision). Again, if a corporation has a net loss for 1 year, this loss is in effect deducted from its next year's income, if any, in determining how much of that income shall be subject to the undistributed profits tax. Further, if a corporation declares dividends greater than the year's earnings, the excess can be carried over to reduce or eliminate the undistributed profits tax of the next 2 years. Finally, it is to be recalled that, even with all these "cushions," failure to distribute profits can result at the maximum in a tax of only 4 percent of adjusted net income.

Senator CONNALLY. You say "adjusted net income;" that is on the theory they were not distributing anything?

Mr. MAGILL. That is the maximum tax that could be imposed.

Senator CONNALLY. If they distributed none at all, they would be paying 4 percent on all of their income, and if they distributed only a part, they would pay the 4 percent on the distributed portion?

Mr. MAGILL. If they distributed none, they would pay 20 percent; if they distributed all, 16 percent.

Senator CONNALLY. You said "adjusted net income," and I wanted to know just what you meant.

Mr. MAGILL. That is a technical term——

Senator CONNALLY. You mean final net amount of tax?

Mr. MAGILL. The maximum tax to which they can be subjected in the case of failure to distribute anything would be a total of about 20 percent.

Senator BROWN. What is the reason for the exemption of banks from the undistributed profits tax?

Mr. MAGILL. That was inserted in 1936, and my understanding is it was thought that since the safety of the public was increased through accumulations of earnings by banks, it was not desirable to force them to distribute.

Senator BROWN. That, to my mind, is the best reason you have for eliminating it altogether, because, if it is socially desirable to maintain banks in a sound condition, why is it not desirable to maintain all other corporations in a sound condition?

Mr. MAGILL. It certainly is desirable to maintain all corporations in good financial condition. The essential basis, as I see it, although others might put it on other grounds, for the undistributed-profits tax in the case of other corporations, is this:

As I have tried to show here, if a corporation distributes its earnings, the Treasury collects the normal and surtax on the distribution; but if the corporation does not distribute anything, the Treasury does not get any normal or surtax with respect to those amounts. Consequently, the Treasury will collect less revenue if the corporation retains its profits than if it distributes them. Still, under the House bill, the undistributed profits tax is not a heavy imposition on corporations if they do not distribute. I think it might be added that you have the record of American corporations generally distributing over 75 percent of their earnings each year. Consequently the effect of the undistributed-profits tax upon them is not paralyzing because they are going to follow that practice anyway.

There is another way of putting the same thing. In 1936, as you are aware, we estimate that we collected from corporations, $160,000,000 in the form of undistributed-profits tax and $1,100,000,000 in normal corporate taxes. The undistributed-profits tax collections were about the same as the capital-stock taxes; it was not the major tax on corporations.

Senator KING. Corporations will pay, in addition to normal tax, excess-profits, capital-stock, and undistributed-profits taxes.

Mr. MAGILL. Yes.

Senator KING. Then the dividends they declare and distribute are subjected to taxation in the hands of distributees?

Mr. MAGILL. Yes; we catch them in all of the ways we can.

Senator KING. You catch them coming and going.

Mr. MAGILL. Yes.

Senator CONNALLY. Your theory is when you tax the distributed dividends in the hands of the individual taxpayers you are really offering an inducement to the corporation and not to the individual?

Mr. MAGILL. It seems so to me.

Senator CONNALLY. Because if you pay it out, the stockholder is going to pay a surtax, but if you keep it in the treasury the corporation has to pay the tax. So, as I understand your whole theory, you are making an effort to somewhat equalize so it will not make any difference to the corporation whether it pays it out or not?

Mr. MAGILL. That is right.

Senator VANDENBERG. And if there is any effort to evade, you can reach them under 102, can you not?

Mr. MAGILL. It is not a question of evasion but of getting an equal tax from earnings, whether distributed or not. I would not urge that all corporations that retain income are doing it for the purpose of evasion or avoidance; on the other hand, looking at it from the point of view of the Treasury, I would like to see us get as much revenue from undistributed profits as we get from the distributed profits.

Senator KING. I understood you to say in response to Senator Brown that the reason you are not imposing taxes upon banks was because it was socially and financially desirable in the interest of the public generally to have our banking institutions sound.

Mr. MAGILL. Not merely sound, but to accumulate reserves.

Senator KING. Exactly. Is it undesirable to have corporations accumulate reserves?

Mr. MAGILL. No; as I said to him, I think it is obviously desirable from the point of view of the Treasury or anyone else that corporations should be as sound as possible. We do not obtain revenue in income taxes from corporations in liquidation. It may be that perhaps you were too generous in 1936 in letting the banks out, but I do not think so. I think in view of the fact that banks are performing a quasi-public service it is well to encourage them to accumulate reserves.

(Resumes reading.)

It seems evident, therefore, that the corporation taxes provided for in the House bill are amply safeguarded against hardships to corporations in general, or in the particular cases to which attention has been drawn. Corporations with small incomes will receive much lower rates of tax than would obtain if a flat tax were applied to all corporations. Likewise, corporations with large incomes which follow a normal American policy of dividend distribution, will receive a lower rate of tax than would obtain if all corporations were taxed at a flat rate.

The problem of adjusting the rates and the method of income taxation, as between different classes of taxpayers, is one of extreme difficulty. The system of corporation taxation and of individual taxation as well can doubtless be further improved as time goes on and experience develops. But if equal taxation of different classes of taxpayers with similar incomes is desirable, as doubtless all would agree, the House bill more nearly approaches the standard than a reversion to the pre-1936 method of taxing corporate incomes.

4. The Treasury fully shares the desire of the Congress and of taxpayers that the administration of the revenue laws should be as simple and as expeditious as possible. Several of the changes embodied in the House bill were adopted for this purpose. The most important is the consolidation into a single intelligible rate schedule of the two sets of estate tax rates and exemptions which have cluttered up the law for the past 6 years. The total burden of the estate tax has not been changed thereby, but the general operation of the tax and, in particular, of the credit for State death taxes has been improved and simplified. Although, as I have stated, the aggregate yield of the estate tax is not changed, the amount of the credit for State death taxes allowed to particular estates will differ somewhat from existing law.

The principal change will be that a great many small estates which under the present law receive no credit or an inadequate credit for State inheritance tax will now receive more liberal treatment. All estates of $1,100,000 or less, or over 98 percent of all taxable estates,

will receive a larger State death tax credit under the House bill than under existing law.

Senator KING. With that ameliorating situation, do you meet the criticism—and I do not use the work opprobriously—that was leveled at the State tax credit by the Governor of New York.

Mr. MAGILL. You meet it in this way—perhaps I had better give you the next sentence so we will have a complete statement.

Senator KING. All right.

Mr. MAGILL. By the same token, estates of more than $1,100,000 will receive slightly less favorable treatment than at present.

In other words the change which was made in the rate schedule and the percentage credit there, from one point of view may be considered a mechanical change. What we sought to do was to eliminate the present confusion in the rate schedule by reason of having two rates schedules and exemptions, and by telescoping the two and giving a credit against the combined result, which would be equivalent in the aggregate to the amount received now. Since the credit is computed on the 1926 rates, in which there was a $100,000 exemption, the effect is that the small estate does not get as complete a credit as the larger estate.

That leads to the statement that the result of giving the credit against the present rates, which are at present imposed under the 1935 law, is that 98 percent of all the estates, the bulk of the estates, will receive greater credit than they do now and that but a few estates will receive less. The total revenue is the same.

Senator GERRY. Is it not true when you refuse to allow the deduction of $50,000 on which gift tax has been paid, that you are thereby increasing the rate that a $50,000 estate will have to pay to about 1,400 percent, I think it was testified yesterday, because when you take off that gift tax as a deduction, you are naturally increasing the rate on the $50,000 estate, and I think that offsets your whole schedule here as to that amount.

Mr. MAGILL. I have been speaking—I separated the two changes in my statement here, and I have not yet spoken of the one to which you refer. So far as consolidation of rates, if you take that and the credit——

Senator GERRY. I think that is true, but when you take into account the other amendment, the result is entirely different.

Mr. MAGILL. Oh, yes. As I will say in a moment, we do contemplate getting additional revenue under the other change, but this particular change does not rob the States. It leaves them where they are now as far as the aggregate is concerned. The reason New York is concerned is because—the fact is, New York and Pennsylvania collect more than half——

Senator GERRY. It is not only New York; my own State has registered a very strong protest against it, and I will have the figures here in a day or two showing what the State will lose.

Senator GEORGE. I would like to have you finish about New York and Pennsylvania.

Mr. MAGILL. I was saying that so far as the question of overlapping taxes is concerned—and perhaps I should speak of it a little more broadly that I have—the Treasury is as much concerned with that as anyone else. It is a very serious problem. So far as the State inheritance taxes are concerned, it is a particularly serious problem with respect to New York, because our figures show that during the 6-year

period 1930 to 1935, the last year for which we have complete information, nearly half of the total estate and inheritance taxes collected by all of the States were collected by New York and Pennsylvania.

Senator GERRY. Is that not true of the income tax, too?

Mr. MAGILL. Not quite to the same degree. The three States—Massachusetts, New York, and Wisconsin—collected four-fifths of all State income taxes which are collected. I do not think Pennsylvania had an income tax.

Senator GERRY. I know I had a very sharp protest from my State officials on this provision about the money they were going to lose.

Mr. MAGILL. I want to be perfectly fair about it. So far as estates in excess of $1,100,000 are concerned, they will get less credit than now under the proposed scheme; those under that will get more.

Senator BULKLEY. Can you give us a table showing the effect of this, by States?

Mr. MAGILL. We could, in one form or another. Of course, the effect on a particular State depends upon what kind of taxable estates you have; that is, what is the proportion of people who are dying and who have estates above $1,100,000. I can show you the last figures we have on how much Ohio collected from State inheritance taxes and what the Federal Government collected from decedents dying in Ohio.

Senator BULKLEY. Of course, we cannot tell who is going to die next year, but we can say what would have been the effect in the last 2 or 3 years.

Mr. MAGILL. There is a table in the hearings I will be glad to refer to, which shows the latest data on State collections from death taxes and also the taxes collected by the Federal Government from decedents who died in the State.

Senator BULKLEY. You say that is already in the record?

Mr. MAGILL. It is in the House hearings. I will give you the reference to it (pp. 134–135, Ways and Means Committee hearings).

The CHAIRMAN. Mr. Magill, I know, so far as I am concerned, I got the impression the consolidation the House bill had made could not affect the status quo of the estate taxes in the States, and when Governor Lehman's letter came, and Mr. Graves' testimony, representing several States' opposition to this proposition, stating instead of getting the 16⅔-percent credit that the House bill is supposed to give on the consolidated proposition, that it would increase it to about 25 percent, I believe, as far as New York is concerned, and that it presents a different situation. Was that matter analyzed by the Ways and Means Committee when this proposition was presented to it?

Mr. MAGILL. Yes; they discussed this. As to the different States, the situation is what Senator Bulkley was just bringing out; that is, how this change will affect the particular State depends on the relative percentages of those dying in that State with estates above $1,000,000 and those below that figure.

The CHAIRMAN. We appreciate that, but did the House committee appreciate the fact that certain States might disrupt their budgets?

Mr. MAGILL. That was brought out there. They had before them this table which appears on pages 134 and 135 of the House hearings, which gives the Federal and State inheritance, estate, and gift tax collections in the various fiscal years from 1930 to 1936 and also the Federal collections for 1937.

The CHAIRMAN. This bill does not effect an increase in revenue to the Federal Government?

Mr. MAGILL. That is right.

The CHAIRMAN. It is only a reformation.

Mr. MAGILL. Yes, sir; aimed at simplicity.

Senator VANDENBERG. Is that your sole reason—simplicity?

Mr. MAGILL. Yes; we felt a change of this kind should be made and that we should not go on indefinitely with the complexities you have now.

I think you have before you the complete case on the subject.

Senator GERRY. State officials said they could not possibly get along with under 25 percent, in Rhode Island and North Carolina, and that they would have to revise their State laws.

Senator TOWNSEND. It affects the State of Delaware seriously.

Senator VANDENBERG. The table on page 134 would not bear with the question we are wrestling with, because it does not indicate the size of the estate.

Mr. MAGILL. No; as I said to Senator Bulkley, how the proposal will affect a particular State will depend on how many decedents die in particular years and the value of their estates.

Senator VANDENBERG. There are no figures available on that?

Mr. MAGILL. I do not think so, no. Of course, it will vary from year to year.

Senator VANDENBERG. Then the House did not have the information before it which is developed by Governor Lehman's letter and these subsequent complaints?

Mr. MAGILL. They had everything developed by the letter, but not the statistics which you refer to, because there are no such things, and I do not think they would do you much good if you had them, because obviously there will not be a regular recurrence of deaths in particular estate-tax brackets. Naturally, they will vary from year to year.

The CHAIRMAN. The Treasury does not combat the assertion that came out in the hearing yesterday, that the credit would have to be increased from 16⅔ to 20 or 25 percent in order to get the revenue in the present law as in the case of New York, New Jersey, and North Carolina?

Mr. MAGILL. I do not know that, but taking the country as a whole, the revised schedule and the revised credit for estate taxes is intended to give us the same revenue we are getting now. As it will actually work out, the bulk of the estates will get a bigger credit than they are now receiving.

Senator GEORGE. The Treasury can compute that?

Mr. MAGILL. Yes.

Senator GEORGE. Would this readjustment which will take place and which positively will affect some States more than others—will that not compel them to modify their inheritance-tax laws?

Mr. MAGILL. It would have that effect in some States and that is why we put ahead the effective date of this schedule; it is for persons dying after December 31, 1939, thus giving the States the opportunity to make any adjustments they might want to make. The credit for State death taxes is based on the 1926 rates, which have not been in effect for some years. Some of the State laws, I believe, refer specifi-

cally to the 1926 Federal Revenue Act, and hence if a change of this character is made, their laws ought to be amended to refer to the current provisions.

The changes in the revenue law so far described result in a net loss as compared to existing law. Consequently, the Ways and Means Committee decided that some of the additional revenue required to maintain the present flow of internal revenue might properly be obtained by decreases in estate tax and gift tax exemptions.

(Resumes reading.)

At present, there are only about 9,000 taxable-estate tax returns filed with the Federal Government each year, although approximately 1,100,000 adult deaths occur annually. Estate- and gift-tax exemptions may aggregate $120,000, plus the indefinite amount of property which may be transferred by gift free from tax through the medium of the annual gift-tax exemption of $5,000 per year per person. In other words, it is a comparatively easy matter for a man to transfer an estate of several hundred thousand dollars to his wife and children over a period of years without any Federal estate or gift taxes at all. The House bill provides that the estate-tax exemption of $40,000 shall be reduced by so much of the gift-tax exemption of $40,000 as has been utilized by the decedent during his life. The result is that the present group of exemptions totaling $120,000 is reduced to $80,000. Secondly, the House bill reduces the annual gift-tax exemption from $5,000 to $3,000.

Senator VANDENBERG. Is there any estimate of what you gain from these particular taxes?

Mr. MAGILL. The figure is, estimating the type of situations we have now, we will get somewhere between $10,000,000 and $15,000,000.

The CHAIRMAN. On both?

Mr. MAGILL. On the two; yes.

(Resumes reading.)

Although the revenue bill covers many other subjects of considerable importance in particular cases, as you know from your detailed study of its provisions, I believe I have mentioned the high lights of the bill. Revenue revision is a continuing process which must be carried out cautiously, not only because of the complexity of the subject itself, but also because of its far-reaching effects upon every citizen in the country. I shall not burden the committee with a recital of other major topics which are now being considered in the Treasury and upon which recommendations may be made in the future at the request of the Congress.

Indeed I think I have taken too much time already.

Many of these could not be considered at this time, because of the generally accepted policy of concentrating attention mainly upon corporation taxes and taxes on capital gains. In due course, we hope that the administrative provisions generally, and in particular the methods of court procedure in tax cases can be simplified and improved. The overlapping of State and Federal taxes is increasing, and needs thorough study and prompt solution. It may be possible to consolidate Federal estate and gift taxes, with an increase in simplicity and in fairness. These and a number of other more detailed problems are now being considered, and data and recommendations will be available later when desired.

The President has strongly urged that the revenue system, as revised, should be so designed as to yield as much as the existing system.

The committee has asked the Treasury to furnish estimates of revenue yield, not only for the next fiscal year, but for the calendar years 1936 and 1937, in which business conditions were better than it is anticipated that they will be during 1938 on the average.

The statistics for 1936 are particularly useful, since we have accurate and complete data as to total incomes and deductions for that year. We agree with the committee that, in considering prospective revenue yields, past performances for year 1936 as well as future probabilities for years like 1938–39, should be taken into account.

The CHAIRMAN. Have you taken that into account in the estimates which you are going to give the committee?

Mr. MAGILL. We have. As I told you the other day in executive session, these estimates which will now be given have been prepared, as I understand it, on the basis, in the case of 1936, of the existing level of business activity for that year, and for 1938 and 1939, upon the levels of business activity which it is anticipated will exist during that year. No account has been taken of the effect of the tax bill itself in stimulating or depressing business activity. In other words, for the sake of getting comparable figures, we will give you the Budget estimates based on the estimated level of business activity and an estimate of what the schedules will produce under those conditions.

The CHAIRMAN. Witnesses by the score have appeared before the committee and have stated certain changes should be made with reference to capital-gains and undistributed-profits taxes, and certain surtaxes, if there is to be a revival of business activity, and that if those changes are made it will cause a revival of business and that the volume of business will be much larger. Your estimators have not taken that into consideration?

Mr. MAGILL. We have not. As we look at it, in the first place we have to be conservative, because these estimates are primarily utilized for financing purposes. We want to know how much we are going to get in from taxes so that we will know how much we will have to raise by other methods. The worst thing we can do is overestimate; that gets us into serious trouble.

The CHAIRMAN. You told us on Monday you would be able to tell us something about the returns from the March 15 returns; can you give any information on that?

Mr. MAGILL. Yes. The data we have now would indicate that the income taxes during the present year will yield about as much as was estimated in the Budget—probably not more and maybe a little less. Looking at the Budget figure as a whole, we think we will obtain about what the Budget estimates were in January for 1937–38. The income-tax collections at the present time are not running ahead of estimated collections, but apparently are going to come out at just about the figure which we anticipated we would get.

Senator CONNALLY. That is, the figure for corporate and individual income taxes, both?

Mr. MAGILL. Yes, sir.

The CHAIRMAN. The other day they were running a little ahead.

Mr. MAGILL. Yes; and since then they have been running a little behind. That is the trouble with trying to make estimates on a daily basis; but looking at the picture with as much common sense as one can, it would appear we are going to get from the income tax about what we thought we were. I do not think you can count on any

more; I think the fact is it will be a little less; but in general it will be about what we anticipated.

Senator VANDENBERG. Can you tell me about, in connection with the estimates you submitted, at what level of business you compute the 1938 calendar year estimates?

Mr. MAGILL. As I understand it, in working out these estimates a large variety of basic data is taken into account, various industries and predictions by experts both inside and outside the Government, as to what business activity is estimated to be, and a whole mass of data is run through before the estimators, headed by Mr. Al F. O'Donnell here [indicating] come out with the figure.

I want to say for the record that these estimates are prepared under the direction of Mr. O'Donnell by our Division of Research and Statistics. These are not my estimates, because, as you know, I am not an estimator.

Senator VANDENBERG. Is there any way for you to say you base your 1938 figures on a subnormal business year, an average business year, or what?

Mr. MAGILL. We base it on a less satisfactory business year than we had either in 1936 or 1937. I believe they are based on the theory that business will increase during the latter part of the year, commencing probably in the late spring or summer.

Senator VANDENBERG. To what extent do you rely on the Federal Reserve index?

Mr. MAGILL. That is one of the factors taken into account.

Senator VANDENBERG. The Federal Reserve index would indicate a tremendously sharp recession, would it not?

Mr. MAGILL. It did during 1937.

Senator VANDENBERG. It brings February 1938 down to 79 as compared to May 1937?

Mr. MAGILL. That is right. As I understand it, I do not think it gives future figures; they anticipate improvement in the latter part of the spring and fall.

Senator VANDENBERG. So this 1938 estimate is based on a general calculation and it is impossible to indicate the general level of business which is contemplated?

Mr. MAGILL. It is pretty difficult to do so because a whole number of different factors are taken into account. As you can readily see, the process of estimating is extremely difficult when you have to do your estimating considerably in advance of the months you are dealing with. These two tables which you have here—I do not know how much these mean to you directly——

The CHAIRMAN. One moment, Mr. Magill. The committee has been working all last week, morning and afternoon, and we have just got this bill over here today and I do not know what the status of it is and I have not kept in touch with it, but I would like to ask if it is the desire of the committee to meet this afternoon?

Senator KING. I hope not.

Senator VANDENBERG. Do you mean to meet for the purpose of writing up the bill?

The CHAIRMAN. I think we have to start writing up the bill pretty soon.

Senator CONNALLY. Have we finished the hearing?

The CHAIRMAN. We will have finished the public hearings after we have finished with Mr. Magill. We are going to hear one or two

people in executive session, but the public hearings will be closed when we get through with Mr. Magill unless some member of the committee wants to continue.

Senator KING. Is there to be a hearing on the proposed processing tax upon wheat?

The CHAIRMAN. The Senator was probably not here yesterday. Senator Pope has introduced an amendment and appeared before the committee wanting us to consider it, and I told him I would submit that to the committee to see whether they wanted to go into that proposition. I had a meeting yesterday with Chairman Doughton and Mr. Vinson and Mr. Cooper, and they would offer no suggestion with reference to it except they said the suggestion never came to them about any processing tax on this bill from any authoritative source and they had not considered it at all in this bill.

My personal feeling is we have had nothing that I know of, except from some of the Senators that want to put it on this bill. However, I think if we go into the processing tax it is only fair to give those who may have different views, whether in opposition or in favor, an opportunity to be heard.

Senator KING. I think we have had enough processing tax for the present and I am opposed to opening up the bill to include a processing tax.

Senator CONNALLY. Could we not have that discussed in executive session, Mr. Chairman?

The CHAIRMAN. I was going to bring it up in executive session.

Mr. Magill, have you finished your statement?

Mr. MAGILL. I have; yes, sir.

The CHAIRMAN. Have you given those estimates?

Mr. MAGILL. Yes, sir. I made up these two tables——

The CHAIRMAN. Let me interrupt you, Mr. Magill, to say we will not have a session this afternoon but will meet tomorrow morning at 10 o'clock in this room.

Senator WALSH. Could arrangements be made with the Democratic leader, not to have the Senate meet until 12 o'clock.

The CHAIRMAN. I will try to see him.

Senator WALSH. We will be engaged constantly in writing up this bill.

Senator GEORGE. I cannot be here tomorrow, and I hope you will not start writing up the bill until Thursday.

The CHAIRMAN. Would it be the desire of the committee—this is Tuesday—that we meet Thursday morning to begin to write up the bill, and try to finish it this week if possible, so that—I would like to request, Mr. Magill—the hearings were quite illuminating and many suggestions were made with reference to administrative features and other things, and the Department, at our request, had a representative here, and I hope that these hearings will be read by the authorities at the Treasury so you may be in a position to give to the committee in executive session the reaction of the Treasury to some of these suggestions.

Mr. MAGILL. I fully expect to do that. I have gone over a digest of what has been occurring here daily, and as soon as the clerk can supply me with the record—he has done a very good job of giving them to me as soon as they come off the press.

The CHAIRMAN. I want the hearings printed quickly. We will meet at 10 o'clock Thursday morning in executive session so we can have

all of this matter in hand and the committee members can read the hearings, those who were not able to be here, so we can move along.

Senator BROWN. There will be no hearing tomorrow?

The CHAIRMAN. No, sir.

Now, Mr. Magill, will you give us those estimates?

Mr. MAGILL. The two mimeographed sheets A and B contain, I hope, the principal estimates you desired on the various alternatives you wanted to consider.

I would be glad to have you question me rather fully about those, because in order to set it up in short tabular form, it is done in a sort of short-hand fashion, and explanations are pretty necessary for you to see what you have there.

The CHAIRMAN. Well, proceed to explain it.

Mr. MAGILL. Taking the first one, on capital gains and losses, exhibit A, the revenue situation as to that is given in the first line. You are familiar with the fact that under the present law, the amount of gain which is taken into an individual's ordinary income depends on certain percentages which are reduced as the time that he has held the asset increases. In other words, for example, taking the extreme case, if he has held an asset for 10 years, only 30 percent of the gain is taken into account, as against 100 percent if he sells it before the end of 1 year.

Senator CONNALLY. Are you not giving a man a premium for not selling?

Mr. MAGILL. The percentages do encourage holding in the sense that the taxpayer gets a lower tax rate as time goes on.

Senator CONNALLY. Is that not an inducement for him to hold it and not sell it, and ought we not offer him some inducement to go ahead and sell, since the more transactions there are the more business will be stimulated?

Mr. MAGILL. I think what you say is true. I think a man is induced to sell by various considerations, however, of which taxes are only one.

Senator CONNALLY. But that is the only one we are concerned with here, the effect of the tax; the other factors we cannot regulate.

I want to say I voted for all of these things, but I am coming around to the view that as to capital gains and losses we should make it more attractive to a man to sell instead of offering him a premium to hold on to it, because if he sells we get revenue from him and the purchaser may then in turn sell again and then we get further revenue from him. It seems to me the considerations for moving up business would be better subserved by a lower rate of tax on the capital gains than to put it so high it would deter a man from selling.

Mr. MAGILL. Of course, you have this other factor; I believe it is the view of our economic experts, and here I speak with caution, that people are induced to sell or to hold by a number of other factors besides the tax considerations.

The report of the Texas Co. has just come out, showing a much better year than the year before. If you own 100 shares, or I own 100 shares in the Texas Co., even though I conclude I could sell them this year to some advantage, I nevertheless think that since the company is going along well I had better hold on to them as there is no advantage in selling Texas shares and buying some other stock. The great bulk of stock is not held for sale but is held primarily for

investment. So I do not suppose you want to go all of the way to encourage people to sell.

Senator CONNALLY. I would put some tax on it, of course, but I was talking to a man from my State with a rather large income and he had it all figured out if he could sell a piece of property, if he sold it now it would run into taxes so high it would practically wipe out any profit he would make; so the result was he did not sell, but waited. If he wants to sell now, the rate is so high there is no inducement to sell. His argument rather convinced me.

Mr. MAGILL. The tax on capital gains is in fact less than on ordinary income if the asset has been held for more than 1 year. I have no doubt that most persons, whether rich or poor, would like to have it lower still. It is a happy thought, but how far is it a matter of judgment?

Senator CONNALLY. But if he does not sell you do not get any tax.

Mr. MAGILL. That is right.

The CHAIRMAN. As an expert, economist, and professor, do you believe it would be helpful to business if we could make the capital-gains tax at a reasonably low figure, and making him hold it a reasonable time, 1 or 2 years? If you do not want me to ask the question, I will withdraw it.

Mr. MAGILL. No; I like your questions. However, I do not have those first three qualifications; I am neither an expert, nor am I at the present time a professor, and I never was an economist, so, my answer will probably be wrong——

Senator KING. An expert, you understand, is a man who knows more and more about less and less.

Mr. MAGILL. I know less and less about less and less, it seems to me.

My own honest belief is the rates on capital gains in the present law are about as liberal as there is any equitable reason for providing. The other consideration is, or course, the one which you have mentioned and the one Senator Connally has mentioned, that is whether, a lowering of these rates, even though they may be low as compared to rates on other types of income, would encourage transactions, and that is desirable.

Senator KING. It would put more money into circulation and increase business?

Mr. MAGILL. Yes. I am told by our economists they do not look forward to very much from that source, but you have had general testimony here to the contrary.

The CHAIRMAN. Give me the names of the economists who have that view.

Mr. MAGILL. The Division of Research and Statistics has a number of economists. The head is Mr. Haas, who has appeared before you in times past. In addition, I have working, primarily with me, Dr. Carl Shoup, who is professor of economics at Columbia and who was also head of the Twentieth Century Fund Study on Facing the Tax Problem, conducted during the past couple of years.

Senator KING. He was not in harmony with many of the views expressed in the reorganization bill.

Mr. MAGILL. I do not know whether he got into that. That probably was another branch——

The CHAIRMAN. How long has be been there?

Mr. MAGILL. He came down as a special assistant durin the fall. He is now on full time, on leave from Columbia.

The CHAIRMAN. He does not agree with Dr. Fairchild, professor of economics at Yale?

Mr. MAGILL. Dr. Fairchild testified yesterday; I do not know what his views are on that.

The CHAIRMAN. I hope he will read the testimony of yesterday on that subject.

Mr. MAGILL. I am sure he will want to.

The CHAIRMAN. It is rather confusing to a layman, except looking at it in a practical way, but every witness who has appeared before this committee, and I think some men of big standing have been among them, have told us it would help business, and God knows I think this committee wants to help business if it can; I think if we lose a little revenue in order to help business, while that loss may be temporary, we will gain it back next year.

Senator CONNALLY. It seems to me there is a differentiation between ordinary income and income from capital gains, because ordinary income, the taxpayer has to pay it; he has no choice. But in the case of capital gains he has a choice; he does not have to realize unless he wants to; he can wait and postpone and get the advantage of 3 or 4 or 5 or 10 years, whereas on ordinary income he has to pay it. We will get that revenue on ordinary income but we will not get it from capital gains unless he realizes it, and when he does realize he brings about a transaction of some kind, a business transaction, and the man to whom he sells it may turn around and sell it to someone else, and it seems to me in that way it stimulates business transactions.

Mr. MAGILL. That is perfectly true. On the other hand, capital gains may accrue over several years' time, whereas ordinary income usually accrues over a single year. So some kind of preferential treatment for capital gains is indicated on that score.

Senator CONNALLY. I think he should pay a tax——

Mr. MAGILL. However, I think the present provisions are sufficiently preferential.

The CHAIRMAN. The House bill is much better in that respect than the present law.

Mr. MAGILL. More liberal; yes, sir.

The CHAIRMAN. But it does not go far enough.

Mr. MAGILL. Not on capital losses, in particular, but there you have a loss of revenue staring you right in the face.

Senator KING. Is it not a fact that Great Britain, after experimenting with the tax upon capital gains and losses, reached the conclusion that those higher rates did not result in increased revenue and were a detriment to business, and they reduced them very, very much, and has not our own experience demonstrated the wisdom of that policy?

Mr. MAGILL. So far as I know Great Britain never had a tax on capital gains, as we know it. So far as the expert recommendations are concerned in Great Britain, they have been that Great Britain impose more capital-gains tax than now. The British tax, profits on business transactions such as sales of securities, just like any other kind of income.

Senator KING. That would not fall into the regular conception of capital gains and losses for tax purposes?

Mr. MAGILL. No, we call that business income. As far as I am aware the British never have taxed capital gains for the reason that their tax law is made up, rather curiously, of a series of schedules com-

prising the different types of income which are taxable. None of these schedules include a tax on isolated transactions for profit, but the recommendations made in 1920 by the Royal Commission were that the British should collect more from capital gains than they are doing.

The CHAIRMAN. It is a little difficult for me to understand this exhibit, and I would like to have an explanation; just go ahead with it.

Mr. MAGILL. An explanation is almost essential, I think.

Taking your present law figures, the 1936 figures——

The CHAIRMAN. This is on capital gains and losses?

Mr. MAGILL. Capital gains and losses, yes, sir. The 1936 figure is supposed to represent the actual net collections from the income tax on capital gains, $187,000,000. During 1937—that, I take it, is an estimate—we take it for 1937 we will collect only $28,700,000, the reason being we anticipate very large losses taken in the latter part of 1937 to offset gains taken in the forepart of the year.

In 1938 it is anticipated we will get more money from capital gains——

Senator KING. Is that because you believe the people are anticipating amelioration in the present capital gains and losses provision and therefore there will be an increased volume of sales and hence an increase in revenue?

Mr. MAGILL. Those considerations are not taken into account at all in here, Senator; they are not considered in these figures. As I understand it, as someone put it the other day, these are cold figures. The tax law, as such, is not taken into account as an encouraging or discouraging factor in working out these figures.

The CHAIRMAN. In 1938 you anticipate $74,000,000?

Mr. MAGILL. $74,500,000.

The CHAIRMAN. That is the calendar year.

Mr. MAGILL. Yes. Now, for fiscal 1939——

The CHAIRMAN. Why did you take fiscal 1939 instead of calendar, as in the others?

Mr. MAGILL. Simply because fiscal 1939 is the next fiscal year. I suppose calendar 1939 would look something like calendar 1938.

The CHAIRMAN. We will understand it a little better if the calendar year is used.

Mr. MAGILL. I gave fiscal 1939 because that is the one we are working toward, and the one for which you have Budget estimates.

The CHAIRMAN. All right. Is that $56,000,000 for half the year?

Mr. MAGILL. No; the whole year.

The CHAIRMAN. From July 1, 1939, to June 30, 1940?

Mr. MAGILL. No; from July 1, 1938, to June 30, 1939.

The CHAIRMAN. I see.

Senator BROWN. That is all based on the application of the 1936 Revenue Act?

Mr. MAGILL. The present law.

The CHAIRMAN. All right. Now take the House bill.

Mr. MAGILL. The House bill, you will notice, has certain loss carry-over provisions which are not contained in the present law. I think you understand those in general. They are pretty complicated, but generally speaking you may have a carry-over of net capital losses to the following year so far as long-term losses are concerned. That

operates to reduce the revenue because it gives the taxpayer that additional advantage. So the bill is estimated to yield less on such business conditions, or such incomes or transactions as you had in 1936.

In the next fiscal year 1938-39, you will notice it is estimated to yield about the same amount. That is for the reason that in computing that fiscal year the loss carry-over provisions would not be operative; they would not be detrimental to revenue in the following fiscal year.

The CHAIRMAN. That is shown by the 57.8?

Mr. MAGILL. Yes.

Senator BULKLEY. I do not follow you. Here is the fiscal year 1939, and that is half based on 1937 and half on 1938 returns, is it not?

Mr. MAGILL. The first three figures that you have here in the second line "House revenue bill of 1938" are the estimated yield of the provisions which you had in the House bill on the actual business which was done in 1936, what it is estimated it was during 1937 and will be during 1938.

Senator BULKLEY. Those are returns for those calendar years?

Mr. MAGILL. It is what it is estimated the returns will be, irrespective of any encouragement or discouragement to business that might result from this bill. We take the transactions which we think will take place during those years as used for the Budget. For fiscal year 1939, that figure is not perfectly comparable with the first three figures that you have, for the reason that the provisions of this bill, so far as capital gains and losses are concerned, take effect January 1, 1938. Now, the loss carry-over provisions are not operable as to past losses——

Senator BULKLEY. But it is the figure for the fiscal year made on the receipts estimated during the fiscal year?

Mr. MAGILL. Exactly.

Senator BULKLEY. But those receipts during the fiscal year are half based on the returns for 1937 and half on the returns for 1938?

Mr. MAGILL. They are about half based on capital gains which were realized during 1937 under that law, and half from capital gains which may be realized this year under this law.

Senator BULKLEY. But how could the receipts for that fiscal year be greater than the returns for either of the years on which they are based?

Mr. MAGILL. Because the House bill effects a considerable number of important changes on the capital gains and losses provisions; it tightens up in some respects and loosens up in others, and as those are estimated to operate for the next fiscal year, the ones tightening up appear to give more benefit.

Senator BULKLEY. But you state that the returns are estimated to show for the calendar years 1937 and 1938, and if those returns are made, how can you possibly collect more than either of them when your receipts, your estimated receipts for fiscal year 1939 are based half on one and half on the other?

Mr. MAGILL. This would not be the whole story, but under the present law, short-term losses, losses on sales of securities held for less than 1 year, for example, may be used to offset long-term gains, gains realized on the sale of property held for 10 years, for instance. Under the House bill that is no longer true. Consequently the immediate effect, as estimated here, will be an increase in revenue for the next

fiscal year. Now, for following years, when the loss carry-over provisions come into operation, you will lose as against existing law.

Senator BULKLEY. I still do not——

The CHAIRMAN. We will ask you more questions about that in executive session.

Mr. MAGILL. I would like to try to answer Senator Bulkley's question.

Senator BULKLEY. I am assuming your returns are all made for 1937 and they show a tax liability of $11,700,000, and then your returns are all made for 1938, and they show $42,000,000. Now, how in the world——

Mr. MAGILL. Your assumption is not quite correct.

Senator BULKLEY. That is what I want to find out

Mr. MAGILL. The first line, under the present law, the figure of $28,700,000 is what we estimate we will get from the net of capital gains and losses during the calendar year 1937 under the present law.

Senator BULKLEY. Returns for operations made in the calendar year 1937?

Mr. MAGILL. Yes; in 1938, the $74,500,000 figure is what we think we would get, net, under the present law for the present year. If the law were changed, as it was in the House bill, we figure we would get less for 1936, 1937 and 1938, as there indicated. For the next fiscal year, 1939, we figure we would get a little more.

Senator BULKLEY. But the fiscal year is a different thing; it is what you estimate to collect and not returns from business done.

Mr. MAGILL. That is right.

Senator BULKLEY. But if you estimate you will collect half of the $11,700,000 and half of the $42,000,000, how could it be $57,000,000 for 1939?

Mr. MAGILL. Well, you see you have here—I see what you mean. You have $28,700,000 and $42,200,000 which would have been about $77,500,000 if the loss carry-over provisions of the House bill were not effective which is true so far as the fiscal year 1939 estimate is concerned.

Senator BULKLEY. Where is the $74,500,000?

Mr. MAGILL. That is in the present law, as applied to the calendar year 1938.

Senator BULKLEY. But I am asking about the second line. Suppose the law is amended as provided in this bill; you estimate that the operations of 1937 would yield $11,700,000.

Mr. MAGILL. During that calendar year, yes.

Senator BULKLEY. You cannot increase that afterward, and you are getting half of that and half of the 1938, which, together, represent 1939.

Mr. MAGILL. No.

Senator BULKLEY. Why not?

Mr. MAGILL. So far as 1937 is concerned, the present law will be in effect, as far as the House bill contemplates.

Senator BULKLEY. I see what you mean now. This is not an estimate on what the yield would have been if the law were amended——

Mr. MAGILL. It is fifty-fifty in effect.

This last column, as I understand, shows what we think you would actually get during the fiscal year 1938–39 if the House bill were adopted, effective as of January 1, 1938.

Senator BULKLEY. So this estimate of $11,700,000 is not regarded as being effective?

Mr. MAGILL. Not really; no, because the House bill would not be effective in connection with 1937.

Senator BULKLEY. I thought this was assuming it were effective.

Mr. MAGILL. I am glad to go into this, because, as I have said, and you have brought out, this last column is not strictly comparable for the reasons we have been discussing, and I gave it to you because I thought you might want to see what you might anticipate getting into the Treasury in the next fiscal year.

The CHAIRMAN. Now, let us take the third one.

Mr. MAGILL. That requires a little explanation. I have described it as the 1924-act method, for simplicity. In that act the substance of the method for taxing capital gains was, so far as gains were concerned, a taxpayer might apply to them a flat tax rate of 12½ percent. As far as losses were concerned, he was not allowed to reduce his tax on other income by more than 12½ percent of the loss; in other words, it limited the deduction on the losses and also limited the tax on the gains.

Senator VANDENBERG. On your table you are applying 15 percent.

Mr. MAGILL. Yes; assuming you utilize that scheme, but use the rate of 15 percent, and assume there were no loss carry-over provisions at all—you could deduct the losses in the way I have described, but you could not carry over any net loss to the following year—the estimated revenue, under that hypothesis, for such a calendar year as 1936, is $156,000,000; for 1937, you would lose money as there would be an excess of deductions for losses over gains; for 1938, the estimate is the receipts would amount to $46,000,000, and so far as the next fiscal year is concerned, we expect to get $39,000,000 from it.

Senator BROWN. I do not see the justification for your low estimates for 1937, all of the way down, in the various methods of computation. You said you thought that was due to the fact there would be a good many sales at losses in the last half of 1937. I want to ask whether you base that on any experience you have so far had in your collections of income-tax returns for 1937?

Mr. MAGILL. No; they have not been sufficiently examined so that this represents an actual figure.

Senator BROWN. I do not particularly remember October and November, but I think December was one of the lowest months in the last several years in total amount of sales on the New York Stock Exchange. I particularly remember in the last week they did practically no business at all.

Senator VANDENBERG. Compared with other years, it was just the reverse.

Mr. MAGILL. There were a lot of tax sales at the end of the year.

Senator BROWN. I know in the last week in December the sales on the exchange were very, very small. So I question whether your estimates for 1937 are sound or borne out by the facts.

Mr. MAGILL. They may not be. As I have said before, I did not make these, but they are made on the basis of as good available data as we can get. I know economists from a large number of banks and brokerage houses in New York were questioned by our people with

respect to existing tax during the fall of 1937, at the time the Budget estimates were being prepared, and our men that handled this ought to have been familiar with what conditions actually were. Whether they used good judgment in estimating from them, I do not know, but I hope they did.

The CHAIRMAN. All right.

Mr. MAGILL. The next line is the fourth line, which assumes a method of taxing capital gains and losses like the one used in the 1924 act, except that the rate is made 15 percent instead of 12½, as it used to be, and that rate is applied to the gain and loss on the sale of assets held over 1 year. Under the system applicable during the twenties, capital gains were gains from sale of property held more than 2 years. Consequently if this were applied to sales held more than 1 year, it would lower the rate applicable to a great many capital gains at present. The next line of figures gives you that.

Senator KING. Was not their experience under capital gains and losses such as to justify the conclusion that restrictive capital gains legislation deterred investments and resulted in loss of revenue, so that we practically abandoned it because we did not obtain any satisfactory results?

Mr. MAGILL. Well, like most other things in this business, the figures are available and what conclusion should be drawn from them is another question. It is true in such years as 1928, for example, the amount of revenue from capital gains was almost as much as the amount of income tax on ordinary income, and that can be interpreted in either of two ways; one interpretation might be that we profited by having a 12½ percent tax on capital gains; the other interpretation might be that during the period of the twenties we had the most active business conditions and the greatest number of sales in securities we have ever known; we have not approached it since. Consequently, we were bound to get more money because the number of transactions was so great.

Senator KING. It is obvious that the greater number of transactions in real estate and in securities, the larger the revenue will be from taxes, and if you have such high tax rates as to deter transactions you are going to greatly reduce your volume of revenue derivable from gains and losses.

Mr. MAGILL. Yes; of course, as you know, we have some regulatory taxes in our scheme of things, such as the taxes on colored oleomargarine, which are so high that it is not sold, or hardly at all, and the tax therefore is not collected, and the same is true on State bank notes. The actual figures on capital gains and losses appear on page 98 of the House hearings.

The CHAIRMAN. I would like for that to be included in the record here.

Mr. MAGILL. It is table 9 on page 98 of the House hearings.

The figures for 1936 are those which you have in front of you.

(The table referred to is as follows:)

Individual income taxes, 1926–35—Taxes on capital gains and losses, taxes on all other income, and total taxes

[In thousands of dollars]

Calendar year	Estimated taxes on capital gains and losses [1]	Estimated taxes on all other income	Total taxes [2]
1926	225, 485	506, 986	732, 471
1927	296, 879	533, 760	830, 639
1928	576, 001	588, 253	1, 164, 254
1929	420, 971	580, 967	1, 001, 938
1930	−15, 226	491, 941	476, 715
1931	−89, 001	335, 128	246, 127
1932	−79, 917	409, 879	329, 962
1933	16, 167	357, 953	374, 120
1934	17, 197	494, 203	511, 400
1935	85, 257	572, 182	657, 439

[1] Net tax liabilities on profit and loss from the sale of assets irrespective of the period assets were held.
[2] Individual income-tax liabilities reported in Statistics of Income.

Source: Treasury Department, Division of Research and Statistics, Nov. 6, 1937.

The CHAIRMAN. What was the amount of capital gains receipts in 1928; it was $300,000,000 odd, was it not?

Mr. MAGILL. It was more than that. In 1928 the estimated tax from capital gains and net of losses was $576,000,000. The estimated tax on all other income was $588,000,000.

Senator TOWNSEND. What was it in 1929?

Mr. MAGILL. $420,900,000 from capital gains and $580,967,000 from ordinary income.

The last one of these computations can be explained, perhaps, for present purposes, in this way:

The attempt there was to give the individual who would not benefit from the 15-percent flat rate, another option, which would be approximately as good for him as the 15-percent rate is for a man of comparatively large income. You will notice essentially he is going to be taxed on his transactions for over 1 year on one-half of his net gain and he gets a limited deduction for the losses. Since that reduces the revenue as to taxpayers in the lower brackets you get a reduced figure of net revenue from that source. That is the last line on the righthand side of the page.

Senator KING. It means, does it not, as presented on this sheet, that any changes which are recommended in the House bill, in the aggregate resultant, were very little to the advantage of the holder of the securities and of greater advantage to those who engage in sales of capital assets?

Mr. MAGILL. The House bill does this, if I may differentiate a little: The House bill, as far as gains are concerned, gives the man with gains in excess of $70,000 a better break than he gets now. So far as the man below that is concerned, it does not do much. So far as losses are concerned, he gets a liberalized provision with respect to losses on long-term transactions, and a somewhat less liberal provision as to short-term transactions.

Senator KING. By and large do you say, Doctor—and I do not put it in interogative form by way of questioning your suggestion—that the provision of this bill will encourage business and induce sales of capital to the advantage of business generally?

Mr. MAGILL. Well, if I may——

Senator KING. It seems to me it is a sort of stalemate and maintains the status quo.

Mr. MAGILL The House bill, as we figure it, will produce a little more or less than the present law; probably slightly less. There is not any large scale revision which may be anticipated from these taxes. So far as a taxpayer with income of more than $70,000 who realizes capital gains, he gets a decided break under the House bill, and so far as the man who realizes losses is concerned, he gets somewhat more liberal treatment than at the present time.

The CHAIRMAN. You estimate on the 1924 act method, applying a flat capital gain rate of 15 percent, with no loss provisions, in comparison with the House bill, that for the year 1938 it would show a 4.2 percent rise.

Mr. MAGILL. $4,200,000 more on 1938 conditions than the House bill.

The CHAIRMAN. And with these losses, on your estimate at a 15 percent rate, there is a slight decrease from the House bill for 1938, the House bill being $42,200,000, and this estimate of 15 percent would be $40,700,000?

Mr. MAGILL. Do you mean plan No. 5?

The CHAIRMAN. That is right.

Mr. MAGILL. Yes, sir.

The CHAIRMAN. That is, without taking into consideration the pick-up in business due to a shift in that method?

Mr. MAGILL. That is right. This is on the basis of the transactions which we think would take place during that year, irrespective of the effect of a tax bill.

Senator TOWNSEND. Dr. Magill, will you prepare a table of the estimated revenue if you broaden the base?

Mr. MAGILL. Yes. You mean if you lower the income tax exemptions?

Senator TOWNSEND. Yes.

Mr. MAGILL. Yes; we have figures on that. What particular changes would you have in mind?

Senator TOWNSEND. I was just trying to figure out, if you had a schedule in lowered exemptions, say, from $2,500 down to $2,000, or $1,500, or whatever your schedule figures it out.

Mr. MAGILL. I have one here that will give you an idea about it. This is a combination; this assumes that the exemption for married persons was reduced from $2,500 to $2,000 and the single person's exemption were likewise reduced 20 percent, from $1,000 to $800, that you would get, we estimate, for the calendar year 1937, $70,700,000 additional revenue.

Senator TOWNSEND. Seventy million?

Mr. MAGILL. About seventy-one million dollars additional.

The CHAIRMAN. I want to ask you one question before we close. You have another exhibit B there and in that I see the House bill for 1937, you estimate under a flat rate of 18 percent, instead of the 16–20 you would get $1,515,000,000 instead of $1,429,000,000.

Mr. MAGILL. That is on business conditions for that year.

The CHAIRMAN. What is that?

Mr. MAGILL. On the basis of business conditions for that year.

The CHAIRMAN. And with no consideration about the helpfulness of the act to business?

Mr. MAGILL. That is right.

The CHAIRMAN. And for fiscal year 1939 it would be $1,041,000,000 under the 16–20 and under the 18-percent flat rate it would be $1,077,000,000?

Mr. MAGILL. That is right.

The CHAIRMAN. So you think there would be a pick-up in revenue with the 18-percent flat rate when compared to that?

Mr. MAGILL. Yes. Bear in mind the Revenue Act of 1938——

The CHAIRMAN. Mr. Magill, we will have to adjourn until 10 o'clock Thursday morning——

Senator KING. I want to ask one question before we adjourn.

Mr. Magill, is the difference between plan No. 4 and plan No. 5 due to the disallowance of losses in excess of $2,000; is it not due to that?

Mr. MAGILL. Not wholly, sir. Plan No. 5 gives a better break to the man with the smaller income than plan No. 4 does.

I will give the committee an explanation of table B at the next meeting.

(Exhibits A and B submitted by Mr. Magill are as follows:)

EXHIBIT A.—*Individual income tax—capital gains and losses—Estimated revenue yield from the taxation of capital gains and losses under present law, under the House revenue bill of 1938 (H. R. 9682), and under various proposed methods of taxation*

[In millions of dollars]

General method of taxing capital gains and losses	Loss carry-over provisions	Calendar years [1]			Fiscal year 1939 [2]
		1936	1937	1938	
1. Present law (Revenue Act of 1936)	None	187.1	28.7	74.5	56.2
2. House revenue bill of 1938 (H. R. 9682)	As provided in the bill	154.0	11.7	42.2	57.8
3. 1924 act method, except that the flat rate is 15 percent.	None	156.6	−7.3	46.4	39.3
4. 1924 act method, except that the flat rate is 15 percent applied to gain or loss from the sale of assets held over 1 year.	do	137.4	−8.4	45.6	38.9
5. Modified 1924 act method:					
Short-term gains and losses (from the sale of assets held 1 year or less): Net gains—enter into net income. Net losses—disallowed in the current year.	Short-term net losses of the current year may be carried forward and applied against short-term net gains of the following year.				
Long-term gains and losses (from the sale of assets held over 1 year): Net gains—option of (1) a flat 15 percent tax rate or (2) entering one-half of net gain into net income.	Long-term net losses disallowed in the current year may be carried forward and applied against long-term net gains of the following year.				
Net losses—enter into net income the smaller of (1) one-half of the net loss, or (2) $2,000.		134.6	8.8	40.7	49.9

Treasury Department, Division of Research and Statistics. March 19, 1938.

[1] Assuming that all provisions are fully reflected in revenues.

[2] Assuming that the proposed changes in law become effective for taxable years beginning after Dec. 31, 1937. The major changes in the law are, therefore, only partially reflected in fiscal year 1939 revenues, while the loss carry-over provisions are not reflected in revenues until the fiscal year 1940.

EXHIBIT B.—*Estimated corporation income tax liabilities under the Revenue Act of 1936, under the revenue bill of 1938 (H. R. 9682)* [1] *and under selected flat tax rates to apply to all corporations*

[In millions of dollars]

	Calendar years [2]			Fiscal year 1939 [3]
	1936	1937	1938	
Revenue Act of 1936	[4] 1,445	[4] 1,541	[4] 873	1,053
Revenue Bill of 1938 [5]	1,282	1,429	851	1,041
Flat rate of 19 percent [6]	1,437	1,599	1,000	1,100
Flat rate of 18½ percent [6]	1,399	1,557	974	1,089
Flat rate of 18 percent [6]	1,361	1,515	948	1,077
Increase (+) or decrease (−) of Revenue Bill of 1938 over 1936 Act	−163	−112	−22	−12
Increase (+) or decrease (−) of 19 percent rate over 1936 1936 Act	−8	+58	+127	+47
Increase (+) or decrease (−) of 18½ percent rate over 1936 Act	−46	+16	+101	+36
Increase (+) or decrease (−) of 18 percent rate over 1936 Act	−84	−26	+75	+24

[1] As passed in the House of Representatives, Mar. 11, 1938.
[2] Assuming that all provisions are fully reflected in revenues.
[3] Assuming that the proposed changes in law become effective for taxable years beginning after Dec. 31, 1937. The Revenue Act of 1936 figure, therefore, includes only that portion of the individual income tax liability which would be lost by repealing the undistributed profits tax on corporations. The major changes in the law are, therefore, only partially reflected in fiscal year 1939 revenues.
[4] Includes the increase in the individual income tax as a result of additional dividends forced out by the undistributed profits tax.
[5] Reflecting the revenue effect of all provisions affecting corporations in the House Bill, including for all years the allowance of the deduction of losses sustained in the sale of depreciable assets and for calendar years 1936, 1937, and 1938 the revenue loss due to the allowance of the redeclaration of capital stock valuation each 3 years.
[6] Applying to all corporations on the base subject to the normal tax under the 1936 Act.

Source; Treasury Department, Division of Research and Statistics, Mar. 19, 1938.

The CHAIRMAN. I desire to place in the record before the hearings are closed a brief submitted by Mr. Arthur B. Hyman, counselor at law, New York City; also a brief submitted by the Operative Buildser Association of the District of Columbia. This latter brief is a copy of a memorandum submitted by the National Association of Real Estate Boards to the Subcommittee of the House Ways and Means Committee. In addition I am placing in the record a letter addressed to the committee by Hon. Henry F. Long, Commissioner of Corporations and Taxation, Commonwealth of Massachusetts, a statement submitted by the Cincinnati Chamber of Commerce, and telegrams received from George DeForest, of Lord, Lord, Day & Lord, New York City, and the American Whaling Co., Inc., of New York City.

BRIEF SUBMITTED BY ARTHUR B. HYMAN, COUNSELOR AT LAW, NEW YORK CITY

Only a short time ago, we emerged from a world-wide depression which we had no power to avert and were moving forward rapidly to what promised to be a higher and wider prosperity than we had ever enjoyed before. With our unlimited resources and our highly developed and efficient industrial and economic system, this consummation was to be expected. There was apparently nothing on the horizon to interrupt our progress. Now we find the forces of recovery in full retreat, which may turn into a rout if Congress does not act speedily to arrest the movement and to reverse it.

There seems to be practical unanimity of opinion that the repeal of the undistributed-profits tax and the repeal or drastic modification of the capital-gains tax would be very powerful factors for accomplishing this result.

For many months, a special committee of the House was engaged in the task of revising the present revenue laws. As a result of its work, supplemented by public hearings before the Ways and Means Committee, the House evolved a bill which, with certain modifications, is now before this committee for consideration.

My primary purpose in addressing you is not so much to discuss the merits and demerits of the various proposals embodied in the bill which is before the committee, or to suggest amendments which I have in mind, but rather to urge the committee to postpone consideration of a general revision of the tax bill and confine its attention to the proposals concerning the undistributed-profits tax and the capital-gains tax. Action to this end is imperative and we cannot afford to delay any further the relief and encouragement which the business of this country sorely needs.

My reason for suggesting this action is that the character of revision needed will require many months. We have been patching our revenue laws for so many years that the present tax bill is a veritable crazy quilt. We have built upon old foundations, showing far too much concern about loopholes and too little about primary objectives. Every time some ingenious taxpayer has evolved a plan for the reduction of his tax liability, the Treasury Department has acted as if the Government were being shaken to its very foundations. Every time a few dollars have been lost as a result of some adverse court decision, the Treasury has reacted as if such a result must necessarily be inequitable and unendurable. Amendment has followed amendment, the sole purpose of which was to prevent the loss of money, the aggregate of which is negligible in relation to the whole. We have thus made ourselves a nation of penny chasers.

Then, too, we seem to have lost sight of the fact that the primary purpose of revenue laws is to raise the money necessary for the maintenance and support of the Government with the least possible shock to the economic system. Our policy of profligate spending has made it necessary to find more and more revenue, and we have been devising ways and means to secure it without regard to the fact that there is a limit to the amount that can be extracted from the economic system without bringing about its complete demoralization. Our actions indicated that we labored under the misconception that the less money the country earns the more we can take in taxes. We doggedly refused to believe what experience seems to have taught—that beyond a certain point taxation results in diminishing returns and that low rates produce greater revenue than inordinately high ones.

We need a new deal in taxation that requires a fresh approach to the subject. The present tax bill is a monstrous imposition upon the people. It fixes the liability of millions who cannot possibly fathom its intricacies. They cannot prepare any but the simplest returns without the assistance of experts. Endless litigation is the inevitable price of such complexity. Not the least of its vices is the resentment against their Government which it creates in the minds of our citizens.

The complete revision of our system of taxation is, in my opinion, desperately needed, but it is not a matter for the moment. The pressing need is for action that will lift business out of the state of demoralization and inertia into which it has fallen and inspire it with confidence. Since income taxes can be collected only if and to the extent that there is income, the course indicated is that which will increase the income and not the rate of taxation.

UNDISTRIBUTED-PROFITS TAX

Discussions of the undistributed-profits tax have been exhaustive. There is little to be said on the subject that has not already been said. To my mind, it is a cancer on the economic system and a complete anomaly in tax legislation. It is generally considered the greatest single cause of the present depression. Capital is the life blood of business. This tax has brought about the flight of capital from enterprise; it has deprived business of the reserves necessary not only for expansion but even for continous operation by forcing into the hands of the stockholders money desperately needed for pay rolls and for the purchase of equipment. It has created unemployment and thus defeated the primary objective of the administration. It has utterly destroyed ambition and initiative. It has produced a dogged "what's the use" psychology.

For the sake of justifying those who advocated the passage of this legislation and who have not the courage to admit what all unbiased judges readily perceive, namely, that it is utterly vicious and without any redeeming feature, a proposal is made to retain it in modified form in the Revenue Act of 1938 upon the theory that the principle of such taxation is sound. It is difficult to perceive how legislation can be sound in principle which, in operation, produces such unfortunate and unacceptable results.

Justification for its continuance is also sought in the claim that its repeal would result in the loss of substantial revenue. That claim is specious. The Federal Government is not committed to any particular method of raising revenue. It certainly is not committed to raising it by a method universally condemned.

Furthermore, it is not easy to reconcile the concern expressed over the loss of revenue from this particular source with the lack of concern over a budget that remains unbalanced year after year. If it had to be conceded, for the sake of argument, what is obviously not so in fact—that there was no other source from which the loss of revenue arising from the repeal of the undistributed-profits tax could be recouped—it is nevertheless perfectly apparent that if we can survive deficits of 2 and 3 billions of dollars a year, we can manage to stagger along with an additional deficit of 20 or 25 millions. As a matter of fact, the estimate is utterly unreliable. We cannot possibly know what effect in dollars and cents the repeal of the undistributed-profits tax will have. If recession in business continues at its present rate, the actual revenue and the estimated revenue are likely to be far apart.

One proposal which is the embodiment of the desire to retain the principle of the undistributed-profits tax is claimed to have virtue in that it applies and subjects to tax only 300 to 600 corporations. That very characteristic is precisely what makes it vicious rather than virtuous. Upon what theory can closely held corporations be singled out for such punitive taxation? Do not the same objections which call for its repeal apply in one case as in the other? In truth, the small corporation, which is frequently the closely held one, is the one hardest hit by the undistributed-surplus tax. It is a waste of time to prolong such argument further. The proposal has been eliminated by amendmenton the floor of the House, and I am sure the Senate will concur in that action.

When we set over against all the arguments which have ever been advanced in support of an undistributed-surplus tax in any form, the economic loss to the country that has resulted and will continue to result if this impost is retained, we shall have little hesitation in reaching the conclusion that it is a luxury that we cannot afford even to please its sponsors.

CAPITAL-GAINS TAX

The capital-gains tax has been the subject of controversy ever since its enactment. Its proponents urge that the profit derived from the sale of capital gains has no just claim to exemption from taxation imposed upon other forms of income. The fundamental differences between income derived from labor or capital and that derived from the sale of capital assets have been discussed frequently and exhaustively. They are recognized in the complicated provisions of every act passed since that of 1921 where the subject was first dealt with. There is very persuasive evidence that the taxation of profits from such sales was not originally contemplated under the sixteenth amendment. However, for a long period of years it has constituted a part of our system of raising revenue, and it only remains now to be determined whether its continuance as a part of that system is justified.

Several features of this form of taxation require examination. What is the effect of this form of taxation upon our economic system? I know of nothing more conducive to prosperity than encouragement of free trading. When I say that, I do not limit its application to the purchase and sale of securities. It applies as well to the purchase and sale of all kinds of property which fall within the definition of capital assets. What ever tends to limit or retard this freedom puts the brakes on business in its broadest sense. It checks individual activity, reduces employment, and curtails the circulation of money.

No one doubts that the panic of 1929 resulted in no small measure from the high taxes imposed upon profits derived from the sale of capital assets. The natural reluctance to realize such profits, created by the heavy impost thereon, resulted in curtailing the supply which would otherwise have been available to offset demand. An inexorable economic law forced prices to heights which had no regard for actual values, and this continued until the whole structure toppled over like a house of cards and brought disaster to the entire country. Here again, as in the case of the undistributed-profits tax, we have a method of raising revenue which is potentially dangerous to economic welfare. This danger should either be eliminated or reduced.

The next question to be considered is how valuable this form of taxation is as a producer of revenue. It has been said by eminent authority that it has been a complete and ghastly failure in this respect. I have no doubt that this is true, and the reason for it is obvious. In years of great business activity and rising prices, substantial sums are likely to be collected. They are given back, however, in subsequent periods when the trend has been reversed. While, as pointed out before, there is great reluctance to sell in a period of rising prices on account of punitive taxation, there is no such reluctance when it becomes desirable and possible to take losses. The year 1937 will probably furnish some very interesting

data on this subject. Those who had taken profits in the early part ofthe year or still had profits when the market started its decline found in this situation an opportunity to escape the tax. I have no doubt that much of the selling which took place toward the end of the year was induced by the opportunity thus presented. This selling, of course, accelerated and intensified the decline.

Any taxation which is so undependable as a source of revenue is manifestly unsound. Its instability as a revenue producer seriously affects the orderly administration of governmental affairs and creates a situation that should be avoided at all costs.

In the Revenue Act of 1932, in order, as it is said, to protect the revenue, Congress embodied provisions limiting the right of the taxpayer to equalize the burden of taxation by deducting from the tax on ordinary income a percentage of the losses sustained on the sale of capital assets. This action annoyed and embittered thousands of people who properly resented it as evidence of governmental immorality. It will not do to say that this reaction was confined to those who were unwilling to bear their just share of the tax burden. It would not be true. People naturally rebel at being made the victims of a game at which both ends are played to the middle. They do not readily reconcile themselves to the situation which arises when, having sold securities at a profit, paid the tax and reinvested the proceeds in other securities, they are denied the right to take losses resulting from the reinvestment.

There are other objections. This form of taxation deprives the Government of other revenue, for its effect is to greatly retard the volume of trading. The New York taxing authorities estimate that the loss resulting from the decreased volume of security trading amounts to $200,000,000 per annum.

Furthermore, the provisions of the various revenue acts dealing with capital gains and losses have been prolific sources of legal controversy. That they are complicated to the point of absurdity will be abundantly clear to anyone who attempts to wade through their mazes; that they have occasioned grievous injustices in a multitude of cases cannot be denied. Elimination of this form of taxation would bring relief not only to those who are called upon to pay, but also to those whose duty it is to assess and collect the tax. The burden that would be lifted from the Board of Tax Appeals and from the courts would be incalculable.

If, despite all this, it appears to be desirable to retain this form of taxation, I suggest that transactions involving the sale of capital assets be segregated from normal income and taxed separately at a rate low enough to encourage rather than restrain them, and that where losses exceed gains, the rate be applied to the excess and allowed as a deduction against the tax on ordinary net income. Obviously, this is entirely fair to the taxpayer and to the Government alike.

The bill now before the committee perpetuates the present system of taxing capital gains upon the basis of the length of time during which the assets in question are held by the taxpayer. This is nothing more than a compromise of principle, and the suggestion that profits earned in capital transactions during the first 13 months are speculative profits has no basis in fact. The difference between speculation and investment cannot be determined by any such standard. Every investment, in fact, every transaction entered into for profit, is more or less speculative in character. One invests in sound securities not for the purpose of holding them indefinitely and not alone for the purpose of stability of income. Inherent in the act of purchase is the hope also of enhancement.

If a substantial enhancement should take place within the year of purchase sound judgment may dictate the advisability of realizing the profit, but that profit is no more to be placed in the speculative category than if it had been taken in the second, third, or tenth year. A low, flat rate of tax applied to all capital transactions is sounder and simpler and takes away the incentive, which the bill itself recognizes, to delay the taking of gains and the stimulation to realize losses. It encourages trading and it unquestionably thereby increases revenue from that source.

I do not concur in the argument set out in the proposed bill that there is no justification for a lower tax on a speculator than on an individual receiving like income from salary or business. I think the hazard in the one case makes the distinction and justifies the lower rate. One who renders service has a reasonable certainty of compensation; one who invests capital in speculative transactions runs a serious risk not only of making no profit but of losing his investment. However, as previously pointed out, investor and speculator alike are subjected to the same high rates of taxation and, in fact, there is no real difference between them.

I understand that the chairman of the committee has asked the Treasury for estimates of the revenue to be expected from the application of a flat rate of taxation.

I cannot see how such estimates can be relied upon. As I have pointed out, large revenues result in periods of prosperity, whereas large losses must necessarily follow in periods of depression. No matter what method is adopted, the revenue to be derived will always remain uncertain. It is to be hoped that we will not again adopt the unconscionable scheme of collecting the tax on profits and limiting the deduction on losses. My reaction to the chairman's request is that the rates suggested by him are unnecessarily high and will defeat their purpose. I believe our greatest revenue was derived from a 12½-percent flat rate. In my opinion, that was also too high. If I were asked to hazard a guess, I should say that a 5-percent rate would produce greater revenue than a 10-percent rate. I see no reason why we should not try the experiment. We cannot know what revenue to expect from any rate or method. I believe the volume of profit taking would be tremendously increased by the very low rate and that the revenue from this source would be much more substantial. It has the added advantage of stimulating business.

In making the foregoing suggestions in relation to a low, flat rate of tax on all capital transactions, excluding, of coures, assets used in carrying on a trade or business (which receive separate treatment in the proposed bill), I do not wish to be understood as favoring the capital-gains tax in any form. I believe experience justifies its elimination and the seeking of other methods of raising revenue that would be more economic and less shocking in operation.

As a matter of fact, the strongest support to my argument in opposition to both the undistributed-surplus tax and the capital-gains tax is to be found in the official report of the Ways and Means Committee. One cannot read it without a feeling of resentment. The attempt to retain the principle of the undistributed-surplus tax and the present system of taxing capital gains and the necessity for tying them in with the various other provisions of the act has resulted in making the tax bill so complicated as to be almost incomprehensible. The proposed bill continues the policy of patching and makes the crazy quilt which existed before a bit crazier than it was.

A tax bill which, to be understood at all, requires intensive study of trained minds and which is almost beyond the ken of the average citizen is an abomination, and the American people should not be called upon to measure their most serious obligations by putting together the pieces of a jigsaw puzzle. The greatest step toward simplification, which is a consummation devoutly to be wished, would be the elimination of the capital-gains tax in its entirety. It would at least be helpful to return to the flat-rate system.

The House has made up part of the revenue lost by its amendments to the bill by additional taxes on commodities. The loss of revenue which would result from the elimination of the capital-gains tax could be made up, as has been suggested, by the reduction of personal exemptions, thus broadening the base of ordinary income taxation and increasing the rates both on personal and corporate incomes. I do not favor exemption from taxation. I believe it to be utterly unsound in principle. Every person enjoying the benefit and protection of his Government should contribute to the expense of its maintenance. The contribution of each individual might be small but the aggregate would be substantial.

As a practical matter, it may well be that the taxation of incomes below a certain minimum is uneconomical. I think that figure could be safely placed well below the present exemption of $1,000 for single persons and $2,500 for married persons, and I think the difficulty of collection has been over-emphasized. Our people are not evaders. They will ordinarily discharge the obligations which the Government imposes upon them, and considerable assurance of collection would follow from the broadening of the provision requiring withholding at the source.

I am not so much concerned with substitute methods of raising revenue, which can be dealt with appropriately in a general revision of the revenue act. I am more concerned with the fact that every day's delay in the adoption of the proposals for repeal of the undistributed profits and capital gains taxes brings us nearer to disaster. The immediate introduction of bills for the repeal of the undistributed profits tax and either the repeal or drastic modification of the capital gains tax would revive the drooping spirits of an harassed people who are utterly discouraged by the failure of their representatives to take prompt and efficient action to relieve a very distressing situation.

While on this subject, I desire to call attention to some of those so-called loophole-closing provisions affecting capital gains.

WASH SALES

The Income Tax Act now in force, as well as others that preceded it, provide for the exclusion of losses on the sale of securities in all cases where, within a period of 30 days before or after the sale or disposition of such securities, the taxpayer has acquired, or has entered into a contract to acquire, substantially identical stock or securities. I earnestly recommend elimination of this provision. I can find neither excuse or justification for it. A loss must be definite and certain in order to be availed of for income-tax purposes. Where one owns securities in a going concern which are worth less than the basis for determining gain or loss, one has sustained a loss in theory but this is not a deductible loss until it has been realized by the sale of the securities.

Before the adoption of this provision, one wishing to establish that loss without sacrificing his position in the particular security could do so by a simultaneous repurchase. This was called a "wash" sale.

I am at a loss to understand why one should not be permitted to take the ordinary means available and, indeed, required, for the establishment of loss, nor why, in order to establish it, he must of necessity give up his position in a security in the future value of which he has confidence. Repurchasing it himself merely places him in a position where, upon a future disposition of the security, he uses the lower basis, that is, the repurchase price, as the basis for determining gain or loss. By this operation, the Government is not actually injured. On the other hand, the provision is utterly futile as a means to the end apparently desired for a taxpayer may accomplish the same result by a simultaneous purchase of other securities. Thus, all that the Government accomplishes is to drive him out of his position in the security which he preferred. What possible advantage this is to the Government is quite beyond my perception.

PERSONAL HOLDING COMPANIES

The present revenue act contains a provision which, in effect, permits the dissolution of foreign holding companies and the transfer of the assets to domestic holding companies without the incidence of a tax. The object of this was, of course, to bring the assets of foreign personal holding companies into the United States. It was a very sensible move on the part of Congress. Strangely enough, however, although domestic personal holding corporations appear to be anathema to the Government, no provision was made for their dissolution and the distribution of their assets to the stockholders without the incidence of tax. I respectfully urge the adoption of legislation to that end. The punitive character of the taxes imposed upon them indicates that their continued existence is not considered desirable by the Government. It is clearly unconscionable, therefore, under such circumstances, not to make their dissolution possible. I have no sympathy whatever for punitive taxation in any form. When it is indulged in, the whole purpose of taxation is distorted.

The House bill, recognizing the seriousness of the capital-gains tax that would be imposed upon the stockholders in case of dissolution, proposes that such stockholders be permitted, with the consent of the Commissioner of Internal Revenue, to pay the resultant tax over a period of 5 years. This does not reach the root of the evil. It is the magnitude of the tax imposed upon the retaking of assets theretofore transferred by the stockholders to the corporation which imposes the barrier against liquidation. If the Government desires the dissolution of personal holding companies, it should make the way easy. If, on the other hand, it has no such desire, it should cease treating them as if they were outlaws.

Although I hope that the committee will adopt my suggestion to postpone further action pending a complete study for the purpose of revamping our whole system of taxation, I nevertheless take the liberty of making certain observations and suggestions which I hope will receive consideration if the committee determines that the House bill should be taken up as a whole at this time.

ESTATE AND GIFT TAXES

The Congress can contribute materially to the economic improvement by a very drastic reduction of both estate and gift taxes. The magnitude of the impost on the estates of deceased persons takes it out of the character of taxation and puts it in the category of confiscation. The effect of this sort of thing upon the economic system is too apparent to require any extended discussion. Potentiality of death duties as a means of increasing revenue is a constant source of temptation to Government. Large sums are easily realized and the dead are incapable of voicing their protests. The subject has been so fully discussed that I shall not

dilate upon it any further than to say that the more money the Government takes out of the pockets of its citizens the less there is left for promotion of public welfare. Just as no nation can spend itself into prosperity, neither can it tax its citizens into prosperity.

Passing from the general to the specific, I wish to direct attention to the fact that in 1932 the Congress passed the gift-tax act in which the rates were, roughly three-quarters of the rates imposed upon decedents' estates. This was done for the purpose, so it was said, of encouraging the making of gifts. The preaching and practice are at variance. It is almost impossible to incur gift tax liability except by an outright transfer and delivery of property to the donee. I make the statement in this form for the purpose of emphasis.

The imposing provisions of title III of the act of 1932 are as follows:

"(a) For the calendar year 1932 and each calendar year thereafter, a tax * * * shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift.

"(b) The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible * * *.

"(c) The tax shall not apply to a transfer of property in trust where the power to revest in the donor title to such property is vested in the donor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such property or income therefrom * * *."

Under section 302 of the estate-tax law, there must be included in the gross estate of every decedent:

"(c) Any interest of which the decedent has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death, or for any period which does not in fact end before his death, (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

"(d) Any interest of which the decedent has at any time made a transfer, in trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke or terminate, or where any such power is relinquished in contemplation of decedent's death."

These provisions of the Gift Tax Act and the Estate Tax Act show clearly the inconsistency between the avowed purpose of encouraging the making of gifts and the consequent enhancement of current revenues and the evident purpose of subjecting almost every gift that one can make to estate taxation.

This inconsistency is emphasized by the provision authorizing a credit for a portion of the gift taxes paid if it should happen that the Commissioner of Internal Revenue subsequently decides that the money which he took for gift taxes was erroneously collected. It is idle to pretend that this credit was for the benefit of the taxpayer. Its purpose was to relieve the Commissioner from the responsibility of determining whether the transfer came under the gift tax provisions or estate tax provisions of the act, notwithstanding the statement of the Supreme Court in *Burnet* v. *Guggenheimer* that a choice must be made as to whether the gift shall be taxed at the time of the creation of the trust or at the death of the settlor.

I respectfully suggest that in the present need for revenue real encouragement be given to the transfer of property inter vivos; that every transfer in trust or otherwise be subjected to the gift tax; that where the property included in the trust finds its way back to the donor or to the settlor and is in his hands at the time of death, it should be subjected to the estate taxes and a credit given for the amount of gift taxes paid.

The provisions of the Estate Tax Act quoted above were important perhaps while there was no Gift Tax Act in effect. The two were intended to be complementary and they should be made so.

DISCHARGE OF TAX LIABILITY IN BANKRUPTCY

My next suggestion is that liability for taxes be made dischargeable in bankruptcy. The Bankruptcy Act is designed for the rehabilitation of debtors. Freedom from debt is accorded in consideration of the surrender by the bankrupt of his property for distribution to his creditors. The United States is entitled to

preference above all others in such distributions. Nevertheless, although he has delivered up all his possessions, he cannot free himself from the claim of the sovereign which is beneficent so far as other people's money is concerned but niggardly where its own is involved. The very purpose of the Bankruptcy Act is thwarted by the failure of Congress to subject liability for taxes to discharge in the same manner as all other debts, for discharge in bankruptcy is of no avail to a debtor if he must remain subject to the most onerous debt of all. The right to preference on distribution is all that the United States should demand. Exception, of course, should be made in cases of failure to file returns and in cases of false and fraudulent returns.

CHARITABLE CONTRIBUTIONS BY CORPORATIONS

The House bill proposes that contributions shall not be allowed as deductions in exces sof 5 percent of net income, even though such contributions constitute business expenses. In support of this proposal, the Committee says that because the limitation is imposed upon the deduction of charitable contributions by corporations, there is no reason why a larger deduction should be allowed merely because it comes under the head of business expenses.

I see much reason for the distinction. In the past, charitable contributions were not deductible by corporations. This restriction was unfair in cases where corporations felt obliged to make such contributions and where they had a direct relation to the operation of the business. Too, the restriction was not conducive to the support of deserving benevolent, charitable and eudcational institutions. In some cases, the deduction of contributions was sustained as a business expense. If they were entitled to be classed as a business expense, they were entitled to be deducted without limitation. Merely because it is now proposed to give to all corporations the right to deduct contributions up to 5 percent of net income affords no justification for applying that limitation in cases where contributions truly constitute a business expense.

RULINGS BY THE COMMISSIONER

Revision of our tax laws should include authority to the Commissioner, upon the request of a taxpayer, to make rulings as to tax liability in connection with proposed transactions which will be binding upon the Government. This authority should be limited and restricted in any manner deemed advisable for the protection of the Government. Such authority, vested in the Commissioner, would make it possible to consumate business transactions which are either abandoned because of uncertainty on the subject or suspended until such time as the question is judicially determined.

While on this subject, I think it not amiss to call attention to the further complications which arise from the proposal to change the method of taxing corporate income. Our present method of computation seems to be reasonably satisfactory. If there is any advantage in the proposal, that advantage is more than offset by the debit against simplicity. We have reached the point where apparently we can no longer think in simple terms. We have adopted tax idioms, explanatory definitions, and arithmetical and other formulas. It would be ludicrous if it was not so serious.

Time does not permit specific recommendations on this and many other subjects which ought to be considered at a more opportune time.

Respectfully submitted.

ARTHUR B. HYMAN,
2 Rector Street, New York, N. Y.

MEMORANDUM SUBMITTED BY THE NATIONAL ASSOCIATION OF REAL ESTATE BOARDS WITH REFERENCE TO CERTAIN PROVISIONS OF THE 1937 REVENUE ACT, APPROVED AUGUST 26, 1937, AND CERTAIN PARTS OF SECTION 351 OF THE REVENUE ACT OF 1936

(Submitted by the Operative Builders Association of the District of Columbia)

The National Association of Real Estate Boards is composed of approximately 500 member boards located in all parts of the United States. It is vitally concerned in promoting and securing such legislation as will enable home building, land development and other building construction to be resumed on a scale to meet the Nation-wide demand for new and better homes and buildings, as well as to aid in national recovery.

We stand ready to pay our just share of taxes. We are sure, however, certain provisions of the 1937 act here discussed were prepared by the framers of the act without their fully realizing the paralyzing effect on the building industry in general and the home-building companies in particular. This memorandum is submitted in pursuance of a resolution adopted at the annual convention of the National Association of Real Estate Boards at Pittsburgh, Pa., on October 18 to October 22, 1937.

SECTION I

Subject.—Exemption of active bona fide operating companies regularly engaged in the building, creating, developing, and marketing of their products and properties reasonably necessary to the conduct of their business in the manner in which such business is customarily and usually conducted by others.

Quotation from 1937 act.—Subsection (*b*), section 352: "EXCEPTIONS.—The term 'personal holding company' does not include a corporation exempt from taxation under section 101, a bank as defined in section 104, a life-insurance company, a surety company, or, except with respect to a taxable year ending on or before the date of the enactment of the Revenue Act of 1937, a foreign personal holding company as defined in section 331."

Recommendation.—We recommend that after the words, "a surety company," above, the following be added:

"An active bona fide operating company, regularly engaged in the building, creating, developing, and marketing of its products and properties reasonably necessary to the conduct of its business in the manner in which such business is customarily and usually conducted by others."

ALTERNATIVE PROPOSALS

(Relating to section I only and to be considered only in case above exemption be not granted)

(a)

Subject.—Exclusion of interest from personal holding company income

Quotation from 1937 act.—Section 353. Personal holding company income: "For the purposes of this title the term 'personal holding company income' means the portion of the gross income which consists of: (*a*) Dividends, interest, royalties (other than mineral, oil, or gas royalties), annuities."

Recommendation.—We submit that interest received on mortgage notes or contracts obtained in the ordinary operations of an active bona fide operating real-estate company should not for the purpose of classification as a personal holding company be used as a part of the 80-percent requirement in the 1937 act with reference to the type of income. We do not contend that interest received on outside investments purchased by the corporation with its undistributed cash earnings should be so exempted.

(b)

Subject.—Change of minimum percentage of rents to gross income from 50 percent to 25 percent in definition of personal holding company income.

Quotation from 1937 act.—Subsection (*g*), section 353. Revenue Act of 1937: "*Rents.*—Rents, unless constituting 50 per centum or more of the gross income. For the purposes of this subsection the term 'rents' means compensation, however designated for the use of or right to use property; but does not include amounts constituting personal holding company income under subsection (*f*)."

Recommendation.—We recommend that the term "25 per centum" to be substituted for the term "50 per centum" in the above subsection (*g*).

For detailed discussion of section I, see pages 5 to 8, inclusive.

SECTION II

Subject.—Permitting corporations to pay debts from earnings without such earnings being subjected to either corporate surtax or personal holding tax when the debts so paid were contracted in good faith in the usual and ordinary way and in connection with the company's regular and usual business.

Quotation from 1936 act.—Paragraph B, subsection (*b*) (2), section 351: "Amounts used or set aside to retire indebtedness incurred prior to January 1,

1934, if such amounts are reasonable with reference to the size and terms of such indebtedness."

(NOTE.—The above applies to personal holding companies only. No such provision or similar provision appears in either the 1936 or 1937 act with reference to corporations generally.)

Recommendation.—We submit that earnings of an active bona fide operating real estate corporation, after paying the normal income tax, should be available for the payment of debts contracted in the purchase of the land and subsequent development, such as the installation of street improvements and utilities to serve such land, the erection of homes thereon and the erection of neighborhood shops to serve such community. When used for the payment of such debts, such earnings should be wholly exempt from both the corporate surtax and the personal holding company tax.

For detailed discussion of section II, see pages 8 to 11 inclusive.

DETAILED DISCUSSION OF SECTION I

1. We find no valid reason why an active bona fide operating real estate company engaged in the business of platting, development and sale of subdivision property; engaged in the erection and sale of homes; the erection, leasing, and selling of neighborhood shops or other types of business buildings; and engaged in the operation of an ordinary real-estate business in usual form and manner, should under such circumstances be defined as a personal holding corporation, regardless of the percentage in value of the stock of such corporations hold by five individuals or less and regardless of the type of its income when derived from such sources.

2. We assume that the corporate set-up is in the usual form in the State where the company operates and is not designed to avoid taxes.

3. We find quite generally throughout the United States that the primary purpose for incorporating companies operating a real-estate business is to avoid land title complications in case of the death of one of the owners.

4. A vast majority of the building operations of the Nation are carried on by companies in this business. They are large employers of labor. They consume a vast amount of durable goods. They have need for extensive lines of credit. Their ability to carry this business on successfully will be seriously and adversely affected with the continuous threat and probability of being classified as a personal holding company.

DETAILED DISCUSSION OF ALTERNATIVE PROPOSALS A AND B OF SECTION I

(a)

1. To help finance their operations, home builders generally obtain or require their purchasers to obtain as large a first mortgage loan as it is possible to get at a reasonable rate of interest.

2. A typical example of terms on a $10,000 home purchase would be for the purchaser to borrow $6,500 secured by a first mortgage on the property, amortized over a period of 20 years; pay $1,000 cash of his own (10 percent down payment being customary in many sections) and give the builder a second mortgage of $2,500 amortized over a period of from 5 to 10 years.

3. In any given volume of sales today, the cumulative volume of second mortgages held by the builder under the long-time payments now in effect is substantially greater than would have been the case a few years ago when shorter terms of payment were customary. This increases the relative amount of interest income over what it was a few years ago and it all comes as a result of the ordinary normal operations of the land developer and home builder from the sale of lots on which the purchaser builds and the sale of the home erected by the builder. This increases substantially the probability of classification as a personal holding corporation, not contemplated by the act of 1937.

4. During periods of active sales, the volume of interest-bearing paper mounts rapidly. The percentage of principal reductions per year has decreased with the longer time payments which all agree offers a much sounder basis for home ownership than short-time mortgages.

5. During periods of depression, when the volume of sales is small, or when the margin of profit on sales is small or entirely wiped out, then the interest income added to the rental income, if any, would in many cases be the sole factor in making that company a personal holding company and taxable as such. Frequently, when the developer has completed the sale of one tract and is preparing and developing another tract in preparation for sale, there is in that case a period when no sales are made, even though there be an active market. Here, too, interest

alone from sales in prior years might again put the company into a personal holding classification.

6. During the depression the great majority of our home builders carried many of their customers over long periods of time with no payments other than interest. To have done otherwise would have deprived many deserving families of their homes.

(b)

1. Many developers and home builders throughout the United States recognize the need of building such necessary neighborhood shops as will serve the ordinary needs of their community. They believe it is better to have them well located, well designed in keeping with the neighborhood restrictions, and carefully operated than to permit their being built along the borders of the surrounding land with no tie-up to the community as to location, design and operation. Under such conditions they might be more injurious than beneficial to the neighborhood as a whole. These shops the developer usually rents, at least during the years required to complete the residential development.

2. Many home builders have been obliged to repossess houses and to take houses in trade which they rent temporarily pending the opportunity to sell them. In other cases they have rented new houses temporarily when unable to sell them. Others have rented land temporarily, awaiting the time when it may be developed and sold.

3. This type of rent from neighborhood shops, from homes, new and old ones, temporarily rented, from land temporarily rented together with its interest income would in many cases put an active bona fide operating real estate company into a personal holding classification not contemplated by the 1937 act.

(c)

Subject.—Schedule of taxes and rates on certain amounts of income.

In case of an active bona fide real estate company and which from its stock ownership and type of income, such as interest, rents, and dividends, would be classified as a personal holding company, it would with the taxable earnings shown below be taxed to extent shown in such schedule.

It is assumed that its earnings were represented by second mortgages, unsold homes, improved lots, or other types of its usual stock in trade or inventory and the earnings not being in cash, no dividends could be paid.

The schedule is as follows:

Not wholly taxable income of—	Combined Amount of normal surtax and personal holding company tax	Minimum rate of tax on portion of income	Maximum rate of tax on portion of income	Average rate of tax on whole income
		Percent	*Percent*	*Percent*
$10,000	7,820.50	8	108	78.20
$15,000	11,952.00	8	113	79.68
$20,000	16,108.50	8	115	80.54
$25,000	20,266.18	8	115	81.06
$30,000	24,423.38	8	115	81.41
$40,000	32,737.75	8	115	81.84
$50,000	41,090.87	8	117	82.18
$100,000	82,675.70	8	117	82.67

The above schedule of taxes is shown merely as a matter of information and for guidance in considering the matters herein discussed. Detailed computation shown on pages 11 to 22, inclusive.

DETAILED DISCUSSION OF SECTION II

1. Real estate subdivision and home building developments are generally long-time projects with very slow turnover.

2. It is an ordinary and usual custom for the developer to purchase the land for development purposes with deferred payments extending over a term of from 10 to 15 years with required principal reductions annually.

3. It is also customary for the developer to borrow a part or all of the money to grade the land and install the street improvements and utilities to serve such land.

4. In the case of sales with typical terms, as outlined in paragraph 2, page 6, the builder, after paying the sales expense, has a part of his borrowed capital and all of his profit, if any, tied up in his second-mortgage paper inasmuch as the 75 percent cash received on such a sale is insufficient to pay for the cost of the house, the lot, the cost of the street improvements and utilities, and the expense of the sale.

5. Many developers and home builders today operate outside of city limits. This generally necessitates complete financing of grading, street improvements, and utilities to serve those properties. This is frequently true inside city limits as well as outside. Such street and other improvements cannot be limited only to the lot or lots sold. Frequently the whole tract must be largely improved before any lots can be sold or homes built and sold. The percentage of sales for all cash is relatively small.

6. Public authorities and private developers are in complete accord in the desirability of developing units of land of sufficient size to afford suitable protection to home buyers by use of restrictions over large areas and thereby stabilize and make permanent neighborhood values. This prolongs the period of time within which the project may be completed.

7. The sources of capital and credit for development and building of this character are extremely limited. Capital is not readily available by sale of stock on the open market. No stock of an active bona fide operating real estate company is listed on the New York Stock Exchange or any other stock exchange.

8. To convert second mortgages on houses or first mortgages on lots, representing deferred purchase money, into cash in order to pay dividends or taxes requires an even greater discount now than ever before, due to the extended term over which the payments mature.

9. Almost all other commodities have a wide market at some price. An unsold house and an unsold improved lot can be usually marketed only in the place they are located. Lack of liquidity of assets of this character makes financing by open market sales of stock a practical impossibility. Neither taxes nor dividends can be paid from earnings in the form of such assets.

10. Land-development and home-building companies, in fact all bona fide operating real-estate companies, engaged in long-range projects of this kind should be permitted to use earnings to pay debts. These debts are frequently contracted for land purchases several years in advance of the sale of the lot or the house or business structure from which the earning is derived. Without privilege of debt payment, credit is unobtainable, and without credit few, if any, housing or general building projects could ever be carried on successfully.

11. The depression demonstrated the extreme difficulty to sell real estate of all kinds; it also demonstrated the inability to obtain outside financing under those conditions, particularly in cases of nonproductive home and home-site development projects; and as a result, many home builders and land developers became bankrupt as land-purchase payments, taxes, and interest became due and they were unable to meet them.

12. Operating real estate companies do not object to any reasonable requirement to distribute earnings over and above debt requirements when those earnings can be converted into cash and thereby be available for distribution.

13. Our problems present difficulties peculiar to our type of business alone. The Federal Government is desirous of encouraging the durable goods industry to further hasten business recovery. We are seeking the means of doing our part in providing the several million new and better homes necessary throughout the United States to bring the Nation's housing requirements to the desired level.

14. To retain the provisions of the 1937 act and of the 1936 act as herein set forth, insofar as all bona fide operating real estate companies are concerned, and to exact surtaxes and personal holding company taxes on earnings required for debt retirement and on earnings not available in cash for distribution to stockholders will seriously retard all building operations. Cessation of building in turn retards consumption of durable goods and the employment of labor in such building operations and in land development, as well as in the production of the materials used therein. The problem of employment and consumption of durable goods in this respect and the effect thereof is Nation-wide.

Detailed computation of taxes on a wholly taxable net income of $10,000 in the hands of a personal holding corporation and with no dividends paid

Normal tax computation:	
$2,000 at 8 percent	$160.00
$8,000 at 11 percent	880.00
Total normal tax	1,040.00
Surtax computation:	
$10,000 minus $1,040 (being adjusted net income before application of specific credit)	8,960.00
5,000 minus $896 (amount of specific credit)	4,104.00
8,960 minus $4,104 (amount subject to surtax)	4,856.00
4,856	
896 at 7 percent	62.72
3,960	
896 at 12 percent	107.52
3,064	
1,792 at 17 percent	304.64
1,272 at 22 percent	279.84
4,104 at 7 percent (specific credit)	287.28
Total surtax	1,042.00
Total normal tax	1,040.00
Total surtax	1,042.00
Sum total of both normal and surtax	2,082.00
Personal holding tax computation:	
$10,000 minus $2,082 (amount subject to personal holding tax)	7,918.00
7,918	
2,000, at 65 percent	1,300.00
5,918, at 75 percent	4,438.50
Total personal holding company tax	5,738.50
Summary:	
Normal tax	1,040.00
Surtax	1,042.00
Personal holding company tax	5,738.50
Total tax on $10,000 income	7,820.50
Average rate ... percent	78.20

c-2

Computation on same type of income of $15,000 is as follows

Normal-tax computation:	
$2,000 at 8 percent	$160.00
$13,000 at 11 percent	1,430.00
Total, normal tax	1,590.00

Computation on same type of income of $15,000 is as follows—Continued

Surtax computation:	
$15, 000 minus $1,590 (adjusted net income before application of specific credit)	$13, 410. 00
5, 000 minus $1,341 (amount of specific credit)	3, 659. 00
13, 410 minus $3,659 (amount subject to surtax)	9, 751. 00
9, 751	
1, 341 at 7 percent	93. 87
8, 410	
1, 341 at 12 percent	160. 92
7, 069	
2, 682 at 17 percent	455. 94
4, 387	
2, 682 at 22 percent	590. 04
1, 705 at 27 percent	460. 35
3, 659 (specific credit) at 7 percent	256. 13
Total, surtax	2, 017. 25
Total, normal tax	1, 590. 00
Total, normal and surtax	3, 607. 25
Personal holding company tax computation:	
$15, 000. 00 minus 3,607.25 (subject to personal holding tax)	11, 392. 75
11, 392. 75	
2, 000. 00 at 65 percent	1, 300. 00
9, 392. 85 at 75 percent	7, 044. 75
Total personal holding company tax	8, 344. 75
Total, normal and surtax	3, 607. 25
Total tax on $15,000 income	11, 952. 00
Average rate percent	79. 68

c-3

Computation on same type of income of $20,000 is as follows

Normal tax computation:	
$2, 000 at 8 percent	$160. 00
13, 000 at 11 percent	1, 430. 00
5, 000 at 13 percent	650. 00
Total normal tax	2, 240. 00
Surtax computation:	
$20, 000 minus $2,240 (adjusted net income before application of specific credit)	17, 760. 00
5, 000 minus $1,776 (specific credit)	3, 224. 00
17, 760 minus $3,224 (subject to surtax)	14, 536. 00
14, 536	
1, 776 at 7 percent	122. 32
12, 760	
1, 776 at 12 percent	213. 12
10, 984	

Computation on same type of income of $20,000 is as follows—Continued

Surtax computation—Continued.	
3, 552 at 17 percent	$603. 84
7, 432	
3, 552 at 22 percent	781. 44
3, 880 at 27 percent	1, 047. 60
3, 224 (specific credit) at 7 percent	225. 68
Total surtax	2, 994. 00
Total normal tax	2, 240. 00
Total, normal and surtax	5, 234. 00
Personal holding company tax computation:	
$20, 000 minus $5,234	14, 766. 00
14, 766	
2, 000 at 65 percent	1, 300. 00
12, 766 at 75 percent	9, 574. 50
Total personal holding company tax	10, 874. 50
Normal tax	2, 240. 00
Surtax	2, 994. 00
Personal holding company tax	10, 874. 50
Total tax	16, 108. 50
Average rate percent	80. 54

c–4

Computation on same type of income of $25,000 is as follows

Normal tax computation:	
$2,000 at 8 percent	$160. 00
13, 000 at 11 percent	1, 430. 00
10, 000 at 13 percent	1, 300. 00
Total normal tax	2, 890. 00
Surtax computation:	
$25, 000 minus $2,890 (adjusted net income before application of specific credit)	22, 110. 00
5, 000 minus $2,211 (amount of specific credit)	2, 789. 00
22, 110 minus $2,789 (subject to surtax)	19, 321. 00
19, 321	
2, 211, at 7 percent	154. 77
17, 110	
2, 211, at 12 percent	265. 32
14, 899	
4, 422, at 17 percent	751. 74
10, 477	
4, 422, at 22 percent	972. 84
6, 055, at 27 percent	1, 634. 85
2, 789 (specific credit), at 7 percent	195. 23
Total surtax	3, 974. 75
Total normal tax	2, 890. 00
Total, normal and surtax	6, 864. 75

Computation on same type of income of $25,000 is as follows—Continued

Personal holding company tax computation:	
$25,000.00 minus $6,864.75 (subject to personal holding company tax)	$18,135.25
18,135.25	
2,000.00, at 65 percent	1,300.00
16,135.25, at 75 percent	12,101.43
Total personal holding company tax	13,401.43
Summary:	
Normal tax	2,890.00
Surtax	3,974.75
Personal-holding tax	13,401.43
Total tax	20,266.18
Average rate percent	81.06

Computation on same type of income of $30,000 is as follows

Normal-tax computation:	
$2,000 at 8 percent	$160.00
$13,000 at 11 percent	1,430.00
$15,000 at 13 percent	1,950.00
Total normal tax	3,540.00
Surtax computation:	
$30,000 minus $3,540 (adjusted net income before deduction of specific credit)	26,460.00
$5,000 minus $2,646 (amount of specific credit)	2,354.00
$26,460 minus $2,354 (amount subject to surtax)	24,106.00
$24,106	
2,646 at 7 percent	185.22
21,460	
2,646 at 12 percent	317.52
18,814	
5,292 at 17 percent	899.64
13,522	
5,292 at 22 percent	1,164.24
8,230 at 27 percent	2,222.10
2,354 at 7 percent (specific credit)	164.78
Total surtax	4,953.50
Total normal tax	3,540.00
Total normal and surtax	8,493.50
Personal holding company tax computation:	
$30,000.00 minus $8,493.50 (subject to personal holding company tax)	21,506.50
21,506.50	
2,000.00 at 65 percent	1,300.00
19,506.50 at 75 percent	14,629.88
Total personal holding company tax	15,929.88

Computation on same type of income of $30,000 is as follows—Continued

Summary:	
Normal tax	$3,540.00
Surtax	4,953.50
Personal holding company tax	15,929.88
Total tax	24,423.38
Average rate percent	81.41

c–6

Computation on same type of income of $40,000 is as follows

Normal tax computation:	
$2,000 at 8 percent	$160.00
13,000 at 11 percent	1,430.00
25,000 at 13 percent	3,250.00
Total normal tax	4,840.00
Surtax computation:	
$40,000 minus $4,840 (adjusted net income before deducting specific credit)	35,160.00
5,000 minus $3,516 (specific credit)	1,484.00
35,160 minus $1,484 (subject to surtax)	33,676.00
33,676	
3,516 at 7 percent	246.12
30,610	
3,516 at 12 percent	421.92
26,644	
7,032 at 17 percent	1,195.44
19,612	
7,032 at 22 percent	1,547.04
12,580 at 27 percent	3,396.60
Specific credit 1,484 at 7 percent	103.88
Total surtax	6,911.00
Total normal tax	4,840.00
Total normal and surtax	11,750.00
Personal holding company tax computation:	
$40,000 minus $11,751 (subject to personal holding company tax)	28,249.00
$28,249	
$2,000 at 65 percent	1,300.00
$26,249 at 75 percent	19,686.75
Total personal holding company tax	20,986.75
Summary:	
Normal tax	4,840.00
Surtax	6,911.00
Personal holding company tax	20,986.75
Total tax	32,737.75
Average rate percent	81.84

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C-7

Computation on same type of income of $50,000 is as follows

Normal tax computation:		
$2,000 at 8 percent		$160.00
$13,000 at 11 percent		1,430.00
$25,000 at 13 percent		3,250.00
$10,000 at 15 percent		1,500.00
Total normal tax		6,340.00
Surtax computation:		
$50,000 minus $6,340 (adjusted net income before application of specific credit)	43,660.00	
5,000 minus $4,366 (specific credit)	634.00	
43,660 minus $634 (amount subject to tax)	43,026.00	
43,026 4,366 at 7 percent	305.62	
38,660 4,366 at 12 percent	523.92	
34,294 8,732 at 17 percent	1,484.44	
25,562 8,732 at 22 percent	1,921.04	
16,830 at 27 percent	4,544.10	
Specific credit $634 at 7 percent	44.38	
Total surtax	8,823.50	
Total normal tax	6,340.00	
Total normal and surtax	15,163.50	
Personal holding company tax computation:		
$50,000.00 minus $15,163.50 (subject to personal holding company tax)	34,836.50	
$34,836.50 2,000.00 at 65 percent	1,300.00	
32,836.50 at 75 percent	24,627.37	
Total personal holding company tax	25,927.37	
Summary:		
Normal tax	6,340.00	
Surtax	8,823.50	
Personal holding company tax	25,927.37	
Total tax	41,090.87	
Average percent	82.18	

C-8

Computation on same type of income of $100,000 is as follows

Normal tax computation:	
$2,000 at 8 percent	$160.00
$13,000 at 11 percent	1,430.00
$25,000 at 13 percent	3,250.00
$60,000 at 15 percent	9,000.00
Total normal tax	13,840.00

Computation on same type of income of $100,000 is as follows—Continued

Surtax computation:	
$100, 000 minus $13,840 (subject to surtax)	$86, 160. 00
8, 616 at 7 percent	603. 12
77, 544	
8, 616 at 12 percent	1, 033. 92
68, 928	
17, 232 at 17 percent	2, 929. 44
51, 696	
17, 232 at 22 percent	3, 791. 04
34, 464 at 27 percent	9, 305. 28
Total surtax	17, 662. 80
Total normal tax	13, 840. 00
Total surtax and normal tax	31, 502. 80
Personal holding company tax computation:	
$100, 000 minus $31,502.80 (subject to personal holding company tax)	68, 497. 20
$68, 497. 20	
2, 000. 00 at 65 percent	1, 300. 00
66, 497. 20 at 75 percent	49, 872. 90
Personal holding company tax	51, 172. 90
Summary:	
Personal holding company tax	51, 172. 90
Normal tax	13, 840. 00
Surtax	17, 662. 80
Total tax	82, 675. 70
Average percent	82. 67

Respectfully submitted.

NATHAN WILLIAM MACCHESNEY,
General Counsel, National Association of Real Estate Boards.

Approved and authorized by National Association of Real Estate Boards:

By PAUL E. STARK,
President.
By HERBERT U. NELSON,
Executive Vice President.
By J. C. NICHOLS,
Vice President.

THE COMMONWEALTH OF MASSACHUSETTS,
DEPARTMENT OF CORPORATIONS AND TAXATION,
Boston, March 19, 1938.

SENATE FINANCE COMMITTEE,
Washington, D. C.

GENTLEMEN: The proposed 1938 revenue act has the appearance of a bill which will very seriously encroach upon revenue sources to which the States are entitled. If the proposal becomes law, Massachusetts will lose a very substantial amount of money, and it is my thought that being unable to appear before your committee, I can best present my point of view through Mr. Mark Graves of the State of New York who has been given the courtesy of a hearing before your committee.

It seems to me to be particularly unfortunate that the States are not given at some stage of the proceedings a definite time in which they can advance through their taxing instrumentalities their views in respect to a Federal revenue act, insofar as the act itself seizes revenue which should go to the States. The Federal Government, having the advantage of no restrictions, may in a revenue act seriously affect such States as New York and Massachusetts and that kind of a State

without perhaps intending to do it as is actually being accomplished in this Federal revenue act. It was my hope that in this act there would be an attempt to adjust its provisions in regard to the requirements of the States who after all by the very force of circumstances see their revenue sources narrowing more and more each year, as the Federal Government demanding more takes those sources which in the past have been the greenest pastures for the State revenue creatures for grazing.

If the Senate Finance Committee will accede to Mr. Graves' request, at least so far as that part of the Federal Revenue Act is concerned, Massachusetts will be protected.

Respectfully submitted.

HENRY F. LONG,
Commissioner of Corporations and Taxation.

STATEMENT BY THE CINCINNATI CHAMBER OF COMMERCE MARCH 21, 1938.—THE 1938 REVENUE BILL

For some months it has been rather generally agreed that the current low level of business volume and employment is caused, at least partly, by the taxation policies of the United States Government.

Heavy taxes on all business enterprises, plus the penalty tax on undistributed profits, plus a virtually paralyzing tax on capital gains, have had the combined effect of stripping businesses of needed working capital, discouraging overdue expansion and improvement of plants and equipment, and making both present and prospective enterprises unattractive from an investment standpoint.

As directors of the Cincinnati Chamber of Commerce, acquainted with the affairs of both large and small business enterprises in this vicinity, we believe the foregoing is a fair statement of the effects of existing Federal taxes upon the business life and employment of the Cincinnati area. This belief, coupled with a desire to support any constructive step looking toward early improvement of business and employment, prompts us to submit the comments which follow with respect to the 1938 revenue bill (H. R. 9682) now being considered by the Finance Committee of the United States Seante.

We are frank to say that the growing willingness of Congress to scrutinize the Federal tax structure in the light of seeing what can be done to facilitate an upturn of business is distinctly heartening. Before passing the bill, the House narrowed the scope of the undistributed profits tax and removed some of its more harmful features, even though retaining the tax in modified form. It opened the way for relaxation of the present harsh treatment of capital gains and losses, and for fairer application of the capital stock tax. Finally, it rejected the proposal for a penalty surtax on closely held corporations, a plan fraught with serious jeopardy for Cincinnati, with its large number of family businesses of moderate size.

In urging the Senate to amend important provisions of the bill, we do not wish to pass over lightly the substantial contribution made by the House to the cause of economic improvement. In several respects, the House bill is less harassing to business than the present law. Only in its increase of rate on corporations with small earnings does it heighten the hurdle which business must take in its effort to activate trade and make employment more abundant.

If the purpose were simply to extend to business a gesture of friendly solicitude for its serious tax plight, the House bill doubtless would serve well enough. But we do not understand that such is the intent of the Congress. We assume that the objective is to correct grave shortcomings in the present revenue law which must be corrected before enduring economic recovery can be more than a pious hope. If that is the case, we respectfully urge the Senate to broaden and deepen the relatively mild relief afforded by the House bill.

Within the past week the chairman of the Senate Finance Committee has aptly stated the case as we see it. Senator Harrison suggests abandonment of the undistributed profits tax. We consider that to be a first essential of restoring business confidence. Nor would that appear imprudent from the standpoint of Government revenue. Any fractional revenue loss resulting from repeal would, in our opinion, be not only offset but exceeded by the greater revenue gained from the larger volume of trade to which restored business confidence naturally would lead.

Into the same process would fit Senator Harrison's companion suggestion for placing corporation taxes once more on a flat-rate basis, as distinguished

from a series of arbitrarily graduated rates. Such action would restore powerful incentives to both large and small businesses. It would give the businessman a certain rather than a contingent or changing tax liability upon which to base his plans. It would eliminate once and for all the numerous instances of palpable unfairness arising in those cases which fall in the twilight zones between arbitrary brackets. It would remove the creeping paralysis inherent in a sharply graduated tax under which those firms able to generate the largest employment, to activate the largest volume of trade, and to produce the largest revenues for a needy Federal Treasury would be the ones most severely discouraged from undertaking the normal enterprises from which the entire Nation benefits.

If Senate action giving effect to Senator Harrison's third suggestion of treating capital gains and losses on a moderate, flat-rate basis could be added to repeal of the undistributed profits tax and reinstatement of flat-rate taxation of corporations, the country's business life would be given a further stimulus now sorely needed. We believe that such action would thaw the frozen investment market appreciably, and once more would permit the free flow of capital seeking profitable investment in commerce and industry. Capital again could move from one investment to another without risking tax confiscation in the transition, and business activity and employment would benefit proportionately.

No thoughtful citizen desirous of buttressing the solvency of the United States Treasury and of making any possible step toward the balanced Budget which ultimately must be sought can differ seriously with the suggestion made not only by Senator Harrison but also by many other public men of substance and experience, namely, that the base of the Federal income tax should be materially broadened. Wider tax consciousness is a prime essential in the development of any effective restraint upon reckless public spending. There are millions of incomes which can make their modest contribution to the expenses of government without any risk of taxation invading adequate standards of living or cutting below the subsistence level. Government financed by the many rather than the few is a first requirement of government controlled by the democratic many rather than a privileged few.

Accordingly, it is our best judgment that if the final form of the 1938 Revenue Act were to reflect such a realistic approach to the tax problems of business, and were to carry into practical effect such recommendations as those already made by the chairman of the Senate Finance Committee, it might assist materially to release a broad onrush of sound business activity and to generate widespread employment of our citizens in gainful occupations, as distinguished from idleness or made-work jobs on uneconomic pump-priming projects. This could be accomplished without loss of revenue to the Treasury, since the Government's experience repeatedly has proved that moderate tax rates applied on a fair tax base produce larger and more stable revenues than do discriminatory or unduly high rates which undermine confidence and destroy taxable profits.

Particularly would realistic tax revision have value in reviving business if it could be accompanied by a reduction of Federal expenditures. We are convinced that no revenue system not ruinous to business can be devised to sustain, year in and year out, Federal spending at current high levels.

NEW YORK, N. Y.

Hon. PAT HARRISON,
Chairman, Senate Finance Committee, Senate Office Building

Testimony A. M. Loomis on behalf Association of American Producers of Domestic Inedible Fats on March 21 before your committee in attacking American whaling companies incorrect as applied Western Operating Corporation, operators of United States ship *Ulysses* which we represent. Permission American registry *Ulysses* granted by Bureau of Navigation on basis complete disclosure of all facts appertaining to ownership of stock. Respectfully request your committee to consider testimony of Hans J. Isbrandtsen, president of Western Operating Corporation and myself before Committee Merchant Marine and Fisheries, House of Representatives on H. R. 8906 and 8595 for facts relating to disclosure and to formation of company and the testimony of John B. Gordon on those hearings for the position of whale oil in the domestic fat and oil economy in this country. I have sufficient confidence in the fairness of your committee to hope that no action will be taken to jeopardize our company in which 35 Americans have invested money on the basis of rulings of Bureau of Navigation and Treasury

Department without hearing our side of the case. Will you kindly make this telegram a part of the record of the hearings on the tax bill.

GEORGE DE FOREST LORD,
LORD, DAY, & LORD,
25 Broadway, New York, N. Y.

NEW YORK, N. Y., *March 22, 1938.*

Hon. PAT HARRISON,
Chairman, Senate Finance Committee,
Washington, D. C.:

Our attention has been brought to purposely misleading and inaccurate testimony of A. M. Loomis on behalf American producers domestic inedible fats before your committee, and attacking American whaling industry. Our company, having 80 percent American ownership, has operated since 1930 under specific rulings of Treasury and Commerce Departments and has cooperated to the fullest extent with all Government authorities concerned. Believe evidence submitted by us, together with testimony of John B. Gordon, covering the position of whale oil in the domestic market at recent hearings on H. R. 8906 and 8595 before House Committee on Merchant Marine and Fisheries very relevant in disproving statements made by Loomis, and trust in all fairness that testimony can be made available to your committee to avoid possibly hasty and unjust action by your committee due to not having available all the facts in the matter. The proposed amendment to subparagraph on page 337, suggested by Loomis, would eliminate the operation of our small factory ship under competition with Norwegian, Japanese, German, and British whaling industries, all of whom take advantage of using skilled and experienced Norwegians in the crews of the killer boats furnishing whales to their factory ships. We would gladly answer any questions your committee may require and will appreciate your including this telegram in the record of the hearings on the tax bill. This matter properly one for Treasury Department consideration.

THE AMERICAN WHALING CO., INC.

The CHAIRMAN. The committee will now adjourn and we will meet in executive session, Thursday morning, at 10 o'clock.

(Whereupon, at 12:05 p. m., the hearings were closed and the committee adjourned until Thursday, March 24, 1938, at 10 a. m.)

(Subsequently the following briefs and letter were submitted and ordered placed in the record.)

STATEMENT OF HERBERT MOORE, PRESIDENT OF TRANSRADIO PRESS SERVICE INC., NEW YORK CITY, FOR THE SENATE FINANCE COMMITTEE

The radio broadcast of daily news is everywhere regarded as the finest public service which radio can render to the public. In the brief space of 4 years the broadcast of news has increased steadily in all sections of the country despite the fact that publishing interests have done their utmost to impede it. Independent news organizations created to serve radio with fresh and honest news have had to withstand the competition of the newspaper-dominated press associations, which are seeking to preserve the newspaper monopoly of news.

Without realizing it, the Congress of the United States is hampering the development of independent newsgathering organizations which gather and distribute news primarily for radio broadcast. The Federal Government continues to enforce the tax upon teletype and telegraph facilities because the authors of the Revenue Act of 1932 did not foresee the development of news publication by means of radio broadcast. Press associations which gather and distribute news primarily for newspaper publications, are thus being indirectly favored by an oversight on the part of the lawmakers. As a result of this oversight, private interests are being served, not the public interest. The Federal Treasury by a rigid interpretation of the letter rather than the spirit of the law, enforces this discretionary tax and is unwittingly aiding the publishing interests in their fight to control the broadcasting of fresh daily news.

The injustice of this tax, as far as radio-news broadcasting is concerned, hinges upon the word "publication." The authors of the legislation itself, when the tax bill was drafted in 1932, perpetuated obsolete concepts of the daily press by defining the term "public press" to mean newspapers. No provision whatsoever was made for publication of daily news by radio or any other instrumentalities.

In those days radio stations did very little news broadcasting and only then by the sufferance of newspapers. In consequence, radio's right to equal treatment, was overlooked by the lawmakers.

Since that time, Transradio Press Service, of which I am president, has established itself in the news field. Privately-owned by American citizens, entirely independent of publisher or broadcaster control, Transradio is today serving worldwide news to approximately 275 radio stations and 40 newspapers throughout the United States and Canada. Transradio news broadcasts are heard daily by an audience of many millions in the 48 States.

Before proceeding further with the reasons why my organization is petitioning this committee to remove the discriminatory tax, I would like to read the text of the pertinent clauses and then comment briefly upon them.

The Revenue Act of 1932 in subdivision B in section 701, reads as follows:

"No tax shall be imposed under this section upon any payment received for service or facilities furnished to the United States or to any State or Territory or political subdivision thereof or the District of Columbia, nor upon any payment received from any person for services or facilities utilized in the collection of news for the public press, if the charge for such service or facilities is billed in writing to such person. The right to exemption under this subsection shall be evidenced in such manner as the Commissioner with the approval of the Secretary may by regulation prescribe."

The tax in question is at the rate of 5 percent upon teletype, telegraph, and telephone facilities. Exemption is clearly provided for the "public press."

In St. 744, Cumulative Bulletin XIII–I, it is provided that "the exemption is applicable only to payments made by newspapers or press associations for messages from one newspaper or press association to another or to or from bona fide correspondents which deal exclusively with the collection of news for the public press or the dissemination of news through the public press."

The phrase "public press" is broad enough, if liberally interpreted, to include the broadcast of news by radio. However, permanent and sure relief to independent news organizations can only be brought about and guaranteed against narrow interpretation by an amendment to the revenue bill itself or by some direct legislative act of Congress. The letter of the law itself should and must be modified to remove the penalty upon scientific progress in the dissemination of news.

It is our contention that the broadcast of news is publication, as much as is the reproduction by printed methods of news material for public consumption. In its purest meaning, the word publication means the act of making public.

In law, there is no real distinction between a radio broadcast station and a newspaper. In the few cases that have come before them, the courts have taken the position that a radio station is virtually identical with a newspaper and that the legal consequences pertaining to the one, apply equally and fully to the other.

Funk & Wagnalls' dictionary in its definition of publication further establishes the reasonableness of our claim in the following language:

"Publication: The act of publishing or offering to public notice; a making known publicly, or to certain persons regarded as constituting a public; notification to people at large orally, or by writing or print; promulgation; proclamation." * * *

The imposition of a tax upon news organization primarily engaged in gathering and distributing news for radio broadcast is an obvious discrimination. It is universally agreed that no tax statute can be applied with discrimination. This statute in question has exempted from its operative effect news-gathering organizations. Organizations responding to such classifications as the United Press, International News Service, and others, are within the exemption. Transradio Press Service, as has been indicated, is engaged in direct competition with such major press services. These press services and Transradio render the same type of service. The only difference is that Transradio serves more radio stations and fewer newspapers, whereas the other press services have more newspaper clients than radio-station clients.

This discrimination, therefore, works to the advantage of our competitors, who are able to quote lower rates to the extent that they do not have to pay the 5 percent tax on their news-gathering and the major portion of their news-distributing facilities.

The difference of 5 percent in delivery costs is a very serious matter where price is the determining factor. The cost of private teletype and telegraph facilities is approximately 75 percent of the gross revenue received from the sale of such news

service to radio stations. Thus, the 5 percent tax when applied against the amount received above actual delivery costs, becomes a 20 percent factor in rate making and creates a damaging differential favorable to our competitors. Their favorable differential is further increased by reasons of our competitors being tax exempt on the telegraph and teletype facilities which they use in gathering their news.

The revision of the discriminatory section of the Revenue Act of 1932 would hurt no one. The direct loss to the Treasury of the United States would be nominal and it is reasonable to believe that it would be more than compensated for by increased revenue which might flow into the Treasury from an enlargement of the taxable business of the independent news organizations. At the present time, we estimate that this discriminatory tax, so far as our organization is concerned, amounts to approximately $750 a month. The release of those funds would enable Transradio to expand and improve its news-gathering facilities to that extent and thereby render a still greater service to the public.

Radio stations are entitled to the same equality and privileges as are newspapers. The President of the United States on numerous occasions has declared that radio shall enjoy the same freedom and opportunity as the daily press enjoys. To bring about this equality, the Revenue Act of 1932, as it applies to public press exemption, must be amended to include phraseology broad enough to embrace radio broadcast of news to the public.

The elimination of this tax assessment will do more than end the discrimination against independent news-gathering organizations. It will assure the freedom of the press of the air and safeguard the right of the American people to receive accurate and fresh information in oral radio broadcast form, as well as in printed form.

Brief Submitted by M. Lee Marshall, New York City

My name is M. Lee Marshall. I am chairman of the board and president of Continental Baking Co. I live in New York City. Our company has manufacturing plants baking bread and cake in 68 cities, small, medium and large, in 28 States, widely scattered over the United States from coast to coast. The nature of our business is such as to quickly apprize us of economic changes in each community and surrounding territory where we have bakeries. In other words, we consider our business a particularly good daily barometer of industrial conditions.

I am firmly convinced that the tax on undistributed corporate income imposed in the Revenue Act of 1936 should be repealed and I respectfully submit my thoughts and reasons supporting this conviction.

Probably one of the outstanding characteristics of the American people is their willingness to try almost anything once, and this characteristic often finds expression in its governmental actions. The tax in question was proposed to the Congress in 1936 and the Congress decided to try it out, although there were many apparently in Congress at the time who had serious misgivings as to how it would work out.

It has been tried now for a period of 2 years and everybody who has taken the trouble to follow it at all has seen how it works particularly businessmen who have had to operate under it and make vital business decisions under its constant pressure. Its record in those 2 years is a dismal one and, in my opinion, it has been a complete failure. It apparently has not produced the revenue expected, but even if it had it would still be a bad tax measure, because of the effects it has had on business, and particularly on employment. Many in and out of Congress at the time the experiment was tried were fearful of just this result; and it has now occurred. Conditions have now reached an alarming point and each day that is wasted will make it more difficult to halt the recession. Every week shows higher figures of unemployment and resultant lowering of business which is spreading all over the country. I believe relief should be given fully, freely, and ungrudgingly and at the earliest possible moment. Only a few months ago, in November of last year, I favored merely modification of the tax because I thought we could as a country still stand the experiment in a modified form, but underlying business conditions have become so much worse since that time, and in such a short time, that I now believe there should be no hesitancy about completely repealing this tax and doing it quickly. Even if it is only a possibility and not a probability that this tax is a very serious threat to business and one of the chief causes of the present business slump, it should be repealed on the chance that repeal will assist in bringing an upturn; and there seems to be a great body of respectable opinion in the country at this time that this is more than a possibility.

Therefore, why not apply now another one of the outsanding characteristics of the American people, namely, its shrewd native common sense by giving up this experiment at once and completely? In business, if we have an interesting experiment proposed to us and we try it for a couple of years and find that it just does not work, we do not continue trying it but we abandon it. What values are to be preserved in maintaining the "principle of this tax," particularly in a time of economic crisis? I have read in the last few weeks a great deal of literature about the tax, including the summary of the majority report of the House Ways and Means Committee published this morning in the New York Times, and in many places I see expressions somewhat to this effect: "If the principle of the bill is to be retained, substantial modifications must be made," etc., and in the summary of the majority committee's report, they state that they are in favor of "retaining the undistributed-profits tax principle for all corporations earning more than $25,000." I am rather impatient about these expressions concerning the "principle of the tax" because I do not find many statements of what the "principle" is or any defense of it. From what I can gather it is essentially not a tax measure but is an attempt through taxation to produce some economic reform or economic object, namely, to accelerate the distribution and flow of capital by forcing the distribution of earnings. This seems to be the theory of such a tax as described in the writings of Mr. Berle and Mr. Tugwell.

Senator King, in a radio colloquy with Representative Celler November 27, 1937, stated that "the avowed purpose of the tax was to force corporations regardless of their condition and welfare to pay out their earnings in dividends upon the theory that large stockholders would then pay income taxes." This seems closer to actual facts. Whichever of these conceptions is correct, there is the common factor in both, i. e.: Force imposed on corporate management to do something under penalty of paying a very substantial tax for failure to do a thing which does extreme violence to the ideas of businessmen as to what constitutes sound, prudent business practice. For the first time we are faced with a tax measure which says to us that if you want to keep your taxes at a minimum (and who doesn't?) you had better distribute all of your earnings to your stockholders and forget about necessary replacement of equipment or plant, or about paying your debts or setting aside part of your earnings against the certainty of less favorable business conditions in the future. That seems to me to be the real and only principle of this tax, a severe penalty upon sound, sensible, and prudent management.

I can see no defense for such a principle and certainly if substantial and needed modifications to the law are granted, which practically all business, big and small, and many persons in Congress demand, there will be no "principle" left. A properly modified law would certainly not produce a great deal of revenue, because after management has done the things which it should be permitted to do without penalty, the balance of earnings will be distributed, in the vast majority of cases, to stockholders. The simplest, clearest, and cleanest way out is to repeal the law forthwith, and thereby eliminate all the evils and at the same time avoid increasing the complexities of our country's already extremely complicated Federal tax system by adding numerous amendments, modifications, and changes to the measure as it is now written.

Another reason I have for outright repeal lies in the majority report of the House Ways and Means Committee just published. It apparently has reached the conclusion that the undistributed profits tax principle, whatever it may be, is a bad thing for corporations earning less than $25,000 a year and is a good thing for those earning more than that. If it is a burden on 88 percent of the corporations which have earnings, it is certainly a burden on the other 12 percent; and it so happens that its burdensome and ruinous effect is retained on the 12 percent of corporations which probably give employment to many, many times the number of men that are employed by the 88 percent. I confess comlete inability to follow the reasoning which admits that a Federal taxing principle is bad for a corporation whose earnings are $24,900 and good for a corporation whose earnings are $25,100, and both in the same line of business.

Another rather unexpected and unfortunate result of this tax measure has also impressed me considerably. One of the main objectives of the Administration and one with which I have entire sympathy is to eliminate insofar as possible the peaks and valleys in the business cycle and level them off so that there are not such violent booms and depressions. Naturally, there is a great diversity of opinion as to how this can best be accomplished, but it is certain that the tax on undistributed corporate income is a very sure way to accelerate the tempo and increase the differences between the peaks and valleys. The reason for this is very simple and has been well illustrated in the 2 years that the tax has been in effect. In 1936 many corporations with reasonably adequate surpluses and no

pressing need for expansion or replacements at that time and no debts to repay distributed all of their earnings to their stockholders.

It probably seemed to those who were not aware of these motives that a really substantial and high degree of prosperity had returned to the country. The recipient of these extra and unusual distributions that were made, particularly toward the end of 1936, undoubtedly in turn spent the money more freely and created in turn the feeling on the part of retailers and other suppliers that large stocks of goods should be acquired for the coming and increasing business boom. The prices of many securities and commodities rose rapidly and then in 1937 when business slowed down and earnings were not as good as in 1936, there was a distribution of earnings on a much lower scale, with the opposite economic and psychological effect. Some corporations which paid their regular and substantial extra dividends in 1936, paid considerably less or nothing at all in 1937. How can there be any approach to stability in the prices for corporate equities when the dividend-paying policy of corporations is bound to be seriously affected by the impact of this tax and really becomes a matter of guesswork. This, obviously, is the very opposite of stability and of a leveling of the peaks and valleys.

Our company so far has not yet been seriously hurt by the direct impact of this tax, because it has been in a position to distribute all of its earnings for the 2 years but it obviously cannot continue to do so indefinitely. We have seen very clearly, however, its indirect effect on our own business caused by the effect it has had on other lines of industry which have greatly curtailed their activities and, therefore, have laid off employees, which, in turn, has affected the sale of bread in the communities where this occurred, and thus, the interests of our own employees and stockholders. I am, therefore, vitally interested in the removal immediately of a factor which I consider the most important cause of the present business recession and its accompanying unemployment, because if things continue as they are we would be forced to curtail our activities to some extent because of the slackening demand, thus in turn creating widening circles of unemployment.

A further reason which just occurs to me for the repeal of this tax (a reason which perhaps is somewhat frivolous and has no foundatioi in logic or economics) is this: There seems to be no dispute that business, both large and small, is almost unanimously opposed to the measure and would favor its repeal because they think it is wrong all the way through. Now, the mere fact that most businessmen are agreed on a proposition does not mean that it is right by any means, because, they apparently have been wrong unanimously many times in the past, but it seems to me that possibly this time they may be right; at least by the law of averages they should be right some time and possibly this is it. Why not give their point of view a trial in 1938, inasmuch as the ideas of the proponents of the tax were given a trial in 1936?.

I do not want to burden this memorandum with a restatement of all of the many reasons and recommendations for modification or repeal which have already been presented to you in far better form, but I do want to point out one specific result of the existence of this tax as applied to our company. During the year 1937 we would have spent approximately half a million dollars which we did not spend at all, on additional equipment and improvements in our plants; and of this half million dollars, nearly one-half would have been spent with one company making bakery machinery. The plant of this company is in a small-sized middle western town and gives employment to approximately 1,000 people and is naturally an important factor in the business life of that community. We did not place these large orders with that firm and we know that it substantially curtailed its operations during late 1937 and the early part of 1938, and laid off a substantial number of its employees.

Even looking at this tax as its proponents would have us do, not strictly as a revenue-producing measure, but as an attempt to accomplish an economic result, and bearing in mind examples of its economic effect such as the one I have just told, experiences which must have been repeated hundreds and hundreds of times in other businesses and industries during the past 2 years, is not the conclusion inescapable that the harmful economic effects far outweigh the advantages claimed for the tax as a measure of economic reform?

In closing I want to say this to you, that if I could adequately describe in words to you the feeling of confusion and uncertainty and bewilderment in my mind and in the minds of my associates when we were first faced with the concrete proposition that we would be unable to keep our taxes at a minimum if we were to set aside a part of our earnings to surplus against the contingencies of the future or if we were to spend money necessary for rehabilitation and expansion of plants and equipment, you would favor the repeal of this tax without hesitancy. Any of you who have been in business will know our feelings without my attempt-

ing to describe them, but all of you must know that American business cannot continue to maintain the high standard of accomplishment, employment, and prosperity for which it has been outstanding above the rest of the world, if the men who are actually managing business enterprises day in and day out are to be kept in such a frame of mind.

BRIEF RELATING TO THE ATTITUDE OF SOUTHERN MANUFACTURERS TOWARD THE UNDISTRIBUTED-PROFITS TAX AND THE CAPITAL-GAINS TAX PRESENTED TO THE SENATE FINANCE COMMITTEE MARCH 24, 1938

The Southern States Industrial Council representing approximately 15,000 southern manufacturers, representative of all manufacturing enterprises in 15 Southern States, outlines briefly below, for the consideration of the committee, the chief objections of southern industry to the undistributed-profits tax and the capital-gains tax, and makes the following recommendation: That the undistributed-profits tax and the capital-gains tax be repealed.

Because the South is a section in which small business enterprises predominate, with 85 percent of its manufacturing plants employing less than 50 workers, this section has felt and reacted to the effects of both of these provisions of the 1936 tax law more than other sections of the country. The reason for this is that the South as no other section has suffered from the lack of reserves, for it has been faced with the necessity of developing plant and securing working capital out of earnings; in other words, "plowing back profits." Thus, the smaller firms, if they are to continue to do business profitably, cannot distribute as large a percentage of their net earnings as can the larger corporations, and under the undistributed-profits tax, as more of the earnings are retained, not only is the tax base enlarged but the rate of the tax also increases. This point is illustrated in an analysis of income-tax returns through August 31, 1937, which clearly indicates that the undistributed-profits tax rate averaged higher for corporations in the lower net-income brackets than for those in the higher brackets, resulting in an unequal burden of taxation upon business in sections where small business predominates.

An analysis of the tax rate as referred to above reveals that the effective tax rate ranged from 3.85 percent for corporations with earnings of less than $5,000 to 0.83 percent for corporations with earnings of $5,000,000 and over. The rate ranged from 3.85 percent indicated above to 2.78 percent for corporations with earnings up to $250,000, then broke sharply to: 2.41 percent for corporations with earnings of from $250,000 to $500,000; 2.12 percent for corporations with earnings of from $500,000 to $1,000,000; 1.62 percent for corporations with earnings of from $1,000,000 to $5,000,000; 0.83 percent for corporations with earnings of from $5,000,000 and over.

The recommendation of the House Ways and Means Committee to exempt from the undistributed-profits tax, corporations with net incomes below $25,000 will not ease the situation to any great extent. While it will eliminate payment of this tax by about 90 percent of those filing returns, nevertheless, such an exemption will discriminate against, and place an unequal burden of taxation upon, those corporations which, though in the minority in number, are responsible for a large percentage of the total income reported. Such an exemption would serve to unbalance competition and would definitely restrict and penalize the expansion and development of those corporations most able to undertake expansion programs, and would tend to put off necessary development in favor of dividend distribution with the hope of ultimate revision and repeal of the principle of taxing undistributed profits. A study entitled "The Undistributed Profits Tax," published by the Brookings Institute, points out with regard to the undistributed-profits tax, that:

"Its fundamental weakness is that it limits the possibility of prompt and flexible capital development and handicaps with particular severity a multitude of small and medium-sized business enterprises."

To determine the extent of mechanization and expansion of industry in the South in 1937, the council made a study of returns from 400 representative southern manufacturing plants. It was found that 74.8 percent had made no improvement or expansion whatever and did not contemplate making any for the year 1938; 18.2 percent indicated that they were in need of such development but did not expect to make it during 1938 because of depressed business conditions, uncertainty as to what the tax policy of the Federal Government will be and unwillingness to pay a penalty on earnings expended for improvement or expansion. Only

7 percent indicated that they were contemplating a program of expansion in 1938. Below are quoted some of the reasons for not expanding during 1938:

"Too much Government interference in business.

"Business uncertainty and threats of Government regulation.

"No expansion on account of tax on undistributed surplus.

"Business uncertainty.

"Lack of capital and stable market.

"No expansion for fear of what Government will do.

"No expansion because of very little incentive.

"No expansion on account of high cost and governmental interference with business.

"No expansion because of undistributed-profits tax.

"Excessive building-labor costs—labor agitation—unsettled Government condition.

"Outlook is too uncertain to make investment.

"Prices too low and taxes too high—takes more than we can make to pay social security tax, unemployment tax—want to get out of business if we can.

"Depends on attitude of administration—expansion would have been made in 1937 but for that fact.

"Do not feel safe in investing additional capital under present uncertainty regarding what Congress may do and dangerous labor conditions.

"Fear of adverse legislation.

"Just not able—pay roll and undistributed profits taxes have just about got us to where we cannot do anything to improve.

"The undivided-profits tax on the necessary funds to purchase additional or new equipment has forced us to prolong the purchase of additional equipment as long as possible.

"Taxes have not left enough money.

"Depends entirely upon administration attitude on taxes and labor conditions.

"Too much rumor about control of business and higher taxes.

"Will expand if undivided-profits tax is repealed.

"Do not know what is coming next in the way of taxes and regulations.

"Conditions too uncertain—taxes increasing to point of absorption of profits—administration attitude too changeable to insure stability.

"Conditions are too unfavorable—too much possible administration in Washington.

"Uncertainty in Government policies.

"Excess-profits tax structure prohibits such expansion.

"Having to pay out all profits in dividends, we have nothing left for expansion—also our taxes are too high.

"Not until we know what Washington will do in the way of tax relief.

"We need more warehouse space, but hesitate to build because of excess-profits tax."

PROPOSED REVENUE BILL INCREASES TAX ON SMALL CORPORATIONS

Analysis of income-tax returns for previous years by income-size classes reveals that the South's proportion of earnings of $25,000 and above is less than for the rest of the country. Thus, for the years 1936 and 1937, the South has paid proportionately higher rates on total earnings than have other sections where corporations with large earnings are concentrated. The proposed revenue bill for 1938, while exempting a great many corporations from the undistributed-profits tax, nevertheless, will increase the normal tax rate on small corporations. Under the proposed bill, the normal tax on corporations with net incomes of $25,000 or less will be increased as follows:

Net income	Present normal tax	Tax under new bill	Amount of increase	Net income	Present normal tax	Tax under new bill	Amount of increase
			Percent				*Percent*
$2,000	$160	$250	56	$8,000	$820	$1,045	27
$3,000	270	375	39	$10,000	1,040	1,325	27
$4,000	380	500	31	$15,000	1,590	2,025	27
$5,000	490	625	27	$20,000	2,240	2,725	21
$6,000	600	765	27	$25,000	2,890	3,525	22

The proposed bill also increases drastically the total tax for corporations with earnings in excess of $25,000. It is found that total taxes would be increased 20 percent for net income of $40,000. Following is a detailed analysis of how the increase would occur:

1936 revenue law:		
Net income	$40, 000. 00	
Normal tax	4, 840. 00	$4, 840. 00
Adjusted net income	35, 160. 00	
Dividend credit	26, 370. 00	
Undistributed profits	8, 790. 00	
Undistributed-profits tax	818. 50	
Total tax		5, 658. 50
Proposed 1938 revenue bill:		
Net income	$40, 000. 00	
20 percent normal tax	8, 000. 00	
4 percent dividend credit	1, 054. 80	
Total tax		6, 945. 20
Increase		*1, 286. 70*

CAPITAL-GAINS TAX

The capital-gains tax should be drastically modified especially with a view to giving equal treatment to capital gains and losses. Under the present law, capital gains are taxed in full, but capital losses are deductible only to the extent of $2,000 of net capital losses. More lenient provisions should be made for distributing losses over a period of years. However, the council is of the opinion that outright repeal of this tax, which after all is a poor revenue producer, would result in a renewed flow of capital transactions, thus creating increased revenue from profits realized on accelerated capital transactions. The tendency now is for capital to lie idle and for great amounts of money to be invested in tax-exempt securities.

An analysis of the rate of capital gains to total net income shows that in every income class, high tax on capital gains after 1929 has discouraged the employment of resources for capital invested.

Ratio of capital gains to total net income

Year:	Percent	Year—Continued	Percent
1926	10. 8	1929	18. 9
1927	12. 8	1934	2. 4
1928	19. 0	1935	4. 9

The experience of the State of New York with a State capital-gains tax is revealed in the statement of Mark Graves, president of the New York State Tax Commission, who urged the following:

First. That capital gains and losses be segregated and taxed at an exceedingly low rate, or—

Second. In lieu, thereof, absolute repeal.

The effect of this tax creates a particular hardship upon sections where industrial growth and development is in its infancy, discouraging and retarding the beginning of new industries and penalizing those that are brave enough to venture forth. Thus, employment opportunities are lost, purchasing power reduced and vast resources of raw materials are not put to use.

Speaking for southern manufacturing industries, the council respectfully requests that the Undistributed Profits Tax and the Capital Gains Tax be repealed immediately, and that this tax might be decided as quickly as possible in order to release business from the fears aroused by uncertainty and instability in Government policies.

Under the present depressed business conditions total taxes should not be increased as is proposed by the Revenue Bill of 1938.

SOUTHERN STATES INDUSTRIAL COUNCIL,
By PRENTISS M. TERRY,
Executive Vice President.

GANSE-KING ESTATE SERVICE,
Boston, Mass., March 23, 1938.

HON. PAT HARRISON,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR HARRISON: In addition to the enclosed statement regarding gift and estate-tax exemptions and exclusions, for the opportunity of filing which I am much obliged, I take the liberty to make an entirely independent suggestion in reference to section 117 (f) which appears on page 134 of the pending revenue bill as reported to the House. This I do at the request of the National Association of Life Underwriters who feel that the proceeds of a life-insurance policy paid to a "transferee for value" should get the same income-tax exemptions on their so-called profit treated as a capital gain as are now allowed under this paragraph to holders of matured bonds.

The provision for an income tax upon the proceeds of a policy owned by a transferee for value is contained in section 22 (2), printed on page 23 of the same report.

Life underwriters claim that such policy proceeds should receive as favorable treatment in this respect as matured bonds and the other evidences of indebtedness mentioned in section 117 (f).

Matured bonds used to be treated as these life-insurance proceeds are at present, but in 1934 subdivision (f) was enacted so as to correct what is an obvious unfairness.

For this purpose they request that after the word "form" in the next to the last line of said paragraph there be added the following words: "or upon a life insurance, endowment, or annuity contract held by a transferee for value by assignment or otherwise," making section 117 (f) read as follows: "For the purpose of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a Government or political subdivision thereof) with interest coupons or in registered form, or upon a life insurance, endowment, or annuity contract held by a transferee for value by assignment or otherwise, shall be considered as amounts received in exchange therefor."

Yours sincerely,

FRANKLIN W. GANSE.

STATEMENT IN REFERENCE TO THE PROPOSED CHANGES IN ESTATE-TAX AND GIFT-TAX EXEMPTIONS AND EXCLUSIONS, SECTIONS 506, 507, AND 510, SUBMITTED BY F. W. GANSE

Sections 506 and 507 diminish the specific estate-tax exemption by the amount of the specific gift-tax exemptions, thus allowing no estate-tax exemption if $40,000 in gift-tax exemptions is taken.

The merger of the two exemptions is confusing to the taxpayer and prevents his planning his estate with some degree of definiteness. The great majority of estate owners honestly try to keep the law and plan to meet their taxes and also to distribute their net estates as carefully as possible. To do this they must estimate their estate shrinkage in advance, while they are alive. Such plans for paying estate taxes and yet leaving solvent estates should be encouraged.

Many estate owners are deterred by the idea that it is practically hopeless to plan these vital matters because one has no sooner done so than the Government makes changes that upset the whole plan.

As a result many factories and other going concerns owned by such estates are forced on the market. This causes severe loss to their communities. If the Government does not care about the vast losses which come from forcing sales of securities and real estate to raise estate tax money, it must care when employees are thrown out of work.

To plan these matters in advance, and provide for tax money in advance, usually out of the residue of the estate or by life insurance, requires that deductions and exemptions remain as constant as possible. It seems not too much to hope that the estate-tax rates will not go higher, since we already lead the world in that field. The great advances in rates made in 1935 were proportionately much larger on small and moderate-sized estates. To cut out the $40,000 estate tax exemption indirectly, bears most heavily on such estates.

Again, while the gift and estate taxes are related, there is no reason why an exemption should not be allowed in each, as in other tax fields, so that the taxpayer can use each independently; one when he is making gifts and the other when he is figuring upon his net estate.

The Government will gain less by this change than by leaving the exemptions, as it leaves other gift- and estate-tax matters, unchanged and thus encouraging the taxpayer to continue plans which will provide for the payment of estate taxes with a minimum of loss to business activity.

Again, many who make gifts up to the exemption limit will leave very small estates, even too small to administer. These the present estate-tax exemption would eliminate, but under the proposed change they would all have to be taxed. What one has given away in good faith is not a part of his estate, yet this change makes it such, and thus penalizes his estate because he has taken action fully approved by law. Suppose he does not claim the exemption when making gifts, thinking it may better be used by his estate, and then fails to leave an estate, the exemption is entirely lost.

These exemptions belong asunder and should not be joined together. These reasons apply with special force against the proposed decrease in the annual individual gift-tax "exclusion", from $5,000 to $3,000. A family of four children was used in the Ways and Means Committee's argument for this change, but the average number of children in these families is nearer two.

From the President down, the idea has been stressed by the Government that our estate and gift taxes should lead to the wider "distribution of wealth." This may certainly be said to be a principle strongly favored by our Government. To bring this about gifts intervivos must be encouraged.

But, having planned a gift-tax system which has been in effect several years, the Treasury Department seems inclined to favor possible increases in gift taxes rather than a policy which will bring in a lower revenue from this source but also encourage the distribution of wealth. Two horses cannot be ridden in this arena any more successfully than in any other; and the estate taxes having been made so onerous should wisely be accompanied by gift-tax rates and exemptions which encourage the habit not only of making gifts in advance of death, but of making them periodically and to as many beneficiaries as possible.

The Senate changed this exclusion originally from $3,000 to $5,000 when gift taxes and estate taxes were both much lower and a strong argument could be made for its increase rather than its decrease. However, the real question is whether those who are trying to plan the distribution of their estates honestly and wisely in accordance with the laws of the land ought not to be permitted to carry out their plans without frequent changes which discourage any careful planning.

Our estate taxes are so high that to raise them would seem absurd. The gift tax is high enough unless the Government really wants to discourage gifts and estate distribution. The exemption in each of these fields is smaller than heretofore and was carefully worked out in connection with the raising of the rates in 1935.

Personal and business income taxes, and many other taxes which are figured and paid annually, are necessarily subject to annual review, and changes in these may at least be dealt with periodically, but taxes which affect one's whole estate, and the future of his dependents, should be kept as stable as possible.

I submit that the Government will in the long run get more in taxes from gifts and estates if it will encourage advance planning to provide for estate taxes and prevent the disruption of business, by leaving these exemptions as they are.

Letter Submitted by the Club Managers Association of America

Re: Repeal of club dues tax.

Finance Committee,
United States Senate, Washington, D. C.

Gentlemen: In behalf of the 750,000 club members representing 2,500 clubs in the United States, it is respectfully requested that you eliminate in the revenue bill now being drawn section 413 of the Revenue Act of 1938.

This section provides for the collection of a 10 percent tax on the dues and fees of social, athletic, or sporting clubs or organizations if the dues or fees of an active resident member are in excess of $25 per annum.

As you all know, clubs provide for a community athletic, social, recreational, and cultural activities. Members in a club bind themselves together in a nonprofit organization and the expense of operation of the club is prorated among the members of the organization in the form of payment of dues. In fact in a great many instances, the club serves as the home of members.

During the recent depression approximately three-fourths of the clubs in this country were in serious financial condition because members were unable to con-

tinue the payment of dues. Membership dropped off on an average of 50 percent with the result there were not sufficient members left to meet payments on mortgages and taxes.

In 1935 and 1936 it is estimated clubs recovered approximately 20 percent of this loss of membership, but in the last 6 months as a result of the recent recession in business clubs are again experiencing not only a falling off in revenue, but a loss of members.

The bulk of the membership of a club is made up of average citizens who have but a limited amount to spend upon the participation in club activities. It is therefore hoped that clubs may be benefited to the extent of not requiring the continued payment of the tax of 10 percent on club dues.

The annual report of the Commissioner of Internal Revenue of the United States Treasury Department for the fiscal year ending June 30, 1936, reports that this tax contributed but $6,090,923.21, and that for the fiscal year ending June 30, 1935, the total amount derived was but $5,784,494.99.

In conclusion, therefore, members of clubs throughout the United States feel:

1. The proceeds of this tax are small in comparison with the work involved in its collection. Originally called a luxury tax, it actually is a nuisance tax.

2. Clubs being nonprofit organizations are limited in membership. They cannot advertise or increase their revenue as a commercial enterprise would do, with the result that the falling off of membership results in serious depreciation of property values used for club purposes.

3. As the home of individuals and one of the institutions which in communities provides the athletic, social, recreational, and cultural activities for so many citizens, clubs should be encouraged and not penalized, for as semicivic institutions they provide facilities that improve our community life.

Respectfully submitted.

CLUB MANAGERS ASSOCIATION OF AMERICA.

Committee:

Darwin Meisnest, Washington Athletic Club, Seattle, Wash., chairman; Fred H. Crawford, Pendennis Club, Louisville, Ky.; J. G. Wetzel, Detroit Club of Detroit, Mich.; Edw. F. Anger, City Athletic Club, New York City; F. E. Bergerson, Beverly Country Club, Chicago, Ill.; R. F. Burke, Arizona Club, Phoenix, Ariz.; Richard Owen, Downtown Club, Newark, N. J.; M. D. Stauffer, Akron City Club, Akron, Ohio; Wayne Miller, Cincinnati Country Club, Cincinnati, Ohio; Wm. F. Roulo, University Club, Detroit, Mich.; John J. Ferguson, Jonathan Clubs, Los Angeles, Calif.; E. Park Akin, Columbia Club, Indianapolis, Ind.; Thos. P. Jones, Harvard Club, Boston, Mass.; Frank H. Murray, Ravisloe Country Club, Homewood, Ill.; J. Fred Smith, University Club, Columbus, Ohio; Fred L. Wood, Denver Athletic Club, Denver, Colo.; Wm. Norcross, Essex Country Club, West Orange, N. J.; P. J. Cannon, Tulsa Club, Tulsa, Okla.; Chas. McKeown, Wisconsin Club, Milwaukee, Wis.; E. M. Ries, Colonial Country Club, Memphis, Tenn.; James Richardson, Multnomah Club, Portland, Oreg.; Verney L. Johnson, St. Paul, Athletic Club, St. Paul; Frank W. Davies, University Club, Washington, D. C.

THE UNDER SECRETARY OF THE TREASURY,
Washington, March 28, 1938.

MY DEAR SENATOR: I have read, in the record of hearings of the pending revenue bill, the letter from Governor Lehman urging the Federal Government to increase to 50 percent the credit given in the bill against Federal estate tax for state death taxes paid, and to introduce a similar credit for the Federal gift tax.

Since the letter affirms certain propositions that seem to me to be open to question, and does not present other propositions and certain specific tax data that seem to me necessary to a full understanding, I offer the following comments:

1. Governor Lehman in effect asks the Federal Government to give up more than $100,000,000 of the annual revenue from estate and gift taxes that it would receive under the present law or the pending bill. The Federal Government, like the States, wishes to lessen tax conflict and increase fiscal coordination, but notable advance in this direction is not likely to be achieved simply by unilateral action when such large revenue aggregates are involved.

2. Governor Lehman says that the Federal Government is "virtually monopolizing" the fields of income taxation (personal and corporate) and estate taxation. An examination of specific instances, however, indicates that this phrasing may be somewhat too vigorous.

As to the income tax, a single person with no dependents, with a net income of $5,000 in salary, pays $140 in Federal income tax—2.8 percent of his income. If he lives in a State like New York that has an income tax, he pays even less Federal tax, since the Federal Government allows him to deduct, in computing net income, the State income tax paid. (New York, on the contrary, does not allow him to deduct Federal tax paid.) If the $5,000 taxpayer is married, with three dependents, he pays $32 in Federal income tax—six-tenths of 1 percent of his income. If he has $10,000 net income from salary he pays 5.6 percent of it in Federal tax if he is single and 3.1 percent if he is married, with three dependents. If he has $20,000 net income, half of which is salary and half of which is his share in corporate net taxable income, his Federal income tax, including his share in the corporation income tax, is about 15 percent of his net income if he is single, and about 13 percent if he is married, with three dependents. These figures suggest that the Federal Government is not "virtually monopolizing" the field of income taxation at these levels. These are the levels in which the States are in any case the most interested, since at high-income levels the taxpayers are often free to move from one State to another and the States therefore find it difficult to tax them at high rates, regardless of the Federal tax.

The income tax now levied by New York State is heavier than the Federal income tax on the $5,000 man and is almost as heavy when the $10,000 level is reached. Even at the $20,000 level New York State's individual income tax is more than two-thirds of the Federal individual income tax.

As to the estate tax, a net estate (before deducting the specific exemption) of $40,000 is entirely exempt from Federal estate tax; at $60,000 the present Federal tax is 1 percent of the estate; at $100,000 it is 4.2 percent. At $250,000 it is 10.5 percent, after allowing for the credit for State death taxes paid. These figures, too, suggest that there is no Federal monopoly of this field.

3. The Governor states a belief that it is "unthinkable" that the States will superimpose upon the Federal tax still higher death duties. But it is doubtful whether many authorities would agree that it would be "unthinkable" to take more than 4.2 percent of a $100,000 estate, for instance. Even if we consider the combined burden (Federal plus State) at this level, the statement still seems too strong, since the added burden now imposed by States on the $100,000 estate is commonly less than 3 percent. Moreover, as I indicate below, the pending bill reduces, at this level, the Federal tax by allowing a credit for State tax, where none is now allowed.

4. The pending bill allows the Federal taxpayer to deduct, from his Federal estate tax otherwise due, the death taxes that he pays to the States, up to 16½ percent of the Federal tax otherwise due. Thus if the Federal tax otherwise due is $100,000 and the estate has paid $10,000 in State death taxes, its actual Federal tax is only $90,000. If the State death taxes total $16,500 instead, the actual Federal tax is only $83,500. But if the State death taxes total $20,000, the actual Federal tax is still $83,500. Therefore up to $16,500, in this case, the taxpayer suffers nothing from the State tax. Beyond that level he does. Governor Lehman concludes, therefore, that no State will dare to put its death taxes higher than 16½ percent of the Federal rates. He says, "for every practical purpose the rates of State estate taxes will be limited to one-sixth of the Federal rates in the various brackets," and adds that "The proposed law assumes the States have but a one-sixth right to tax estates." Two observations are necessary here:

(*a*) With respect to all but very wealthy taxpayers, experience has shown that the States have in fact dared to go beyond, and considerably beyond, the credit allowed by the Federal Government—that is, they have dared to put a real additional burden on the estates under their jurisdiction. Since 1926 the maximum credit has been 80 percent of the Federal tax that would be due under the rates and exemptions of the old Federal law of 1926. Computations for a hypothetical estate that is fairly typical in the composition of its assets and in distribution among beneficiaries shows that at the present time, for an estate of $300,000, all but 4 of the 48 States impose a death tax or death taxes greater in amount than the maximum credit allowed against the Federal tax. For an estate of this size, the maximum credit amounts to slightly less than 1 percent of the estate (0.96 percent).[1] Under Governor Lehman's reasoning, then, we should expect to find

[1] Under the pending bill it will be greater, but, still, less than 2 percent.

that no State is imposing a death tax of more than 1 percent. But, to cite a few typical examples, Illinois taxes this estate at 2.76 percent, Massachusetts at 3.34 percent, New York at 1.42 percent, and Ohio at 2.23 percent. Utah takes 8.15 percent. These figures were obtained by replies to questionnaires sent to State officials. The Treasury is of course ready to supply exact details of computation and assumptions as to composition and distribution of estate if they are desired.

At the $100,000 level under the present law no credit at all is allowed; nevertheless 32 States take between 1 and 4 percent of such an estate in tax.

At the $500,000 level, the present Federal credit equals 1.74 of this hypothetical estate, but Illinois takes 3.52 percent, Massachusetts takes 4 percent, New York takes 2.29 percent, and Ohio takes 2.58 percent. Utah takes 8.89 percent.

The Federal tax credit has therefore not fixed "the ceiling" for State death taxes on such estates in the past; there seems no reason to expect that it will in the future.

(*b*) With respect to very wealthy taxpayers, the Federal tax credit fixes a basement rather than a ceiling. Without any credit at these levels, interstate competition for wealthy persons would probably drive state death tax rates down, possibly to zero in some cases, as occurred in the well-known instance of Florida. Readers of the Governor's letter might infer that there was something restrictive about the Federal credit. Actually, the credit keeps State death tax rates on those wealthy taxpayers higher than they otherwise would be. The Governor therefore wants the basement level hoisted. His letter does not, of course, request the Federal Government to repeal completely its estate tax law.

5. The Governor's letter says that in the pending bill, "Federal [estate] taxes [are] increased, credit for State taxes decreased." This is true only for large estates. The letter does not point out that for all estates (before specific exemption) below $1,100,000 [2] the exact reverse is the case—the Federal taxes are decreased and the credit for State taxes increased, compared with the present law. Thus the bill raises the "ceiling," to use the Governor's term, for these estates. On the average, for the country as a whole, the change in the form of the crediting provision will slightly increase the credit for State taxes, and will cause a decrease of about $1,000,000 a year in Federal estate tax revenue, on the basis of most recent statistics available.

6. The Governor says that the result of the Federal use of the income and estate tax fields is that "the bulk of State and local revenue is shouldered on real property." But there is no evidence that the bulk would not still be on real property even if the Federal Government levied no income or estate taxes at all; indeed, the relative magnitudes involved are evidence the other way.

7. Governor Lehman advocates a 50-percent credit against the gift tax. The gift tax is in part a preventive tax, to lessen the flow of *inter vivos* gifts compared with what it would be with no gift tax at all, and thus preserve the income tax and estate tax revenue. A crediting provision would in no way increase its effectiveness in this function. To encourage States to levy gift taxes (as a crediting device would do) would further increase duplication of administration. The revenue amounts involved are at present slight. A credit of 50 percent of the Federal gift tax, if fully taken up by the States, would yield them, on the basis of Federal collections during the fiscal year 1937, a total of some $12,000,000. Without taking a definite position that no such credit should ever be allowed, one can at least disagree with Governor Lehman's conclusion that it is "perfectly obvious" that this should be done.

Federal-State fiscal coordination is so important that, at the risk of commenting at undue length, it has seemed desirable in this instance to specify certain facts that may serve as a basis for further exchange of views and proposals for betterment of Federal-State tax relations.

Sincerely yours,

ROSWELL MAGILL,
Under Secretary of the Treasury.

HON. PAT HARRISON,
United States Senate.

[2] Not $700,000, as might be inferred from the letter.

PIPER, CAREY & HALL,
Baltimore, March 28, 1938.

Hon. PAT HARRISON,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SIR: I desire to suggest certain amendments to the proposed tax bill H. R. 9682 now being considered by your committee. The purpose of these amendments is to encourage the simplification of holding companies. One relates to holding companies generally and the other is confined to public utility holding company systems as defined in the Public Utility Holding Company Act of 1935.

The proposed amendments to section 112 of H. R. 9682 which would cover all holding companies are as follows:

Section 112(g) of H. R. 9682 is hereby amended to read in part as follows:

"(g) *Definition of reorganization.*—As stated in this section and section 113 *except subsection* (k) *of section 112* * * *"

Section 112 of H. R. 9682 is hereby amended by adding thereto the following subsection:

"(k) *Reorganization of holding company systems.*—No gain or loss shall be recognized upon the consummation of, or upon any transaction incident to, a reorganization of any corporation or corporations constituting or forming a part of a holding company system (as herein defined) if such reorganization results in the simplification of, or the elimination of complexities in, the corporate structure or structures of, or the fair and equitable distribution of voting power among the holders of securities of, such corporation or corporations or of any such holding company system of which it or they are members, or in the elimination of, or reduction in the number of the, corporations comprising any such system. The term 'reorganization', as used in this subsection (k), means any merger, consolidation, reincorporation, readjustment of debt or capitalization or both, sale or exchange of assets, liquidation or dissolution of any corporation or corporations constituting or forming a part of any such holding company system. A 'holding company system', as used in this subsection (k) means any company which directly or indirectly owns, holds, or controls with power to vote at least a majority of the outstanding securities of one or more corporations which are at all times entitled to vote for the election of directors, together with all such corporations whose voting securities are so owned, held, or controlled by such company."

In connection with the suggestions relating to public utility holding companies, in the report of Senator Wheeler from the Committee on Interstate Commerce, which accompanied the Public Utility Act of 1935, Report No. 621 of the Seventy-fourth Congress, first session, appears the following:

"The committee is of the opinion that careful consideration should be given to the advisability of amending the revenue acts to encourage voluntary corporate reorganization for the purposes of simplifying holding company structures, eliminating unnecessary complexities therein, and otherwise complying with the policies underlying holding company legislation. Such amendments should be considered not only in relation to the stamp and transfer taxes but to the income taxes as well. Naturally, any exemptions provided for these purposes should be limited to the needs of such purposes. The committee has taken no definite action on this matter because of the parliamentary procedure which may be construed to require such an amendment of the revenue act to originate in the House, but it definitely recommends concurrence by the Senate in any such amendment originating in the House."

There can be no question but that the taxes referred to have prevented many simplifications which would otherwise have been made had it not been for the tax burdens incident thereto.

The Public Utility Act of 1935 itself, and particularly title 1 thereof, was designed to insure the simplification of public utility holding company systems. The complexity of most of such systems is the necessary result of the method by which they were built up. Nearly every large system is the result of the purchase of other systems or of individual operating companies. Thus, in the building of a large system many useless holding companies are acquired. Wherever possible, these useless companies are eliminated. However, there are many obstacles to such elimination. Sometimes financing is required to retire outstanding securities, sometimes minority interest obstruct the proposed elimination, sometimes simplification is prevented by State laws and their application.

In many cases, however, simplification would be possible were it not for the tax burdens incident thereto. These burdens generally take the form of taxes upon

profits, resulting from exchanges of securities or properties in connection with the process of simplification. Taxes on transfers and original issues of securities in connection therewith impose an added burden.

Therefore, in order to lighten these tax burdens and in line with the statement above quoted from the report of the Interstate Commerce Committee, it is suggested that section 112 of H. R. 9682, dealing with tax free exchanges of securities or other property, be amended by adding thereto a new subsection which will provide for the nonrecognition of gain or loss in connection with reorganizations, however effected, which result in the simplification of holding company systems. This amendment is a necessary addition to section 112, which at the present time is so limited in scope that it substantially restricts the formulation of plans of reorganization and simplification which are exempt from tax.

In the event that the first suggested amendment covering all types of holding companies does not meet with the approval of the committee, and the committee would only be interested in promoting simplifications of public utility holding company systems as provided in section 11 of the Public Utility Holding Company Act, the following amendments are suggested:

Section 112 (g) of H. R. 9682 is hereby amended to read in part as follows:

"(g) *Definition of reorganization.*—As used in this section and section 113, *except subsection (k) of section 112* * * *"

Section 112 of H. R. 9682 is hereby amended by adding thereto the following subsection:

(k) *Reorganization of public utility holding company systems.*—No gain or loss shall be recognized upon the consummation of, or upon any transaction incident to, a reorganization of any corporation or corporations constituting or forming a part of a holding company system (as defined in secton 2 (a) (9) of the Public Utility Holding Company Act of 1935) if such reorganization results in the simplification of, or the elimination of complexities in, the corporate structure or structures of, or the fair and equitable distribution of voting power among the holders of securities of, or the confining to those necessary or appropriate to the operations of an integrated public-utility system (as defined in section 2 (a) (29) of the Public Utility Holding Company Act of 1935) of the properties and business of, such corporation or corporations or of any such holding company system of which it or they are members, or in the elimination of, or reduction in the number of the corporations comprising any such system. The term "reorganiz a-tion," as used in this subsection (k) means any merger, consolidation, reincorporation, readjustment of debt or capitalization or both, sale or exchange of assets, liquidation or dissolution of any corporation or corporations constituting or forming a part of any such holding-company system."

In order further to promote simplification of holding company structures through reorganizations or otherwise, it is suggested that the applicable stamp tax provisions relating to original issues of bonds and other securities including the transfer of stocks be amended so that no such stamp taxes shall be imposed in connection with the reorganization of holding company systems as to which gain or loss is not recognized under the provisions of section 112. To accomplish this purpose, the following amendments of H. R. 9682 are proposed:

Schedule A-1 of Title VIII of the Revenue Act of 1926 as amended by section 721 (a) of the Revenue Act of 1932 is hereby amended by adding thereto after the second proviso contained therein the following additional proviso:

"*Provided further,* That the tax shall not be imposed on issues of the instruments referred to herein in connection with a reorganization as defined in section 112 (g) or section 112 (k) of the Revenue Act of (1936 as amended) if any of the gain or loss f om the exchange or distribution involved in such reorganization is not recognized under the income tax law applicable to the year in which such reorganization is consummated."

Schedule A-2 of Title VIII of the Revenue Act of 1926 as amended by section 722 of the Revenue Act of 1932 is hereby amended by adding thereto after the proviso contained therein the following additional proviso:

"*Provided further,* That the tax shall not be imposed on original issues of shares or certificates or similar interests in connection with a reorganization (as defined in section 112 (g) or section 112 (k) of the Revenue Act of 1936 as amended) if any of the gain or loss from the exchange or distribution involved in such reorganization is not recognized under the income tax law applicable to the year in which such reorganization is consummated."

Schedule A-3 of Title VIII of the Revenue Act of 1926 as amended by section 723 of the Revenue Act of 1932 and Public, No. 842, Seventy-fourth Congress, approved June 29, 1936, is hereby amended by adding thereto after the second proviso contained therein the following additional proviso:

"*Provided further*, That the tax shall not be imposed on deliveries or transfers of shares or certificates or similar interests in connection with a reorganization (as defined in section 112 (g) or section 112 (k) of the Revenue Act of 1936 as amended) if any of the gain or loss from the exchange or distribution involved in the delivery or transfer is not recognized under the income tax law applicable to the year in which the delivery or transfer is made: * * *"

I believe the suggestions I am offering in this letter are helpful and constructive and I hope that you will give them your careful consideration and bring them to the attention of your committee, and also include them in the report of the hearings.

Very truly yours,

JAMES PIPER.