REVENUE ACT OF 1943

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

SEVENTY-EIGHTH CONGRESS

FIRST SESSION

ON

H. R. 3687

AN ACT TO PROVIDE REVENUE, AND FOR OTHER PURPOSES

REVISED

NOVEMBER 29, 30, DECEMBER 1, 2, 3, 4, 6, AND 15, 1943

Printed for the use of the Committee on Finance

UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1944

93331

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REVENUE ACT OF 1943

MONDAY, NOVEMBER 29, 1943

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

The committee met at 10 a. m., pursuant to call, in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

Present: Senators George (chairman), Walsh, Barkley, Clark, Byrd, Johnson, Radcliffe, Lucas, Vandenberg, Davis, Lodge, Danaher, Thomas, Butler, and Milliken.

The CHAIRMAN. The committee will come to order. The committee has before it, Mr. Secretary, H. R. 3687, an act to provide revenue, and for other purposes, a bill which passed the House of Representatives last week. We will be glad to hear you at this time.

I think it advisable that none of the witnesses be interrupted in their general statement. I make that suggestion in the interest of those who appear and in the interest of time. Of course, questions will be in order after the general statement is finished, but I believe that we will make time if we refrain from interrupting those who appear while they are presenting a general statement.

Now, Mr. Secretary, we will be very glad to hear from you.

STATEMENT OF HON. HENRY MORGENTHAU, JR., SECRETARY OF THE TREASURY, (ACCOMPANIED BY ROY BLOUGH, DIRECTOR OF TAX RESEARCH, TREASURY DEPARTMENT)

Secretary MORGENTHAU. Mr. Chairman and gentlemen, when I appeared before the Ways and Means Committee of the House on October 4 to present the administration's suggestions for increased war taxes, I gave to that committee as best I could a picture of the financial position of the Nation and its wartime revenue needs. I stated that the fiscal situation required much heavier wartime taxation and that it was our opinion that the people could pay additional wartime taxes of at least $10.5 billion. The Ways and Means Committee and the House reached a different result and approved a bill increasing revenues by only $2,000,000,000. In view of this wide difference on a matter so important to the present and future welfare of this Nation, we have carefully reviewed the fiscal situation. I am appearing before you today to present our conclusions.

The outstanding fact in our financial picture is the stupendous bill which this war will leave behind. On that point there can be no quibbling. We are accumulating debt at the rate of over $150,000,000 a day. Last month (October 1943) the Federal Government spent

$5.6 billion more than it collected in revenue. In the fiscal year 1942 the deficit was $21,000,000,000, in 1943 it was $57,000,000,000, and in 1944 it is expected to be $57,000,000,000 again. On the basis of any estimates we can now make, we foresee a public debt at the end of the present fiscal year of about $200,000,000,000. On such a debt the interest charges alone will be close to $4,000,000,000 a year. As the war continues, the debt, the interest, and the problems of repayment will grow larger and larger.

In this situation if we pay in taxes any less than we can now afford to pay, we shall be unfair to those who must face the accumulated bill after the war has been fought and won. We shall be doing a particularly great injustice to the men who are fighting our battles on foreign soil. We shall not only be asking the 10,000,000 members of the armed forces to give the most important years out of their lives to fight the war. We shall also be requiring them as a large body of future taxpayers to pay in taxes after the war what we could and should have paid while they were fighting.

It is clear that we are not paying all the wartime taxes that we can and should pay. We are not now fighting an all-out war on the fiscal front. All the estimates of national income, by whomever made, bear eloquent testimony to the fact that the ability of the American people to pay increased taxes is far from being exhausted. In the fiscal year 1939 individuals had incomes, after personal taxes, of $65,000,000,000. In the fiscal year 1944, it is estimated that individuals will have incomes of $126,000,000,000, after allowance for all present taxes. That is, after paying taxes, incomes of people in the United States will have almost doubled since 1939.

The incomes of the American people are not only ample to pay much higher taxes. The spending power of these incomes is so great as to threaten rapid and burdensome increases in the cost of living. About half of American productive effort is going into war equipment and supplies for our armed forces. These products are not available for civilian consumption. Yet our people are being paid for all they produce. They thus have far more money to spend than there are goods on which to spend it. In the fiscal year 1944 this surplus of income over goods is expected to amount to about $36,000,000,000 after payment of personal taxes. If those who hold this surplus income try to spend it on consumer goods the inevitable result will be black markets, ruptured price ceilings, and substantial increases in the cost of living, followed by tremendous pressures for higher wages and farm prices, which will set in motion further forces in the spiral of inflation.

Up to this point spending has been held down and we have avoided disastrous price increases. We have done this through a variety of measures. Price ceilings and rationing, wage and salary stabilization, and the taxes already imposed have all had a restraining effect. The campaigns for the voluntary purchase of war bonds with their emphasis on saving have been a strong influence in curbing spending.

But we cannot expect these controls to hold indefinitely in the face of a continued large surplus of income over goods and a great accumulation of spendable liquid wartime savings. Day after day, the continuous pressure of spending power has been cracking our price controls a little here and a little there and threatens to produce a major break-down. We are courting danger if we do not do all that is

possible through the tax mechanism to strengthen the foundations of our stabilization program.

I have been told that the American people do not believe in the dangers of inflation. I cannot believe that is true, but there may be a confusion of meaning. If by inflation is meant a situation where money becomes worthless, I agree that the danger now is not of that character. It is rather the danger of substantial and continuous and, at least in part, permanent rises in prices that would undermine standards of living, reduce the value of investments, and impair the security we seek to achieve through savings and insurance. Unfortunately, lack of belief in the danger of inflation does not remove that danger. There are few indeed who have followed with care the developments of the recent past who are not concerned over the possible break-down of the stabilization program. Higher wartime taxes obviously cannot meet the danger alone but they are necessary if it is to be met.

I have also been told that some people have a defeatist attitude toward our fiscal problem. They argue that, since the deficit is so large, the Government debt so huge, and the inflationary possibilities of surplus income and accumulated private savings so great, a few billion dollars more or less will not make a great deal of difference and that, therefore, we might as well avoid the unpopularity of imposing additional taxes. I think this would be a poor excuse to give to the returning soldier who will be interested to know what sacrifices we incurred at home to protect his future.

In fact, however, $10.5 billion of additional taxes would have very important effects on the deficit, the debt, and the inflationary pressure. In its direct effects on spending, in the renewed assurance it would give that the elected and appointed representatives of the people take the problems of the public debt seriously, and in the sobering influence it would have on public understanding of the true cost of the war, a $10.5 billion increase in taxes would be immensely beneficial.

Perhaps the most superficially plausible and therefore the most insidious argument I have recently heard is that economy in governmental expenditures is a substitute for higher taxes. Economy is always an important objective and a tax bill makes it neither more nor less desirable. I am in complete and hearty sympathy with any measure that can be adopted to reduce governmental costs, to reduce even war costs so long as the reductions do not impair our war effort. But if we are to fight the war to a speedy conclusion we cannot relax our fighting or our production for war. That means we cannot significantly relax our spending. I am not in sympathy with any measures or any proposal to cut expenditures in any way that will make out total production anything less than an all-out effort.

At the time I appeared before the Ways and Means Committee, I said that "while it may be possible, and I hope it is, to curtail some governmental expenditures, even that will not lessen our need for getting at this time all that the American people can possibly give us in additional taxation." That is still my position.

The Bureau of the Budget has just released estimates that total expenditures for the fiscal year 1944 which ends next June 30 will amount to $98,000,000,000 instead of the $106,000,000,000 in the estimate issued last August. It is understood that this decrease in expenditures represents a combination of changes in the war program

and a delay in reaching the production goals of some items. Revenues were estimated at $41,000,000,000 instead of $38,000,000,000. The over-all result of the revision is to reduce the previously expected deficit from $68,000,000,000 to $57,000,000,000 for the fiscal year 1944.

There is nothing in the new Budget figures in our opinion to warrant reducing our goal below $10.5 billion of additional wartime taxes. If no one had originally expected more than a $57,000,000,000 deficit for the fiscal year 1944, the amount would appear tremendous, which it truly is. It is no less so because it represents a reduction from a previously estimated higher figure; $57,000,000,000 is equal to last year's record deficit, and is almost three times the deficit of 1942.

The Budget revisions do not alter the fact that we can pay much higher taxes; they do not in any degree affect our moral obligation to meet now all of the costs of the war that can be met by current taxation; and they do not affect in significant degree the serious inflationary dangers that face us for the balance of this fiscal year, the succeeding fiscal years as long as the war shall last, and in the post-war period. Our tax goal, as I pointed out to the Ways and Means Committee, was the amount that we believed could be fairly distributed without undue sacrifice and hardship. From every point of view it is a minimum fiscal program in the light of the deficit, the accumulated debt, and the inflationary pressure.

In view of all these facts, the House bill, in my opinion, falls far short even of an attempt to meet our fiscal needs in a realistic or courageous way.

Let us bear in mind that an essential part of fighting a war is paying for it in the right way at the right time. There is no escape from the costs of war. It is a great fallacy to suppose that we can fight history's greatest war to save what we hold most dear without financial sacrifice. Inevitably we shall experience much greater financial sacrifice than we have thus far. Taxation now, during the war, is the easiest way to make that sacrifice.

In presenting our national fiscal problem to you, I have endeavored to perform the duty placed on the Secretary of the Treasury by law and tradition. I have endeavored to show you as objectively and as clearly as I can that a tax program of not less than $10.5 billion is needed to safeguard the financial and economic future of this country during the war and after the war.

The CHAIRMAN. Are there any questions?

Senator VANDENBERG. Mr. Secretary, if in the final analysis you were confronted with these two alternatives: On the one hand you had to take approximately the House bill, or on the other hand you had to take the House bill plus a general Federal sales tax, which alternative would you take?

Secretary MORGENTHAU. You will have to say that again, please.

Senator VANDENBERG. If you are ultimately confronted with a situation in which you had to choose one of two alternatives: On the one hand a bill approximately similar to the House bill in total revenue, or the House bill plus a general Federal sales tax, which alternative would you take?

Secretary MORGENTHAU. Senator Vandenberg, how are those alternatives going to be put up to me as Secretary of the Treasury and an appointed officer?

Senator VANDENBERG. You are our chief financial adviser and I would greatly welcome your opinion on that subject.

Secretary MORGENTHAU. Let me see if I understand the question, please. You have had time to think about it in the way you put it to me.

Senator LUCAS. Mr. Chairman, we cannot hear either the questions or the answers

The CHAIRMAN. Let us have order in the room.

Secretary MORGENTHAU. If I understand you correctly, what you are asking my advice about -and I take it in the middle of the war you are asking it with all sincerity- ---

Senator VANDENBERG. Certainly.

Secretary MORGENTHAU. Which would the Treasury prefer: The Ways and Means Committee bill as it is or a sales tax added to it; is that it?

Senator VANDENBERG. Yes.

Secretary MORGENTHAU. Now, before I can answer your question intelligently—and I am serious - what kind of a sales tax are you talking about?

Senator VANDENBERG. Oh, a general sales tax such as you might be willing to agree with us upon. You know what I am getting at, Mr. Secretary.

Secretary MORGENTHAU. No; I am not sure that I do.

Senator VANDENBERG. You said in your very excellent and able presentation that there must be no quibbling about the problem we confront. I am simply asking you the general question whether, if this committee finally reaches the point where it cannot find the taxes, in its own judgment, the taxes you want, except through the application of a general Federal sales tax, whether that would meet with your approval.

Secretary MORGENTHAU. I do not know what percentage sales tax you have in mind.

Senator VANDENBERG. Would that make a difference in your viewpoint?

Secretary MORGENTHAU. It would make a difference, and it also would make a difference what exemptions you have in mind.

Senator VANDENBERG. Suppose you wrote the rates and exemptions.

Secretary MORGENTHAU. I am not here suggesting a sales tax.

Senator VANDENBERG. Well, is there any answer to my question, Mr. Secretary? You have said, and the President has said, if all other recourses are gone, a general sales tax is not to be ignored. Now I want to know whether, if we reach the conclusion on this committee that all other reasonable recourses have been exhausted, you would be willing to accept a sales tax.

Secretary MORGENTHAU. I do not know that either the President or I have ever made the statement such as you are trying to put in my mouth now. I do not know of such a statement made by either the President or by me.

Senator VANDENBERG. The President has made it in his message to the Congress. I do not know whether you made it or not.

Secretary MORGENTHAU. About the sales tax being the last recourse?

Senator VANDENBERG. Yes. But regardless of that, let us not get off on a side track, let us stick to the question.

Secretary MORGENTHAU. No; but I have still got to come back, that it makes a lot of difference, the rate and the exemption.

Senator VANDENBERG. Yes; it makes a great deal of difference to me, too.

Secretary MORGENTHAU. Let me ask you a question. Are you proposing an exemption, for instance, on food?

Senator VANDENBERG. I am asking you regarding the general principle involved. We can work out the exemptions. Perhaps it ought to be a sales tax that starts at a very nominal figure and increases in luxuries and nonessentials. That is the general point I am trying to ask you about. I am asking it in all sincerity. If we reach the point where two or three billion dollars is all we can find, as apparently it was all the House could find, would you still be satisfied with our action if in raising that total we went into the field of a general sales tax?

Senator CLARK. The question of how much money you can raise on a general sales tax becomes necessary, doesn't it, Mr. Secretary?

Secretary MORGENTHAU. It does, Senator. I cannot answer it "Yes" or "No" without making a statement. If the chairman will permit me, I would like to read a statement stating the Treasury's position.

The CHAIRMAN. You may read anything you wish, Mr. Secretary.

Secretary MORGENTHAU. If I have the chairman of the committee's permission, I would like to read a statement.

The CHAIRMAN. Yes, sir, you may read it.

Secretary MORGENTHAU. The Treasury proposals do not include a general sales tax. I should like briefly to state the reasons for our decision.

The form of sales tax which would produce the most revenue and cause the least rupturing of price ceilings is the retail sales tax. The highest rate I have heard mentioned is 10 percent. That is over three times as high as the rate now in force in any State.

A 10 percent sales tax with no exemptions for necessities of life would raise at current sales levels about $6,000,000,000, or about one-tenth of this year's estimated deficit.

Such a tax would be very harsh, especially on low-income families with children. It is completely lacking in any relation to ability to pay because it hits families much harder than single individuals at the same income levels and it hits people with small incomes much harder than people with larger ones. Such a tax would be opposed to every principle of tax equity and would in my opinion interfere with the war effort.

There are many proponents of the sales tax who would agree with these criticisms and who propose to meet them by allowing exemptions of the necessities of life. Such exemptions would indeed improve the character of the tax, although they would still leave the discrimination against large families. However, the exemptions would quickly remove so much of the tax base as to leave little more than an empty shell.

The exemption of food would reduce the yield by 2.4 billion dollars; the exemption of medicine would reduce the yield another 200 million dollars; the exemption of clothing would reduce the yield by another 1.1 billion dollars. Those exemptions do not include all of the necessities of life, but let us stop at that point. A sales tax with such exemptions would yield about 2.6 billion dollars. However, of that amount, about 1.2 billion dollars would come from goods and services

already subject to Federal excise taxes. The tax yields from the sale of these commodities can be increased or decreased by adjusting the excise tax rates. No sales tax is needed to produce revenue from them. All that is left after excluding such commodities is 1.4 billion dollars. Nearly 600 million dollars of the 1.4 billion dollars would come from equipment, chemicals, and materials used in business and thus entering into the costs of doing business, with resultant increases in the costs of doing business and in prices to the Government and to the public.

Most of the remaining 800 million dollars tax would be on items that might properly be subject to sales taxation. It is hardly necessary to point out that the expenses to 2½ million businessmen and increased costs to Government, as well as the use of precious manpower, would not be justified by yields of this kind when there are other methods of raising money at hand which do not call for heavy increases in costs of administration and compliance.

It is very doubtful if a general sales tax without the exemption of necessities of life would really be helpful in financing the war or restraining inflationary price rises. The imposition of a substantial sales tax would almost surely be the signal for widespread demands for higher wages and farm prices which, if allowed, would result in large additional costs to Government and increases in the cost of living over and beyond the amount of the tax. These dangers are much greater in the sales tax than in excise taxes or income taxes. Excise taxes touch in only minor respects commodities that are necessities of life, while income taxes have personal exemptions which protect minimum living standards.

Personal exemptions could be introduced into the sales tax, but the inconvenience of distributing and using exemption coupons and the resultant reduction in revenue would be serious factors. Even the most simple sales tax would require the use of much precious manpower and machines by Government and business. It is doubtful if manpower and those machines could be secured without interfering with the war effort.

For the above reasons, my answer to Senator Vandenberg's question is "No." We would prefer not having a sales tax.

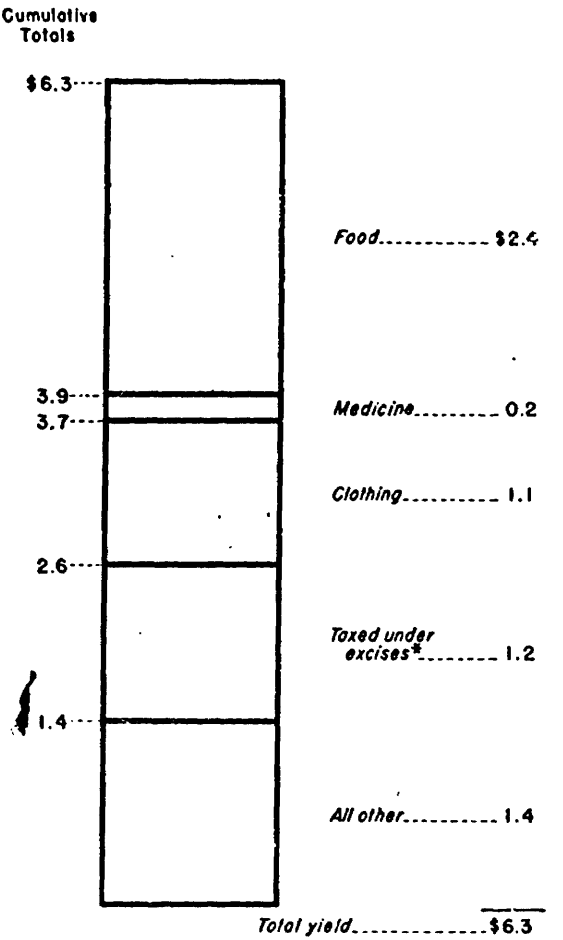
Senator BARKLEY. Do I understand the Treasury's position is, the House bill does not reach all the sources that are available to the Congress in the raising of revenue, without leaving the sales tax entirely out of consideration?

Secretary MORGENTHAU. Yes, sir.

(The following graph was submitted by Secretary Morgenthau in connection with the sales tax:)

TEN PERCENT FEDERAL RETAIL SALES TAX

(Dollar figures are in billions)



*Excludes a small amount of food and clothing now subject to excises.

Office of the Secretary of the Treasury, Division of Tax Research, Nov. 20, 1943.

Senator VANDENBERG. I think all of the arguments you present are important. They certainly have to be canvassed. I can understand in the final analysis you would prefer a bill without a sales tax, and so would I, but I was just wondering if there was not anything else whether you would prefer a bill which stopped at two or three billion dollars without a sales tax.

Secretary MORGENTHAU. I think I made my position clear. I think we understand each other.

Senator VANDENBERG. May I search now for just one figure, which I would like very much, if it is available. You have repeatedly referred to the ability of the American people to pay increased taxes. Am I correct in the recollection that from the Treasury has come some statement suggesting that four-fifths of our increased income is from incomes of $5,000 or under? Is that correct?

Secretary MORGENTHAU. May I answer that by reading?

Senator VANDENBERG. Yes. I think we ought to explain that we did not rehearse this affair.

The CHAIRMAN. All right, Mr. Secretary.

Secretary MORGENTHAU. You have been most helpful. I appreciate the assistance.

Senator VANDENBERG. You are surely a mind reader.

Secretary MORGENTHAU. With the help of Senator Vandenberg I will now proceed.

The CHAIRMAN. All right.

TAX BURDENS ON THE LOWER INCOME GROUPS

Secretary MORGENTHAU. It is contended that persons with incomes of less than $5,000 are the major source of inflationary pressure and that these persons would escape their fair share of the additional tax load under the Treasury proposals. Although at 1944 levels of income about 81 percent of the total cash income will be received by persons with incomes under $5,000, only 65 percent of the net income above income tax exemptions will be received by this group. Likewise, although 61 percent of total income will be received by persons with incomes under $3,000, only 39 percent of the net income above income tax exemptions will be received by this group.

Looking behind these aggregates to individual cases, we find that the margin of disposable income over and above wartime needs is very narrow for the millions of persons in the lower income brackets. Out of 67.3 million income recipients in the calendar year 1944, 58.2 million are expected to receive net incomes of less than $3,000. The average cash income per recipient before taxes will be $1,650 and after existing taxes, about $1,500. The demands of wartime living on incomes of this size leave little margin for additional taxes and afford few opportunities for inflationary spending.

Nevertheless, the urgent requirements of war finance demand that we tap even this small margin of disposable income. Under the Treasury proposals one-half of the income tax increases would fall on persons with net incomes of less than $5,000 and about one-fourth on persons with less than $3,000. Much the same proportions hold for the complete Treasury program, including proposed changes in corporation taxes and in excise taxes.

May I add this figure, the figure you and a number of other people were interested in, the same as I was interested in. How much

taxes do the 9,000,000 people pay under the present law. Now, that is Federal taxes, and the figure that they pay under the present law, the 9,000,000 people, all Federal taxes, is one billion——

Senator VANDENBERG. What 9,000,000 is that?

Secretary MORGENTHAU. The 9,000,000 people exempted from the Victory tax under the Treasury proposal. As the law stands today, the 9,000,000 people who would be exempted if the Victory tax was done away with under the Treasury proposal, the one you may have read about in the papers that I was criticized over, supposing the Congress had accepted or did accept the Treasury proposal, those 9,000,000 people would still bear approximately $1,150,000,000 of Federal taxes.

Senator VANDENBERG. I do not think you quite understood the purport of my question, Mr. Secretary. I am not criticizing the Treasury's position at all.

Secretary MORGENTHAU. Do I make this clear?

Senator VANDENBERG. Yes. I was interested in the basic question. Am I incorrect in remembering that either you or someone in the Treasury has said that four-fifths of the increased individual incomes in the United States are in incomes of $5,000 or under?

Secretary MORGENTHAU. Let me just ask Mr. Paul: I do not know whether I said it or somebody else. Let me ask Mr. Paul. May I?

Senator VANDENBERG. Surely.

Mr. PAUL. The Secretary made a general statement, in his statement before the Ways and Means Committee, that four-fifths of the income, national income, was received by persons receiving $5,000 and under. This statement which he has just read shows the figure is 81 percent. The Secretary has also here pointed out how much of that income is below and how much is above the exemption level.

Senator VANDENBERG. So the four-fifths would refer to the total income and not to the increased income?

Mr. PAUL. The four-fifths refers to the total personal income, but it includes the income which is under the exemption level.

Senator BARKLEY. How does that $1,100,000,000 you just mentioned there, the Federal taxes that would be paid by the identical people who would be relieved of the Victory tax, compare with the amount of Victory taxes that they pay?

Mr. PAUL. Under the present law, the Victory taxpayers as distinguished from income taxpayers pay $275,000,000. That is the 9,000,000 taxpayers who are proposed to be exempted by the Treasury proposals. Now, it is tentatively estimated that those people bear under the present law in total, all Federal taxes, $1,149,000,000. Under the Treasury proposal they would bear $1,142,000,000, while under the House bill they would bear $1,144,000,000. Such close figures may be a coincidence since no one can estimate this sort of thing to such a fine point, but the conclusion is there is no difference as to those 9,000,000 taxpayers of any appreciable amount between the present law, the Treasury proposal, and the House bill when you consider the total taxes as distinguished merely from Victory taxes.

Senator BYRD. Mr. Secretary, the proposal of the Ways and Means Committee wiped out the taxes on about 9,000,000 taxpayers.

Secretary MORGENTHAU. That is the point. The point is this: The Treasury proposals would have removed a little less than $300,-

000,000 of taxes that these 9,000,000 people were paying under the Victory tax, but under the Treasury proposal and under the House bill as it passed, these 9,000,000 people would still bear approximately $1,150,000,000 worth of Federal taxes.

The CHAIRMAN. You mean by that excise taxes?

Secretary MORGENTHAU. Yes, sir, and all other Federal taxes.

Senator BARKLEY. In other words, by a reshifting of the tax, these identical 9,000,000 people who now pay $1,149,000,000 including the Victory tax of less than $300,000,00 ——

Secretary MORGENTHAU (interposing). No. We are going on the assumption that the Victory tax has been removed.

Senator BARKLEY. I thought you said they at present pay $1,149,000,000.

Secretary MORGENTHAU. Including the Victory tax.

Senator BARKLEY. Including the Victory tax?

Secretary MORGENTHAU. Yes.

Senator BARKLEY. So when you remove the $275,000,000 Victory tax you recoup a part of it, or almost all of it, by reshifting the tax which these same people would pay, as I understand.

Secretary MORGENTHAU. Practically all of it.

Senator BYRD. You eliminate them from the payment of any income taxes?

Secretary MORGENTHAU. That is correct, but they still would pay roughly $1,150,000,000.

Senator BYRD. They would pay excise taxes on gasoline?

Secretary MORGENTHAU. And cigarettes, and so forth.

Senator BYRD. It is an actual reduction in taxes on your proposal as to the 9,000,000 people. Upon what basis do you justify that, in view of the need for revenue, as you express in your statement, and the general prosperity?

Secretary MORGENTHAU. The main reason for recommending the removal of the Victory tax, which was $275,000,000, was for simplification of the tax returns. After we had removed it and added the new taxes the Treasury proposes, there was almost no difference in what they would pay directly and indirectly to the Federal Government.

Senator CLARK. Mr. Secretary, the amount that these particular taxpayers pay in excise taxes is purely conjectural, is it not? There is no way on earth to break the figures down and find out how much particular taxpayers would pay in excise taxes.

Secretary MORGENTHAU. I asked for an estimate. This was the estimate given to me.

The CHAIRMAN. I wanted to ask you on that point, Mr. Secretary, what are the total excise taxes paid by all the American people?

Secretary MORGENTHAU. May Mr. Blough answer you?

The CHAIRMAN. Yes.

Mr. BLOUGH. Naturally any break-down of excise taxes or other kinds of taxes than the direct income tax has to be done on the best basis we can do it, with the best information at our disposal. We are not putting any money-back guaranties on this distribution. I think it is the best that can be done objectively and fairly with the information at hand.

The CHAIRMAN. I would like to know what is the total received from the 130,000,000.

Mr. BLOUGH. To answer your question on the excise taxes, at present, under present law, we have a total excise tax for everybody of $3,909,000,000.

Under the Treasury proposal that would have been $6,420,000,000.

Now, there are small amounts, around $400,000,000 of taxes, which were really paid by the Government on sales which we dropped out of the picture, leaving the taxes on sales to private individuals under present law—that is, excise taxes—of $3,471,000,000, and $6,000,000,000 under the Treasury proposal. That is the grand total which was allocated to all income groups.

The CHAIRMAN. Can you allocate the $1,150,000,000 of that to the 9,000,000 people in the lowest income bracket?

Mr. BLOUGH. We allocated $601,000,000 of that to the 9,000,000 people who would have been relieved from the Victory tax under the Treasury proposals. Now, there remains, then, a substantial amount, about a half-billion dollars more, and $361,000,000 of that is reflected in employment taxes which are paid directly and for which the estimate can be fairly accurate.

The CHAIRMAN. Yes; but they are the beneficiaries of those taxes, are they not?

Mr. BLOUGH. Well, if the $361,000,000 is to be subtracted, it will be subtracted under present law and it will be subtracted under the Treasury proposal.

The CHAIRMAN. I mean, it is not irrevocably a Treasury asset.

Mr. BLOUGH. That is quite right. So far as the present financial position of these taxpayers is concerned, it is a burden on them which they must pay now, and it does not change the comparison between the present law and the Treasury proposal.

Secretary MORGENTHAU. Could I have just 1 minute, Mr. Chairman?

The CHAIRMAN. I went to make just this observation, and I think it is worthy of consideration. If anything like a billion dollars is paid by the 9,000,000 people in the lower brackets, you are dangerously approaching a conclusion as to where an inflationary pressure on prices lies in excise taxes. In other words, if the 9,000,000 people, if the Treasury's original proposal had been followed, were relieved entirely of a Victory tax, or a substitute for the Victory tax as the House has provided in its 3 percent net income tax, why, it seems very clear that if that same 9,000,000 people are spending anything like a billion dollars in excise taxes, or plus even the special taxes which Mr. Blough now points out, that you are very close to the inescapable conclusion that there is a tremendous pressure on your prices in that group.

Senator CLARK. Mr. Chairman, might we have that table of Mr. Blough's inserted in the record? I think it would be very helpful to the committee.

The CHAIRMAN. Yes.

Senator BARKLEY. I do not know whether he read it all or not. I think he has something else there that he did not read.

The CHAIRMAN. Mr. Blough, if you did not finish the break-down of the table of excise taxes paid by the 9,000,000 taxpayers, please complete it and put it in the record.

Mr. BLOUGH. Well, to complete the whole discussion would occupy some time and it may be better to put it in the record. Any questions which may be asked, of course, I would be glad to answer.

The CHAIRMAN. You may put it in the record.
(The table referred to is as follows:)

Preliminary estimated distribution of Federal excise taxes under present law, Treasury proposal, and the House bill, by statutory net income classes at levels of income estimated for calendar year 1944

[Amount of taxes in millions of dollars]

Statutory net income per income recipient [1]	Excise taxes				
	Total under			Increase or decrease (−) over present law under	
	Present law	Treasury proposal	House bill	Treasury proposal [2]	House bill
Under $1,000	$314	$531	$405	−$219	$92
$1,000 to $3,000	1,800	3,080	2,341	1,280	541
$3,000 to $5,000	769	1,343	1,037	574	268
$5,000 to $10,000	395	601	470	205	124
$10,000 and over	240	442	360	202	120
Total for amounts allocated by net income level	3,471	6,000	4,613	2,529	1,142
Unallocated by income levels [3]	438	430	491	−18	53
Total	3,909	6,430	5,104	2,511	1,195
Memorandum: Amount allocated to individuals subject to Victory tax under present law but not subject to income tax under Treasury proposal	351	601	456	250	105

[1] The income distribution assumed in making these estimates is shown in the Ways and Means Committee hearings, Revenue Revision of 1943, p. 21, revised.

[2] The basis of the excise tax distribution in this column differs from that in the Ways and Means Committee hearings, Revenue Revision of 1943, p. 187. The previous estimate was grouped by classes of consumer income rather than by classes of statutory net income. In the present distribution an estimated allocation of the excise tax burden of each consumer unit bracket has been made to the different brackets of net income in accordance with the division of family income among different members filing income tax returns.

[3] Taxes paid out of funds derived from sales of goods to Government

Source: Treasury Department, Division of Tax Research.

The CHAIRMAN. Is there some other statement you wish to make, Mr. Secretary? Did you wish to add something?

Secretary MORGENTHAU. No.

The CHAIRMAN. Are there other questions by the committee?

Senator BYRD. Mr. Chairman, I would like to ask the Secretary if he is unalterably opposed to the sales tax, what is his plan or the Treasury's plan to produce revenue.

Secretary MORGENTHAU. Senator Byrd, we are prepared, if the committee wants to—Mr. Paul is, rather—to give several alternative plans whereby the 10.5 billion dollars can be raised through the income tax. He has a document about that thick [indicating].

The CHAIRMAN. Mr. Secretary, I do not want to raise any controversial question with you at all, but I simply want to get it clear. I think the committee is entitled to have it clear. We understand that you are not recommending, at least, any type of sales tax.

Secretary MORGENTHAU. That is clear.

The CHAIRMAN. That is correct?

Secretary MORGENTHAU. Yes, sir.

The CHAIRMAN. The committee also very well understands, I think, that your position is unchanged so far as any form of compulsory savings is concerned beyond the recommendation submitted to the Ways and Means Committee.

Secretary MORGENTHAU. That is correct.

The CHAIRMAN. I merely wanted to make that clear. I personally respect your position on both the suggestions made, but it is a matter that the committee is entitled to have made perfectly clear.

If we are to step up the taxes now by 10.5 billion dollars, in view of the rapid step-up that has occurred since 1940 in individual and corporate rates, then the committee probably would take the view that all methods of raising taxes or providing additional revenue ought to be left wide open to it, even though you do not agree with our method.

Secretary MORGENTHAU. Well, after all, I need not remind you I am an appointed officer. You people are elected. Under usage and law you ask me to come up here and make recommendations.

The CHAIRMAN. That is correct; yes.

Secretary MORGENTHAU. That is what I am here for.

The CHAIRMAN. We understand. I merely wanted to get clear on this general question of compulsory savings or post-war credit and sales tax, because those questions will be coming up all during our consideration.

Secretary MORGENTHAU. As long as we are taking the trouble to point out my responsibility, I might also add if the Congress does not choose to raise 10.5 billion dollars I do not consider that I have been turned down. After all, with all due respect, I just feel it is the people and not myself personally, that is all. I am just here giving you the best that we have in the Treasury and you can do anything you want with it. That is your privilege.

Senator BYRD. Mr. Chairman, I would like to ask the Secretary this question. The last sentence of his statement says:

> I have endeavored to show you as objectively and as clearly as I can that a tax program of not less than 10.5 billion dollars is needed to safeguard the financial and economic future of this country during the war and after the war.

That is pretty strong language. As I understand the Secretary, he thinks the objections to the sales tax are greater than the necessity of safeguarding the financial and economic future of the country, if the sales tax is determined by the committee and Congress as being the only means of raising this additional revenue.

Secretary MORGENTHAU. Senator Byrd, I may be wrong, but I am going on the assumption that by the time the Congress of the United States gets through considering the so-called 10 percent sales tax, they are not going to put a tax on food, they are not going to put a tax on medicine, they are not going to put a tax on clothing, and they are not going to double up on taxes which we already get through excise taxes, and by the time we get through, the taxes remaining are only $1,400,000,000. Now, I have asked the Bureau of Internal Revenue to give me some figures as to how much it would take to administer a Federal retail sales tax. It would take some 6,700 additional people. It would cost $18,000,000. The cost of collection would be about 0.6 percent. I simply feel by the time the Congress eliminates all these things——

Senator BYRD. Suppose Congress does not eliminate it? You spoke of the cost of collection in the lower income group. I have got a table here from the Office of Price Administration that shows that a family that has an income of from $1,500 to $2,000 pays for food and beverages $587 a year. A 10 percent tax on that would be $58. That same family pays for clothing $187 a year. A 10 percent tax on that would

be $18. Now, you would regard that family as being in the lower income bracket, would you not?

Secretary MORGENTHAU. Yes; I would.

Senator BYRD. Take a family from $1,000 to $1,500, that family pays $481 for food and beverages, with a tax of $48; clothing, $140, with a tax of $14.

A family with a $10,000 income pays $1,720 for food and beverages, with a tax of $172, and $1,033 for clothing, making at tax of $103.

In time of war do you think that is excessive as a general contribution of all the citizens of the country to the expenditure necessary to win this war?

Secretary MORGENTHAU. Senator Byrd, you cannot consider a sales tax standing on its own feet without considering what you can get in the way of revenue from an income tax or from excise taxes, and we in the Treasury simply feel that you can get the money by taxing the same people through income taxes.

Senator BYRD. I am speaking of the principle.

Secretary MORGENTHAU. Do you mind if I finish?

Senator BYRD. Yes, sir; go ahead.

Secretary MORGENTHAU. I am saying, as opposed to getting the same money through a sales tax, you can do it in a fairer way and a more economical way through the income tax and through excise taxes. I have no phobia against the sales tax. I am simply here trying to point out that you can do it in a more economical way, with less people administering it in the Federal Government, less trouble to the taxpayer. You can get the same money with less repercussions, less interference with the war effort, through the income tax than through the sales tax. After all, you have the right to disagree with me. You can throw my opinion, or the Treasury's opinion, aside. That is your privilege.

Senator BYRD. It is a matter of administration with you and not a matter of principle?

Secretary MORGENTHAU. We consider all kinds of taxes. We simply feel that to raise the money in a manner which is the fairest, with less repercussions, the most economical, is through income taxes rather than through excise taxes or the sales taxes.

Senator BYRD. Why do you single out the sales tax? That is the only tax that the Treasury, so far as I know, has indicated a strong disapproval of.

Secretary MORGENTHAU. I did not single it out. I did not mention it in my statement. It was Senator Vandenberg who asked me about it. I did not single it out. It was due to Senator Vandenberg raising the question that has highlighted the thing. It was not mentioned in my statement. I purposely left it out.

Senator VANDENBERG. Why did not you tell me that?

Secretary MORGENTHAU. Senator Vandenberg was very curious and I tried to satisfy his curiosity.

Senator BYRD. You have repeatedly opposed the sales tax in the past, of course. Understand me, I do not favor the sales tax as a peacetime measure but at the time of a desperate war with these astronomic figures, I think a general sales tax is the legitimate way to raise revenue. It will not create hardships, we could not claim they will, because you can see from the table, which has been secured from responsible authorities, that people who have an income of $1,500 to

$2,000 will not pay much more over $100, maybe $150 a year, in taxes.

Secretary MORGENTHAU. I wish Senator Vandenberg would ask me about joint returns, oil-well depletion, community property taxes, and tax-exempt State bonds, but he did not.

Senator VANDENBERG. You are not limited by my questions in any testimony that you want to give.

Secretary MORGENTHAU. There would be a lot of other ways of raising revenue. Those are some of them which we have repeatedly recommended. If anybody is looking very hard for revenue we can give you any one of those three or four methods which would very nicely raise a lot of money.

Senator BYRD. As I understand your position, you prefer not to have any increase in this present bill if it embodies any general sales tax.

Secretary MORGENTHAU. I have answered that question. Talking for the administration, we feel that the sales tax is the least desirable method of raising the money which has been suggested.

Senator BYRD. Could you give me a yes or no answer? Would you prefer to leave the bill as it is or would you prefer to have a sales tax attached to it?

Secretary MORGENTHAU. I think I answered that in my answer to Senator Vandenberg. I think it is the least desirable of all methods of raising the revenue.

Senator CLARK. It comes down to this, does it not, Mr. Secretary: If you do not exempt food, clothing, and medicine, the vital necessities of life, and in addition apply the Federal tax on top of the sales tax, you impose an intolerable burden on the taxpayers who are less able to pay, and if you did that, then the amount of money that you would get in is rather negligible?

Secretary MORGENTHAU. That is correct.

Senator BARKLEY. Perhaps this is not a proper question, but with the attitude of the Congress heretofore and at present regarding sales taxes, would you be willing to express an opinion whether it is likely the Congress would pass a sales tax that would include a tax on food, clothing, and medicine?

Secretary MORGENTHAU. I think it is very unlikely.

Senator CLARK. It has never done it since I have been on the committee.

Senator BYRD. It was only defeated by one vote in the Senate Finance Committee last year.

Mr. Chairman, I ask the privilege of putting in the record a statement showing the amount spent by the families in different income groups for food, clothing, and so forth, which shows it does not place an intolerable burden on the poor person.

The CHAIRMAN. Very well.

(The table referred to will appear in the revised edition.)

Senator WALSH. Mr. Secretary, the war has brought about a tremendous increase in the income of the country and in the income of many individual income taxpayers. There are many taxpayers in the country who have not benefited by the war, those who have fixed incomes, those who are living on pensions, annuities, the so-called white-collar class, but there are many, many people who have had greatly increased incomes as the result of the war. Now, the taxes levied today are proportioned alike on these two groups. Has the

Treasury any proposal in the nature of excess profit on individuals, to reach and to tax the large increased income that has come to large numbers of people as a result of the war?

Secretary MORGENTHAU. Senator Walsh, naturally we studied that, and I am sure Mr. Paul would be very glad to speak to that point, if you want him to.

Senator WALSH. Do you have a proposal along that line, Mr. Paul?

Mr. PAUL. We have no proposal. On the contrary, that proposal was discussed at great length in the Ways and Means Committee. A Treasury memorandum is in the record. We opposed that form of tax for the reasons there stated, and I would be very glad now, if you please, to repeat those reasons, or to summarize them.

Senator WALSH. If they are in the record I can read them.

Mr. PAUL. They appear at page 67 of the preliminary print of the hearings before the House Ways and Means Committee.

Senator WALSH. So the Treasury does not approve of any effort being made to search out and find a way of levying higher taxes upon that group whose income has been materially increased as a result of the war as against the group whose income has not increased since the war?

Mr. PAUL. I would certainly not say we have not approved of such an effort, Senator Walsh. We tried very hard to get at that source of revenue but we found no way that comports with fairness and administrative feasibility, and we have, therefore, had to disregard it as a possible source of revenue.

Senator WALSH. The result is we go before the country and say to all taxpayers, those who receive no increase, no benefit as the result of the war, "You are going to be taxed on the same basis, on the same level, as those who had great additions to their income as the result of the war."

Mr. PAUL. On the contrary, before the Ways and Means Committee we proposed certain measures of relief for the people whose incomes had not increased or whose incomes had fallen. We proposed, through the door of relief to stationary incomes, to tax at a greater rate immediately the incomes which had risen, but we did oppose a tax directly measured by increases in income.

Senator CLARK. Is not that the crux, Mr. Paul, of all this talk about the necessity of higher taxation as distinguished from the purpose of raising revenue, the purpose of absorbing the increase in national income? In other words, when you begin to talk about the inflationary features of the thing, it is the people who have lots of money or more money than they ever thought of before that create the greater danger of inflation, not people whose incomes have remained stationary or diminished, either by increased taxes or increased cost of living. It seems to me that is the crux of the argument about inflation.

Mr. PAUL. It seems to me there is inflationary pressure from people whose income has increased, but one has to consider a proposal of this kind from the money angle, from the angle whether you can propose such a tax from the angle of administrative feasibility, from the angle of war production. As we pointed out in the Ways and Means Committee hearing, that latter consideration is one of the most important considerations against such a tax, the discouragement it would be to the overtime workers, the discouragement it would be with respect to women in industry. We therefore thought such a tax would injure

the war effort. We thought it would be completely unfeasible from the administrative standpoint. We thought there were many aspects of the tax that would be unfair from the point of distributing the tax burden.

Senator BARKLEY. Under the constitutional provision, all taxes should be uniform throughout the United States. If you look into the question whether we can levy a different rate of taxation upon a man who is making $2,000 a year and only made $1,000 before the war, and another man who is making $2,000 and who has been making it all the time, can you search out the man who has had his income increased and put a different rate upon him because of the increase?

Mr. PAUL. I am in some doubt, from the constitutional standpoint, as to whether you can impose one tax upon one man who is making, say, $3,000 a year, and a different tax on another man who is making the same amount of money. But even regardless of constitutional grounds, I do not know how you are going to explain to a man who is making $2,000 a year why you are going to tax him more than another man who is making the same amount. I do not know how you are going to explain that satisfactorily, apart from the constitutional question.

Senator BARKLEY. Mr. Secretary, let me ask you this question. You have emphasized, and everybody emphasizes, the two principal reasons in regard to the tax bill that you recommended: One is the necessity for revenue and the other is the necessity of curbing inflation, that there was no inflationary element in it at all, there was no danger from inflation. Would you still think that $10,500,000,000 ought to be raised for the purpose of the Treasury?

Secretary MORGENTHAU. Yes.

Senator BARKLEY. In the course of this war it is necessary?

Secretary MORGENTHAU. Yes.

Senator BARKLEY. It would be difficult to allocate what part of it would be attributed to tax needs and what part to the desire to curb inflation. If it is all needed, the inflationary element is rather incidental, is it not, important as it is?

Secretary MORGENTHAU. I would not say it is incidental, Senator Barkley. Both elements are in there.

Senator BARKLEY. Yes.

Secretary MORGENTHAU. We have studied this thing very carefully and we do so continuously. We feel with income payments to individuals running at the rate it is, over $142,000,000,000 or $143,000,000,000 for this year, the country can pay an additional $10,500,000,000 worth of taxes. It would be both helpful from the standpoint of keeping the national debt down and it also would be helpful on its impact on spending.

Senator VANDENBERG. That would be a good argument if they could also pay their grocery bills without a subsidy, would it not?

Senator BARKLEY. I make a point of order. This committee is not considering the subsidy bill.

Senator VANDENBERG. The point of order is sustained, because there is not any answer to it.

Senator LODGE. Mr. Chairman, I would like to ask the Secretary one or two questions. I was detained in getting here so it may be that you have covered this already, but do I understand your sole reason for favoring the repeal of the V[illegible]ory tax is in order to simplify procedure?

Secretary MORGENTHAU. Yes, sir.

Senator LODGE. When you referred to this sales tax minus taxation on food, clothes, and medicine, you gave the argument that the cost of collection would be 0.6.

Secretary MORGENTHAU. Let me just take that back. It is 0.3 percent if you raised $6,300,000,000. It would cost a little over $18,000,000 to administer the $6,300,000,000. Now, as the amount you collected went down, the percentage would naturally rise.

Senator LODGE. The tax less food, clothes, and medicine would yield about $2,000,000,000, is not that right?

The CHAIRMAN. Senator Lodge, here is the chart.

Senator LODGE. I am quite sure the Secretary said there would be an administrative cost of 0.6.

Secretary MORGENTHAU. I did say that.

Senator LODGE. What I am getting at is this: Stated in the same terms, what is the cost of collecting the Victory tax?

Secretary MORGENTHAU. The figures that I have given, $18,000,000 on a little over $6,000,000,000 worth of taxes, that would be 0.3 percent. But then, as your amount went down, the $18,000,000 would still stay the same.

Senator LODGE. That is right. I understand that.

Secretary MORGENTHAU. I will give you the other figure.

Senator LODGE. What I am trying to get at is, what is a proper administrative cost? The 0.6 you inferred was too high.

Secretary MORGENTHAU. Yes.

Senator LODGE. What is about right? Four? Three?

Secretary MORGENTHAU. Well, 0.3 is correct; $18,000,000 on $6,000,000,000 comes out 0.3 percent.

Senator LODGE. That is not an unreasonable percentage?

Secretary MORGENTHAU. Well, I think I will put it a little bit differently, if you do not mind. It is adding 6,000 additional people to the Federal pay roll, when we have already got the excise tax and the income tax, and with that machinery we could collect any reasonable amount of increase that the Congress would place on excise and income taxes at little additional cost but if you throw in something entirely new, we have to set up a new bureau and so forth and so on.

Senator LODGE. Roughly, can you furnish for me about what the cost is on collecting other types of taxation?

Secretary MORGENTHAU. I will be glad to furnish it for you. I cannot do it at this minute.

Senator LODGE. Stated in the same terms, so there would be a basis of comparison of what it would cost to collect the different taxes.

(The information requested is as follows:)

Cost of collecting the internal revenue for the fiscal year 1943 [1]

Collections	[2] $22, 227, 341, 483. 00
Administrative costs	98, 568, 512. 00
Cost of collecting $100	. 44

[1] Not including amounts of taxes refunded or the cost of collections made by the Post Office Department.

[2] Excluding $114,043,015 collected by post offices.

Source: Bureau of Internal Revenue, Dec. 1, 1943.

Senator LODGE. I would like also to have a statement furnished as to what the cost is of collecting the Victory taxes.

Secretary MORGENTHAU. We will be glad to do it if we can.

Senator LODGE. There isn't anybody who knows how much it would cost to collect the Victory tax?

Secretary MORGENTHAU. Do you know?

Senator LODGE. Is it 6 percent?

Mr. PAUL. I do not think you can get that figure, Senator Lodge, because the Victory tax is administered along with the income tax. I will try to get it for you, but I think it would be impossible to segregate the cost of collecting the Victory tax from the other taxes.

The CHAIRMAN. You have never collected any of it anyway, except that part of it that has been withheld.

Mr. PAUL. That is right.

Senator LODGE. Your objection to the Victory tax is not that it costs too much to collect but it is a complication?

Mr. PAUL. I was going to point out in my statement that the objection at this time is the undue complexity which it introduces in our system. There are objections on equitable grounds, but that hasn't anything to do with it.

Senator LODGE. That complexity does not reflect itself in the cost of collection but the time that it requires the personnel to work on it?

Mr. PAUL. As I was going to point out in my statement, the complexity goes not only to our burden in the Treasury or the Internal Revenue Department, but the burden on the employers throughout the country and the burden on taxpayers, and the danger such burden adds to the whole income-tax system.

Senator LODGE. That is all.

Senator BARKLEY. Mr. Secretary, just as a layman it strikes me that $18,000,000 expended to collect $6,000,000,000 is not an exorbitant amount. I am not throwing that out as an argument for the sales tax because I am in sympathy with your view about that, but I am not scared about that $18,000,000.

Secretary MORGENTHAU. I am giving here the facts as they are. Another 6,700 employees, another $18,000,000 added to the Bureau of Internal Revenue's budget, would create just that much greater burden.

Senator BARKLEY. Do you think there would be any difficulty in obtaining the 6,700 people?

Secretary MORGENTHAU. Yes; I do. Even if we could get them, what would be more difficult is the office machinery, which is next to impossible.

Senator BARKLEY. Probably it would be more difficult to get rid of them after you had once gotten them than it would be to get them.

Senator WALSH. Mr. Secretary, could you or Mr. Paul give the committee the alternate proposals to increase the income taxes?

Secretary MORGENTHAU. Mr. Paul will do that.

The CHAIRMAN. As soon as the committee is through with questions, Mr. Paul will follow the Secretary.

Senator LUCAS. Mr. Chairman, I would like to ask one question or two.

The CHAIRMAN. Yes, Senator Lucas.

Senator LUCAS. As I understand it, the House considered the sales tax, in the Ways and Means Committee, before they reported this bill.

Secretary MORGENTHAU. Yes; they voted it down.

Senator LUCAS. In connection with the hearings held, is there a break-down in the testimony showing the various States that have a sales tax, the rates and the commodities?

Secretary MORGENTHAU. Oh, yes. We will be glad to furnish that.

The CHAIRMAN. That is in the House hearings, Senator Lucas.

Senator LUCAS. I presumed it was.

Secretary MORGENTHAU. It was furnished to the House.

Senator LUCAS. One further question. How much money must the Treasury borrow during the fiscal year, in line with the Budget estimate?

Secretary MORGENTHAU. We have got to borrow between 30 and 35 billion dollars additional for the rest of the fiscal year.

Senator LUCAS. How do you propose to raise that?

Secretary MORGENTHAU. Well, we are going to raise the maximum amount outside of the banks. We are now preparing for a Fourth War Loan starting the middle of January, where we proposed to raise $14 billion of it, and we will have a Fifth War Loan sometime along in May where we will raise likely about the same.

Senator LUCAS. How long can we continue to sell these bonds, Mr. Secretary?

Secretary MORGENTHAU. Well, that is a very difficult question to answer.

Senator LUCAS. The raising of $10.5 billion if we could do that, would aid materially, would it not?

Secretary MORGENTHAU. It would be very helpful, because we and the President feel—I know I am repeating myself—that the country can pay another 10.5 billion dollars worth of taxes, and that will have not only a very sobering effect but it will reduce the necessity of borrowing by that amount, which we believe will have a helpful effect on the inflationary problem.

There is also the question of the cost of living. I do not believe that 10.5 billion dollars is the only answer, but it would help the war on the home front in the cost of living problem. I do not want to leave the impression that I feel I cannot raise the money necessary to finance the war if the situation stays approximately as it is.

Senator JOHNSON. Mr. Secretary, is it not true that each bond drive has been more successful than the previous bond drive?

Secretary MORGENTHAU. Very much so. In each succeeding one we got additional money from the public and less from the banks.

Senator JOHNSON. Is there any reason to believe that that trend will not continue?

Secretary MORGENTHAU. I think it will.

Senator CLARK. Mr. Secretary, how did you fix on the figure of 10.5 billion dollars? At the last war we had the general theory of raising one-third of the expenses out of taxation. Before the war started, you started with the theory of raising two-thirds from taxation

Secretary MORGENTHAU. That is right.

Senator CLARK. This 10.5 billion dollars, added to what we have got now, what we raised this year, does not bear any particular relationship to any particular formula or any particular figure, even based on the amount of national income or the amount of expenditures or the amount of the debt, or anything else. It just seems somebody down at the Treasury Department arrived at that figure, that it would be a fine figure to have. It is just like the fellow who told me

one time that he would like to have $7,000,000. I asked him why he picked out the figure of $7,000,000, and he said, "$7,000,000 is a nice sum to have." How did you arrive at the figure of 10.5 billion instead of 10 billion or 11 billion dollars?

Secretary MORGENTHAU. If we had been like the fellow in your story, if we wanted a nice figure, we would be up here asking for 21 billion dollars instead of 10.5 billion dollars, because that would be a nice figure to have. We arranged during the summer, after the Congress passed the last bill, a number of schedules on corporation and individual income taxes and excise taxes, and we made very careful studies. We made very careful studies in regard to the war production, we consulted the War Department, we consulted the Navy, we consulted Mr. Nelson's organization, and we had these various schedules, some very much higher. After consulting with the other departments we came to the conclusion that this figure of 10.5 billion dollars, based on income-tax schedules, was an amount that we could recommend to the Congress as being, in our opinion, the amount which would be fair and just. Now, we have other schedules which are very much higher, but we feel, and the other departments we consulted felt, that they were excessive. We did not feel that this schedule was excessive.

Senator CLARK. This figure, then, represents what you think is best and fair?

Secretary MORGENTHAU. Exactly. It was not arrived at lightly, it was after months and months of study and consultation.

Senator BYRD. The present income is about 40 percent of the total expenses?

Secretary MORGENTHAU. The total revenue.

Senator BYRD. The total revenue is about 40 percent?

Secretary MORGENTHAU. Better than that.

Senator BYRD. This $10,000,000,000 will make it around 50 percent?

Secretary MORGENTHAU. Yes, sir.

Senator BARKLEY. Mr. Secretary, last week, a week or so ago, the newspapers carried a story that the War Department was going to turn back $13,000,000,000 of unexpended appropriation, and probably the Navy Department would turn back 5 or 6 billion dollars. That was looked upon as a very roseate picture, that would obviate the necessity of raising any more taxes. I see here you have really, I suppose, given us the low-down on that, that there will be an unexpended $7,000,000,000 instead of $13,000,000, which includes the total of all Government agencies, not centered in one department.

Secretary MORGENTHAU. That is right.

Senator BARKELEY. The amount of the public debt on July 1 will be $7,000,000,000 less than you calculated a year ago it would be. Does that in any way alter your viewpoint that the $10.5 billion is necessary?

Secretary MORGENTHAU. Could I just digress 1 minute before I answer your question?

Senator BARKLEY. Yes.

Secretary MORGENTHAU. I do not want to leave the impression that I have any inside information. The Bureau of the Budget released the statement to the newspapers, which was in yesterday's newspapers. My statement was prepared after I got the figures

from the Bureau of the Budget, and the Bureau of the Budget's responsibilities are to furnish those figures.

Senator BARKLEY. I understand that. I think it is unfortunate that the earlier story got out, that there was 18 or 19 billion dollars turned back into the Treasury of unexpended money. Of course they did not mean that at all, but everybody that read the story thought that was what it meant.

Secretary MORGENTHAU. I agree with you it is most unfortunate because it gave an entirely false impression to the country. The statement which the Bureau of the Budget got out in Sunday's papers corrected that. I mean, they went into it at great length.

Now to answer your question, after getting the latest figures and seeing that the deficit for the country for this fiscal year would be reduced by $11,000,000,000, we still felt that that in no way affected the amount that the country could stand in additional taxes. That is why I appeared here this morning asking for an additional $10.5 billion.

Senator BARKLEY. With that curtailment of $7 billion the estimated expenditures for this fiscal year still remain at $98,000,000,000. With the present law raising about $41 billion, it still leaves about $57 billion, $56,000,000,000 or $57,000,000,000, or whatever it is, expenditures over and above revenue.

Secretary MORGENTHAU. That is right.

Senator CLARK. Here is the statement of the Budget Director. I am reading from yesterday's Times-Herald:

> Budget Director Harold E. Smith predicted 1944 war spending would be $8,000,000,000 shorter than the previous list made at $100 billion, and Government receipts would be $3,000,000,000 more than the $18,000,000,000 formerly anticipated.

That does change the income to the extent of $11,000,000,000, does it not?

Secretary MORGENTHAU. The Budget figures, as I read them in my statement, show that the actual deficit for the fiscal year ending June 30, 1944, will be $11,000,000,000 less than the previous estimate. I mean, as far as the amount of taxes that this country can pay, that does not affect it at all.

Senator CLARK. It does not affect it at all, I grant you, but it does change the picture to the extent of $11,000,000,000.

Secretary MORGENTHAU. That is right, but the $57,000,000,000, is still a big deficit in anybody's money.

Senator CLARK. Considerably less than $68,000,000,000

The CHAIRMAN. If there are no other questions from the Secretary, Mr. Secretary, we thank you.

We will hear from Mr. Bell. Thank you very much for your appearance.

Secretary MORGENTHAU. Thank you.

STATEMENT OF DANIEL W. BELL, THE UNDER SECRETARY OF THE TREASURY

The CHAIRMAN. Mr. Paul, before you start, I asked Mr. Bell if he would be kind enough to indicate the net amount going into the Treasury under the present renegotiation provisions in the House

bill. I would like to have that in the record, assuming that the House bill becomes the law on the point.

Mr. BELL. Would you like for me to give that now, or just insert it in the record?

The CHAIRMAN. I would like for you to give it to the committee, if it is brief, before Mr. Paul commences.

Mr. BELL. According to the estimate we have just received, on the renegotiated contracts that are now pretty well settled, we will get back about $4.5 billion. $2.5 billion of that amount will be applied against contract adjustments. In other words, that money will not come into the Treasury, but it will reduce the amount of the contracts. $1,949,000,000 will be returned to the Treasury in the form of cash. We have already received about $1,279,000,000 of that, leaving about $670,000,000 yet to come. These estimates cover only renegotiations up to date and do not take into account any recoveries under the House bill.

The CHAIRMAN. During the fiscal year?

Mr. BELL. It may not all come in during the fiscal year, but the chances are that most of it will.

Senator BARKLEY. Does that take into consideration the quarter of a billion dollars revenue?

Mr. BELL. It is in the present revenue estimates.

The CHAIRMAN. To the extent that it has actually been returned, has that all been taken into consideration?

Mr. BELL. The estimate for this year has taken these receipts into consideration. That represents more than two-thirds of the estimated miscellaneous receipts.

Senator BARKLEY. A lot of that has been paid or will be paid in taxes?

Mr. BELL. Yes, some of it would have been paid as taxes, excess profit taxes, but how much I cannot tell you.

Senator BARKLEY. You would not know how to calculate the net amount after deducting the amount paid in excess profit taxes that have been paid?

Mr. BELL. Mr. Paul says he will try to furnish that for the record. I haven't got it.

The CHAIRMAN. You may put that statement in the record if you wish.

(The statement referred to is as follows:)

The question has been asked as to how much of the amounts recovered as miscellaneous revenues and receipts because of renegotiation of contracts would have been paid in taxes if there had been no renegotiation law.

While there may be some exceptions in certain cases where the corporations have large excess-profits-tax credits and have converted largely to war production, in which cases at least a portion of the excessive profits would be subjected to the normal and surtax rates, most of the profits determined by price adjustment boards to be excessive are also profits which would have been subjected to the excess profits tax rates.

In the short run, therefore, the Federal Government would have in most cases collected the excess profits taxes on the excessive profits at the prevailing rate of excess profits taxes applicable in the case of the particular corporation. Under the Revenue Act of 1942, for instance, the rate for most corporations would have been 90 percent gross and 81 percent net (after allowing for post-war credit) of the amount of excessive profits. Under the proposed law, as it passed the House of Representatives, the respective rates are 95 and 85.5 percent. In the case of those corporations where the 80 percent ceiling applies, the corresponding rates would have been 80 percent gross and 72 percent net. In the case of the deter-

mination of excessive profits which were subjected to the Revenue Act of 1941, the rates would have been lower, and there was no post-war credit.

In the long run, all or any part of these short-run Government recoveries which would have been paid in excess profits taxes if there were no renegotiation of contracts might have been recouped by the corporations by taking advantage of the provisions of the law which would permit the corporation to reopen its tax return and to recompute its liability. One provision affords the privilege of amortizing more rapidly than at the 20 percent per year rate, facilities for which a certificate of emergency had been issued, providing that the emergency period ended less than 5 years after rapid amortization of the particular property began, or providing that the facility ceased to be necessary in accordance with the law. Other provisions permit the carry-back of net operating losses for 2 years and the carry-back for 2 years of any unused excess profits tax credit. Another provision is section 722 of the Internal Revenue Code which provides relief for the taxpayer when it is shown that the excess profits tax is excessive and discriminatory, by permitting reconstruction of the base period earnings. In an extreme case the constructive base period net income approved under section 722 might wipe out adjusted excess profits net income in the year for which excessive profits had been determined, and in such a case, the corporation could, if there had been no renegotiation of contracts, have recovered the excess-profits taxes paid.

To sum up, therefore, it is possible that in the long run, the Government might not have received any money in the form of taxes from the amounts which the price adjustment boards have determined to be excessive. At the maximum they would have received in the long run the net excess profits taxes at the rate which under present law is 81 percent and under H. R. 3687, as passed by the House of Representatives, is 85.5 percent.

Of the $1,825,000,000 estimated for miscellaneous revenues and receipts for the fiscal year 1944, $1,500,000,000 are estimated to originate as a result of the renegotiation of contracts. Of this amount it is estimated that the Government would have collected as taxes $1,231,400,000 if there had been no renegotiation of contracts. Of the $1,231,400,000 $97,400,000 is estimated to represent the amount of the post-war credit not taken currently which would have been repaid to corporations after the war.

Of course, if there had been no renegotiation of contracts, corporations would still have had a claim against these taxes which would have been paid, because of the following provisions in the law: Rapid amortization of emergency facilities, net operating loss carry-back, carry-back of unused excess-profits credit and relief provided under section 722 of the Internal Revenue Code.

Source: Treasury Department, Division of Research and Statistics, November 29, 1943

STATEMENT OF RANDOLPH PAUL, GENERAL COUNSEL OF THE TREASURY

The CHAIRMAN. Mr. Paul, we may not be able to run longer than 12 o'clock.

Mr. PAUL. My statement may now be shortened because of some of the points covered by the Secretary.

A. INTRODUCTION

The purpose of my statement today is, first, to explain in detail the specific recommendations of the Treasury and to compare them with the provisions of H. R. 3687, the House bill; second, to indicate some of the technical considerations underlying the Treasury proposals; and, third, to examine with you some of the principal criticisms which have been made of the administration's proposals for $10.5 billion of additional taxes.

B. REVENUE COMPARISON OF THE TREASURY PROPOSALS AND THE HOUSE BILL (H. R. 3687)

In his statement to the Ways and Means Committee on October 4, 1943, the Secretary recommended wartime tax increases totaling $10.58 billion for a full year of operation. (See exhibit 1.) The bill now

before you would raise $2.05 billion. These totals are made up as follows:

[In millions of dollars]

	Increases run for—	
	Treasury proposals[1]	House bill[2]
Individual income taxes	6,528.5	225.0
Corporate taxes	1,138.1	937.9
Estate and gift taxes	401.6	
Excise taxes	2,511.1	1,191.8
Miscellaneous receipts		158.8
	10,579.3	[3] 2,017.5

[1] For a detailed comparison of estimated liabilities under the present law and the Treasury proposals, see exhibit 2, pp. 72-74.
[2] For a detailed comparison of estimated liabilities under the present law and the House bill, see pp. 10-83.
[3] This estimate is in contrast with the Ways and Means Committee's estimate of a yield of $2,159,000,000.

There is attached hereto as appendix A a statement comparing the proposals made by the Treasury to the Ways and Means Committee with the provisions of the House bill.

C. THE INDIVIDUAL INCOME TAX

The major objectives of the Treasury individual income-tax proposal are (1) to simplify the income tax by absorbing the Victory tax into the regular income-tax structure, and (2) to add $6.5 billion to tax revenues. The major objective of the income-tax provisions in the House bill is to replace the Victory tax with a minimum tax and adjustments in the regular income tax.

1. SIMPLIFICATION THROUGH VICTORY TAX INTEGRATION

The chairman of this committee and many others have expressed concern over the complexities of our tax laws and an urgent desire to simplify our tax structure. The Treasury shares the view that simplification is a first order of business, and on several occasions has made specific suggestions to this end. Especially in the case of the individual income tax, which directly affects more than 50,000,000 taxpayers, simplification has become crucially important. No really effective simplification is possible without eliminating the Victory tax. Both the Treasury proposal and the House bill recognize this fact by replacing the Victory tax with adjustments in the regular income tax.[1]

(*a*) *Comparison of Treasury and House bill methods of integration.*—The method suggested by the Treasury to absorb the Victory tax into the regular income tax structure would (*a*) repeal the Victory tax; (*b*) eliminate the earned income credit; (*c*) reduce the personal exemption for a married person or head of family from $1,200 to $1,100, and the dependent credit from $350 to $300, leaving the single person's exemption unchanged; and (*d*) increase surtax rates by 3 percentage points on surtax net income up to $38,000, and by 4 to 7 points above that level.

The House bill (*a*) repeals the Victory tax; (*b*) eliminates the earned income credit; (*c*) imposes a minimum tax of 3 percent on the excess of net income over special personal exemptions ($500 for a single

[1] One proposal for simplification recommended by the Treasury has already been applied to 1941 tax returns filed next March. In Public Law 151, the Congress changed the Victory tax rate from a gross to a net basis by providing for automatic current allowance of the post-war credit. This change eliminates a complicated step in computing the Victory tax.

individual or a married person filing a separate return, and $700 for a married couple filing a joint return, plus $100 for each dependent);[2] (*d*) sets the personal exemption under the regular income tax at $500 for each married person filing a separate return; (*e*) increases the normal tax rate from 6 percent to 10 percent; and (*f*) decreases surtax rates by 1 percentage point on surtax net income between $6,000 and $12,000 and increases them by 1 to 3 percentage points on surtax net income above $38,000. The combined normal tax and surtax increase would be 4 percentage points on net taxable income up to $6,000; 3 points between $6,000 and $12,000; 4 points between $12,000 and $38,000; and 5 to 7 points above that level.

Comparing the Treasury proposal with the House bill, we find that they differ sharply in the technique of integration. The principal difference is this: The House bill substitutes for the Victory tax a 3-percent minimum tax with new exemptions; the Treasury proposal employs no minimum tax but would reduce the credit for dependents by $50 and the exemption for a married couple by $100. Comparative burdens under the House bill and the Treasury integration proposal are shown in exhibit 4.[3]

(*b*) *Analysis of the integration plan in H. R. 3687.* In the process of absorbing the Victory tax into the regular income tax structure, both the House bill and the Treasury proposal eliminate the earned-income credit and thereby simplify tax computation. But the real promise of simplification this year lies in substituting a single income base for a double base, a single set of exemptions for a double set, and a single tax computation for a double one. The Treasury integration proposal would realize this promise in full. The House bill realizes the same promise only in a minor degree, and at the same time adds some complexities found neither in the present law nor in the Treasury proposal.

The House bill eliminates the gross base of the Victory tax and substitutes a single for a double tax computation on the simplified form (Form 1040A). Both the regular income tax and the minimum tax are computed on the basis of income tax net income. Moreover, a table indicating the regular tax and minimum tax is provided for users of the simplified form. This is all to the good, but it is only a small part of the simplification that is needed.

The House bill does not eliminate the dual set of personal exemptions and will still require users of the long form (Form 1040) to determine which of two taxes applies to their incomes. In addition, it will confuse taxpayers with its complicated minimum tax. It will make it disadvantageous for many taxpayers now using the simplified form to use that form in the future. It will require millions of married couples to go through a series of alternative tax computations to ascertain their lowest possible liability.

(1) Confusion caused by minimum tax: The House bill provides that taxpayers shall pay either the minimum tax or the regular tax, whichever is larger. Two alternative taxes with different rates and

[2] The taxpayer pays either this minimum tax or the tax computed at the regular rates and exemptions, whichever is higher.

[3] A comparison of surtax and normal tax rates under the House and Treasury proposals will be found in exhibit 3 appended to this statement. The combined normal tax and surtax under the House bill is 1 percentage point higher than the combined taxes under the Treasury integration proposal in the ranges from zero to $6,000, and $12,000 to $70,000. In the ranges between $6,000 and $12,000, and above $70,000, the two plans apply the same combined tax rates.

exemptions will confront taxpayers using the long form. A table can be appended to that form showing the net income "breaking points" above which the regular tax applies and below which the minimum tax applies. But this mechanical guide cannot remove the confusion inherent in having two alternative taxes side by side.

The confusion caused by the House bill may perhaps best be visualized by a specific example. Take the case of a married couple with two dependents, the husband having $900 of net income from business and the wife $700. Their minimum combined liability under the House bill will be realized by filing separate returns, each claiming one dependent. The husband will be subject to the regular tax, the wife, to the minimum tax. The husband will get a $350 credit for the one dependent and will apply a 23-percent rate to his income. The wife will get a $100 credit for the other dependent and will apply a 3-percent rate to her income. The confusion in this family is apparent.

(2) The necessity of comparing taxes under separate and joint returns: Under the House bill the problem of choosing between joint and separate returns is not only greatly complicated, but is forced upon millions of taxpayers not now affected by it because of the difference in aggregate exemptions depending upon whether separate or joint returns are filed. Under present law the problem is restricted to the comparatively few married couples having combined net incomes reaching beyond the first surtax bracket. The choice is fairly clear. It involves persons who are for the most part familiar with tax procedure. To married couples with combined surtax net incomes below $2,000, it is generally a matter of indifference whether they file separate or joint returns.

However, under the House bill it is no longer a matter of indifference. Married taxpayers in even the lowest income brackets, many of them newcomers to the income tax, will be driven to compare the tax advantages of joint and separate returns. They will find that the advantage shifts with the size of income, with the particular division of income between husband and wife, and with the number and division of dependents. Because of these variables, no clear dividing lines or income zones can be established to guide taxpayers into one type of return or the other. In order to determine their lowest tax liability, they will have to resort to a method of trial and error involving numerous alternative computations.

Merely stating the provisions of the House bill on this point demonstrates how bewildered the taxpayer will be. Under the minimum tax husband and wife receive an exemption of $500 each, or a total of $1,000, if they file separate returns, but only one $700 exemption if they file a joint return. Under the regular income tax, their exemption is still $500 each, or a total of $1,000, on separate returns, but is $1,200 on a joint return.[4] In other words, the minimum tax exemption will be smaller under a joint return than under separate returns, thus offering an inducement to file separate returns. The regular tax exemption, on the other hand, will be greater under a joint return than under separate returns, thus offering an inducement to file joint returns. By setting the credit for dependents at $100 for the minimum tax in contrast with $350 for the regular tax,

[4] None of the $500 exemption allowed on a separate return may be shifted from one spouse to the other under either the minimum or the regular tax.

the House bill further complicates the choice between joint and separate returns.

The large number of variables injected by the House bill will force husband and wife who both receive income to compute a series of alternative taxes to ascertain their lowest possible liability. I should like to cite an example which brings home more forcibly than any lengthy explanation the nature of the compliance burden imposed on these taxpayers. The example is that of a married couple with 3 children and a net income of $2,125, of which the husband receives $1,250 and the wife, $875. Using Form 1040, this couple could reach five different tax results. This would involve nine separate tax computations. These computations are necessary to determine the maximum tax advantage under (1) joint or separate returns and (2) different divisions of the dependents between husband and wife. (See illustration in appendix B.) To be absolutely certain that they have arrived at their lowest possible tax, this couple would also have to make nine tax determinations on the short form (1040A). The actual case in which 18 tax computations would be made to ascertain the lowest tax would be rare. But the mere fact that such cases can occur and that a problem similar in kind, if not in degree, will be faced by many taxpayers is a serious indictment of this phase of the House bill.

Senator CLARK. How does that compare with existing law, Mr. Paul?

Mr. PAUL. It is much more complicated.

Senator CLARK. Would you prefer to finish the statement?

Mr. PAUL. Yes. I will come to that.

With such extreme complexity established beyond any doubt, the question might still arise (*a*) whether the number of necessary tax computations is much larger than under present law, (*b*) whether the tax differentials involved are substantial, and (*c*) whether many taxpayers will be affected.

(*a*) There is no incentive under present law for married persons with small incomes to file separate returns, and the problem of allocating dependents is thereby avoided.

(*b*) The illustration in appendix B shows that the tax differentials under the various procedures for computing the tax can be very substantial. On the modest income of $2,125 in the example cited, the tax liability computed on Form 1040 ranges from $24.75 under the most advantageous method to $174.75 under the least advantageous method of filing.

(*c*) Estimates indicate that the House bill will confront well over 10 million married couples with the choice between joint and separate returns. Under that bill it is estimated that 10.7 million joint returns will be filed for 1944.[5]

In addition, a number of separate returns will also be filed by married couples where both receive income. The great majority of millions of married couples will decide to file either joint or separate returns only after making difficult, time-consuming comparisons.

(3) Decreased use of the simplified return: Another undesirable byproduct of the House bill is that it would in effect deny the use of the simplified form (1040A) to many taxpayers now able to use that form. Husband and wife may use Form 1040A as a separate return as long as both use it and neither has more than $3,000 of gross income.

[5] Under present law, 8.2 million joint returns are expected, while under the Treasury integration proposal, the figure would be 6.7 million.

The House bill, by providing married couples with a $1,200 exemption if they file joint returns but a combined exemption of only $1,000 if they file separate returns, places a premium on joint returns. As a result, many married persons with combined gross incomes between $3,000 and $6,000, who now file separate returns on Form 1040A, will be penalized by a $200 reduction in exemption if they continue to use Form 1040A. Plainly, they will turn to the more complicated Form 1040. Since it is desirable to extend rather than restrict the use of the simplified form, this effect of the House bill is unfortunate.

(4) Complication of the withholding process: In addition to complicating tax returns and the filing process, H. R. 3687 complicates collection at the source and raises new problems for employers. Many employers withhold on the exact basis instead of by wage brackets, either to approximate the final liability more closely or because their mechanical equipment requires the use of the exact computation. Since the Victory tax exemption is $624 regardless of family status, present law requires the employer to apply only one set of exemptions varying with family status. But under the House bill the minimum tax will also have variable exemptions. Employers will thus be confronted with two sets of varying exemptions, as well as two tax rates, in determining how much to withhold.

Senator CLARK. Mr. Paul, that makes necessary a change in the method of computation at the time of a very busy season of the year both for the Bureau of Internal Revenue and for the employers, does it not?

Mr. PAUL. That is right.

The problem of year-end refunds and additional tax payments is also aggravated.[6]

Husbands and wives filing separate returns have fixed exemptions of $500 each. No shift of part of the exemption from one to the other is permitted as under present law. Situations will frequently arise, therefore, where one spouse is entitled to a refund and the other is subject to additional tax. Yet, because the exemption is fixed at $500, the opportunity that exists today for canceling out the refund and the additional liability is removed. For example, if the wife works part of the year but does not take any of the withholding exemption, she is entitled to a refund. The husband, who takes the entire withholding exemption, will probably have to pay additional tax. But even if the wife's refund is equal to or greater than the husband's remaining liability, there is no way of shifting the personal exemption and thus offsetting one against the other. He will have to pay the tax and she will have to wait for a refund.

(5) Complication of the administrative process: The House bill also makes heavy demands upon administration. For 1944, it will require the filing and processing of 41.7 million returns, representing 52.4 million taxpayers, in contrast with the Treasury proposal, which would require only 36.5 million returns representing 43.2 million taxpayers.[7] The House bill, like the present law, requires millions of returns from persons in those income brackets in which the ratio of administrative effort to tax proceeds is highest. Moreover, the com-

[6] The Treasury has recommended changes in the withholding procedure that would minimize the problem of year-end refunds and additional tax payments. The Treasury proposed that withholding be applied on a graduated basis to the taxpayer's full liability rather than merely to his partial liability under the normal tax and the first bracket of surtax. It also proposed narrower withholding brackets to adjust amounts withheld more closely to actual tax liabilities.

[7] Under present law the figures would be 44.1 million returns and 53.3 million taxpayers.

plexity and confusion generated by the double exemptions and computations and by the involved choice between joint and separate returns will inevitably burden administration. Both in terms of the taxpayers who will throng the collectors' offices for help, and in terms of the volume of errors that taxpayers will make, the House bill magnifies the problems of administration.

Senator VANDENBERG. Mr. Paul, may I ask you just one question so I can get oriented?

Mr. PAUL. Yes, Senator.

Senator VANDENBERG. Is there any difference in the net result to the Treasury finally, in the Treasury scheme of integration, and the House scheme, in connection with the Victory tax?

Mr. PAUL. In revenue yield?

Senator VANDENBERG. Yes.

Mr. PAUL. I am coming to that in just a minute.

Senator VANDENBERG. All right.

Mr. PAUL (continuing). (c) *Contrast of House bill with Treasury integration proposal from the standpoint of simplicity.*—The contrast between the House bill and the Treasury proposal on the score of simplicity is complete. What the House bill gains in removing the Victory tax, it loses in introducing the minimum tax. It retains the complexities of a double tax system and adds special vagaries of its own. It burdens administration with new problems at a time when it is still faced by the enormous task of adjusting itself to current collection. Worst of all, it will require taxpayers to struggle with the new minimum tax concept even before they finish hurdling the Victory tax barrier.

Under the Treasury proposal, on the other hand, there would be no double tax base, no double exemptions, and no multiple choices and computations. Administration would be simplified by dropping the Victory tax. Similarly, withholding would be simplified by dropping the minimum withholding feature necessary to guarantee collection of the Victory tax. Most important, compliance would be simplified. Taxpayers could face the prospect of filing their necessarily complicated annual return next March with the assurance that future income tax returns would be both more understandable and simpler.

(d) *Tax increases and decreases under the House bill and the Treasury integration proposal.*—Some contend that the Treasury proposal achieves simplicity at an excessively high cost in tax reduction for taxpayers in the lowest brackets and that the House bill involves no corresponding cost. I should like to cite the facts refuting this contention.

The Treasury integration proposal would exempt entirely 9.1 million taxpayers who now pay a net Victory tax of 275 million dollars. Including these, it would reduce taxes for 18 million taxpayers, the combined reduction totaling 436 million dollars. The House bill exempts only 130,000 taxpayers, but reduces taxes for a total of 26.0 million taxpayers; the aggregate reduction is 370 million dollars, only 66 million dollars less than the Treasury proposal. The Treasury proposal would increase liabilities for 34.4 million taxpayers, the increases totaling 711 million dollars. The House bill increases liabilities for 26.4 million taxpayers, the increases totaling 459 million

dollars. While the 9 million taxpayers who would be exempted under the Treasury proposal pay 275 million dollars under present law, they would pay only 161 million dollars under the House bill. This figure of 161 million dollars measures the reduction involved in their elimination from the income tax rolls.

Senator BYRD. Do you think it is wise to eliminate taxpayers at this time?

Mr. PAUL. These 9 million taxpayers?

Senator BYRD. Yes.

Mr. PAUL. I think it is wise in view of the complications involved in keeping the tax on those taxpayers. I do not think the 161 million dollars we collect from those classes is worth the complication it involves for them and for the other taxpayers, all the rest of the 50 million, and also the danger that that complication involves for the whole Federal tax system.

Senator BYRD. I thought you said 337 million dollars was released.

Mr. PAUL. The Treasury proposals lowered the exemptions. We picked up 2 million taxpayers that way. That leaves 9 million taxpayers who are removed from the rolls by the Treasury proposal. Under existing law they would pay 275 million dollars of tax. Under the House bill they would pay 161 million dollars of tax. Now, the collection of that tax of 161 million dollars from the 9 million taxpayers in my opinion is not worth the complication that the collection involves, not only for those taxpayers but for all other taxpayers, the whole 50 million taxpayers. I would go further than that in saying it is not worth the danger it involves for the whole tax system, especially when you consider an additional fact, that there is not any difference of any appreciable degree between the burden of taxes upon those taxpayers between the present law and the proposal of the Treasury and the House bill.

Any integration plan will inevitably change liabilities of many taxpayers. The major concern should be that the changes meet the tests of simplicity and fairness. The Treasury changes meet these tests far better than the changes in H. R. 3687. While the Treasury integration proposal would reduce taxes only for taxpayers in the lowest brackets and subject to family responsibilities, the House bill would apply reductions to taxpayers with incomes as high as $3,931 (married person with two dependents) and $4,572 (married person with three dependents). More important, the Treasury proposal would simplify the entire income-tax structure in eliminating $275,000,000 of tax for the 9,000,000 taxpayers least able to pay and most expensive to tax. In contrast, the House bill complicates that structure and multiplies the compliance burdens of over 50,000,000 persons merely to keep the 9,000,000 taxpayers on the rolls, and to exact from them the relatively small sum of $161,000,000. It seems utterly unreasonable to erect a mountain of complexity for such a molehill of revenue.

(e) *Conclusion on simplification.*—Simplicity in income taxation implies both mechanical ease of compliance and understandability of the basic tax rules. The integration scheme in H. R. 3687 violates both of these standards. It has been amply illustrated that the mechanical problems of compliance under the minimum tax may be even more burdensome than those associated with the Victory tax. But even assuming that master tables could be developed to cope

with most of the mechanical complexities of the House bill, the problem of simplicity would not be solved. The minimum tax and its relationship to the regular tax completely defy understanding on the part of the average taxpayer.

Senator CLARK. I do not see where either one of them, the Treasury proposal or the House bill, is any particular improvement over the present system.

Mr. PAUL. The improvement involved in the Treasury proposal over the present law is a different matter. I have been comparing the Treasury proposal with the House bill. The Treasury proposal as compared with the present law involves a different set of comparisons. It eliminates 9,000,000 taxpayers; it eliminates all the work involved in auditing, checking, and in policing those returns. That is a lot of work. The work might be worth while if it brought in enough money, but it only brings in $275,000,000 under present law.

Another comparison between the Treasury proposal and the present law, as distinguished from the House bill, is that it means that the whole withholding procedure is easier for employers, and there are various other comparisons.

Senator CLARK. Of course, one of the minor, I should say, ever-present disadvantages of the tax system is changing the system of computation every year, so the fellow never makes out his tax return in two successive tax returns on the same basis. I am not talking of rates but of the same method of computation.

Mr. PAUL. I agree with you.

Senator CLARK. Unless there is some very substantial advantage in revenue, it seems to me the system ought not to be changed too rapidly.

Mr. PAUL. Your point I agree with completely. That was the point I made with respect to taxpayers next March who just will hopefully, I assume, learn the Victory tax, and they have to turn around and learn this new minimum tax.

Senator CLARK. If you are coming to this, don't bother to answer now. I would like you to tell us specifically whether you prefer the Victory tax or the minimum tax.

Mr. PAUL. I am almost at that point. I am about to say I prefer the Victory tax.

A tax law which affects over 50,000,000 people must be made understandable to them if it is to survive. It must be explainable to them over the radio, in the press, and through the mails. I might be able to visualize mechanical guides which would help taxpayers to stumble in robot fashion through income-tax compliance under the House bill. I cannot visualize an information campaign that could make this tax understandable to taxpayers generally.

Putting the minimum tax in its proper perspective, it is not an overstatement to say that its complexities will jeopardize the whole income-tax system. Merely to collect $161,000,000 from 9,000,000 taxpayers near the bottom of the income scale, it endangers the collection of more than $17,000,000,000 from over 50,000,000 taxpayers throughout the scale. The House bill offers the American taxpayer a minimum tax "cure" that is worse than the Victory tax "disease." We cannot afford to disappoint the mass of taxpayers who have been promised relief from the complexities of our present dual tax structure. We cannot risk a break-down in the mainstay of our Federal tax system in the midst of total war.

The question of Victory tax integration is of crucial importance. I am firmly convinced that the Treasury integration proposal would achieve real simplification at a modest and entirely reasonable cost.

2. INCREASE IN REVENUE

(a) *The Treasury proposal.*—Thus far, I have discussed only the Victory tax integration segment of the Treasury individual income-tax proposal. The Treasury has also recommended as part of a 10.5 billion-dollar program of wartime taxes that an additional 6.5 billion dollars of revenue be raised in individual income taxes. The surtax-rate increases suggested to raise this revenue of course include the changes designed to absorb the Victory tax. Exhibit 5 appended to this statement shows the schedule of surtax rates proposed to the Ways and Means Committee on October 4, 1943.[8] (See also exhibits 6 and 7.)

Two alternative schedules for raising approximately 6.5 billion dollars of added income-tax revenue are also attached for the convenience of your committee. (See exhibits 8, 9, and 10.) It will be seen that these alternative schedules would impose a heavier burden in the lower-income brackets than the October 4 proposal.[9] The exact additional burden is indicated in the footnote in my statement.

Senator BYRD. Under your proposal you are not comparing the House bill with existing law?

Mr. PAUL. In respect to the $6.5 billion revenue, that was a comparison with existing law. Do you mean with respect to revenue or with respect to the simplification aspect?

Senator BYRD. Both. As I understand it, you are not figuring on a good deal from the House bill.

Mr. PAUL. A good deal of my emphasis has been on that, but comparing it with the present law, which includes the Victory tax, I have just made a few comparisons. The Victory tax makes it impossible for us to simplify our present law because we have two taxes with two sets of exemptions and two income-tax bases. We find that it is totally impossible to get out a return and to make the tax understandable when we have these two alternative taxes in it, and it complicates withholding. A large part of the problem is solved when you drop the 9,000,000 taxpayers. I am not saying drop them because of the tax consideration involved at all, I am saying because the dropping of those taxpayers will permit us, will leave us with one income tax, one set of exemptions, one set of rates, and so forth, and will make it possible for us to understand the tax, which we cannot do otherwise.

I say also I think we will never be able to understand the tax that is in the House bill. We will be even less able to understand it then we are able to understand the Victory tax. As Senator Clark has just pointed out, it will be a change-over after 1 year's operation to an entirely new tax.

Senator BYRD. Would you favor the retention of the present Victory tax to the provisions in the House bill?

[8] It will be seen from exhibit 5 that the Treasury is recommending that four separate surtax brackets of $500 each be substituted for the present first bracket of $2,000. This change enables a better adjustment of taxes to capacities to pay in the lower-income brackets.

[9] Persons with net incomes of less than $5,000 would pay 3.5 billion dollars out of the total of 6.5 billion dollars additional income tax under the Treasury proposal of October 4; 3.9 billion dollars out of 6.7 billion dollars under alternative proposal A; and 4.4 billion dollars out of 6.8 billion dollars under alternative proposal B.

Mr. PAUL. I have given a good deal of thought to that and I would say I would. At least, the taxpayers next March will know something about that tax, maybe not too much. They will not have to learn an entirely new tax right in the midst of filing their returns under a tax system that would include the Victory tax.

I would like to call your attention to the fact, Senator, that there has been a great deal of public demand for the repeal of the Victory tax, not because particularly of its impact but because of its frightful amount of complications.

(*b*) *The House bill.*—Revenue is only an incidental consideration in the income-tax provisions of the House bill. Those provisions will add $226,000,000 to income-tax revenues. Of this amount about $90,000,000 is attributable to the changes made in connection with Victory-tax integration. About $150,000,000 is attributable to the disallowance of deductions for Federal import duties and miscellaneous excise and stamp taxes not otherwise deductible as business expenses.[10] The other individual income-tax changes made by the House bill are of a technical character.

3. ANSWER TO CRITICISMS OF THE TREASURY PROPOSALS FOR HIGHER INCOME TAXES

I should now like to examine with you some criticisms that have been made of the Treasury's affirmative income-tax proposals. The three arguments I shall examine are (1) that the Treasury proposals would not bear heavily enough on the lower-income brackets; (2) that the American people do not have the capacity to pay more income taxes, and (3) that income-tax rates in 1944 will be confiscatory.

Now, I think I may omit reading the next part of my statement because it has been covered by the Secretary's testimony.

(*b*) *Capacity to pay.*—A second contention is that the American people do not have the capacity to pay additional income taxes. The facts contradict this contention. Individual incomes after personal taxes amounted to $65,000,000,000 in the fiscal year 1939 and are expected to amount to $126,000,000,000 in the fiscal year 1944. The corresponding figures before subtracting personal taxes are $68,000,000,000 and $148,000,000,000. In other words, personal taxes show an increase of $19,000,000,000 while incomes before taxes show an increase of $80,000,000,000. Less than one-fourth of the increase in annual income payments generated by defense and war activities is being absorbed by taxes.

Senator BYRD. That income of $126,000,000,000 is after they pay taxes?

Mr. PAUL. The $126,000,000,000 for the fiscal year 1944 is after taxes.

Senator BYRD. After taxes?

Mr. PAUL. After personal taxes.

Senator BYRD. That does not include the corporate taxes?

Mr. PAUL. It includes the corporate taxes insofar as the corporate taxes come out of the national income.

Senator BYRD. All the citizens had an income of $126 billion net after paying taxes?

[10] This disallowance was recommended by the Treasury. At present, the allowance of deductions under sec. 23 (c) is inconsistent and depends entirely on the legal language used in imposing the tax. For example, admissions taxes are allowed as deductions, but the cabaret tax is not. Uniformity in the matter of deductibility is desirable. Revenue, administrative, and equity considerations also suggest disallowance of these taxes insofar as they constitute personal expenses.

Mr. PAUL. That is in the fiscal year 1944; yes. You understand that does not cover any excise or sales taxes that are in the prices that are paid.

Senator BYRD. That means the direct taxes?

Mr. PAUL. That is right. That $126,000,000,000 compares with $65,000,000,000 in the fiscal year 1935. The difference, I think, is about $80,000,000,000, and less than one-fourth of the increase in annual income payments generated by the defense and war activities is being absorbed by personal taxes.

The CHAIRMAN. You said 1935.

Mr. PAUL. 1939, Senator George.

The CHAIRMAN. You mean 1939.

Mr. PAUL. Yes, after taxes in 1939, after personal taxes, I gave the figure of $65,000,000,000.

The CHAIRMAN. We have gone up more than three times, I think, since 1939.

Mr. PAUL. We have gone up considerably more than three times. My recollection is in 1939 the taxes were less than $2,000,000,000—just a minute. Personal taxes were $3,000,000,000 in 1939.

Senator BYRD. Both of these figures are net figures?

Mr. PAUL. These are net after personal taxes.

Senator BYRD. That is what I mean, net after personal taxes. The same argument you make now would apply to sales taxes, too, would it not, the ability of people to pay?

Mr. PAUL. The ability of people to pay and sales taxes are entirely different matters, because the sales tax has a large impact in the low brackets, the very lowest brackets, where there is not any ability to pay.

The CHAIRMAN. You are estimating the amount of money that was possessed by individuals in 1939 and estimating the amount they will have in 1944?

Mr. PAUL. Fiscal 1944. That is after taxes, Senator George, after personal taxes.

The CHAIRMAN. Don't you think, when you consider the ability of the taxpayers to meet the tax liability, you have got to consider what that increase has been since 1939? Roughly, it would be five times as much.

Mr. PAUL. What the increase of taxes has been?

The CHAIRMAN. Yes, on individuals.

Mr. PAUL. I think the increase in taxes has been very great since 1939, but it has not kept pace, my point is, with the increase in income. I think the great difficulty with respect to this increase is the increase does not go to all the people, that there are some stationary incomes involved.

The CHAIRMAN. That is the great difficulty, but we have got the rate up now over 1939 around six times as much as it was in 1939, and the difficulty is we haven't got uniform incomes, nor uniform increases in those incomes of 1939. You have got a lot of people standing at the 1939 post, so to speak.

Mr. PAUL. Standing at what? I beg your pardon.

The CHAIRMAN. At the 1939 income figure.

Mr. PAUL. Of course, I agree with you there is a serious problem with respect to the stationary incomes.

The CHAIRMAN. That always has to be considered when you are trying to say how much more tax can be borne by the taxpayers, does it not?

Mr. PAUL. I think it is also fair to consider not only that aspect of it, which I agree with you is the problem, the problem of the stationary income, but also the great increase in total incomes.

The CHAIRMAN. I do not know that I am thoroughly in accord with you on that point. That is what ruined the farmers in the last war. They estimated the value of the land on the basis of its income-producing capacity under highly artificial war conditions. You might say we can make changes in our tax law, but if you look at the $157,000,000,000 that the national income is now, certainly as a national product——

Mr. PAUL (interposing). The national product is of course much larger.

The CHAIRMAN. There certainly is that much product. If you look on it as a basis on which you are going to levy taxes, you have also got to take into consideration that that is a temporary income, it is artificial, it is produced by the war. Assuming the war ended in March, with these rates on individuals, they will run all during that year, and when the income drops down precipitously you would have a pretty badly broke people.

Mr. PAUL. That is a good argument, for the reason you indicate, that we have the current tax-collection system, because immediately the income drops, the tax collections will also drop.

The CHAIRMAN. But not the rate.

Mr. PAUL. But not the rate, but the rate can be dropped to meet future conditions. We are dealing today with a condition of vastly expanded income. What we should have when unforeseeable conditions arise in the future, I do not know. I do not think the problem is analogous to the farm problem, because people at that time, on the basis of expanded income, increased the values. The mortgages were fixed on the property, they were there for all time, without possibility of change.

The CHAIRMAN. I understand the national income is a factor in fixing the taxes, but the difficulty I have about it is to make it the main, controlling factor. It seems to me to be illogical and one fraught with all kinds of possible difficulties to your general economy, because I know we are not going to decrease these rates fast enough to take care of a declining national income when the war ends.

Senator JOHNSON. The rates are graduated, however.

The CHAIRMAN. The rates are graduated. I am talking about increasing them all the way up.

Senator JOHNSON. You say the rates are static, but that is not quite true because they are graduated.

The CHAIRMAN. Oh, yes; they are graduated.

Senator JOHNSON. I think the figures are very, very important. This is the first time they have been called to my attention. How did you get these figures? Did you get them off the income-tax returns?

Mr. PAUL. No, we got those figures by estimates of national income payments. They are all payments of income to individuals. Then we subtract from the income payments to individuals, and that includes all kinds of payments, dividends, salaries, and so on. We subtract from that all personal taxes, the taxes that have to come out of those incomes before the incomes are really spendable or disposable.

Those estimates are not made from returns because they include a lot of income that would not be reflected in returns, people who do not file returns, for instance.

Senator JOHNSON. I was in hopes that they would be derived from returns so we would have something exact and not an estimate.

Mr. PAUL. The Department of Commerce does the basic statistical work on those figures. I do not think there has been, in all the discussion on this subject, very much question about the figures, a billion or two in the total amount, but those are pretty well established figures.

Senator JOHNSON. It is only a break-down, then, of the national income figures that we have had before us all the time?

Mr. PAUL. That is right.

Senator JOHNSON. It is merely a break-down?

Mr. PAUL. It is a break-down by subtracting from the gross total of individual income payments of personal taxes which must come out of the payments before you can really say that the income is spendable, or savable, one might say.

I do not know whether you want me to go on any more.

Senator BYRD. Suppose a man in business who was not a company, incorporated, got an income and he spent part of that income for other services?

Mr. PAUL. For what?

Senator BYRD. For personal service. Suppose he was engaged in business, as there are many people, partnership, not incorporated.

Mr. PAUL. That is right.

Senator BYRD. This has nothing to do with corporations?

Mr. PAUL. This includes all personal income consisting of dividends paid by corporations and other incomes.

Senator BYRD. Suppose this person spent money out of the money that comes in, for services of different kinds in business, there would be duplication in that case, would there not?

Mr. PAUL. No. If they are business expenses, they are excluded from the total. These are only personal income payments. They are withdrawals from any kind of business.

Senator BYRD. I do not know how you can make that a part of the income tax.

Mr. PAUL. Maybe Mr. Blough can explain the technique of how the studies are made by the Department of Commerce. I understand they are not just guesses, they are pretty accurate estimates. I have not heard of a serious disagreement about the figures.

Senator BYRD. It is pretty hard to prove them.

Mr. BLOUGH. They cannot be proved one way or the other, Senator. We could use some additional information to good advantage. Certain studies which would greatly increase the accuracy of these figures have been proposed from time to time to the Appropriation Committees and have been turned down. The Department of Commerce collects data of very many kinds from almost every imaginable source: Social Security wage reports, reports of the payments of dividends which come to their attention, trade association statistics of various kinds, and a whole mass of figures collected here, there, and everywhere by the Government and private agencies, including the income tax returns, which, however, are primarily of

value in checking the previous estimates and correcting them, seeing how much in error the current methods are. On the basis of those figures from very many sources, various series of statistical estimates are made and combined. It is not an accounting process, it is not a census, but it is a procedure which has been built up over the last 15 or 20 years and which has come to be pretty well accepted, and when these figures were checked up in later years they stood up pretty well. You cannot say they are an absolute guaranty of correctness, but they are good estimates.

Senator BYRD. The basis of the national income is taken first?

Mr. BLOUGH. They build the national income up on really two bases in order to check: one is the production which various industries put out. The goods they sell, the goods they produce, and the services that they furnish in all walks of life and all kinds of businesses are gotten and added together in order to get at the income produced. Then they proceed from another direction to collect payments, such as wages, salaries, and dividends. They build it up in that direction so as to have something of a cross-check, because, by and large, the goods that are produced, including the war goods, must check very well with the income payments plus business savings, reserves, and taxes.

Senator BYRD. This figure, plus the taxes, does that equal the national income?

Mr. BLOUGH. That equals what is called income payments. The national income is a slightly different concept, because the national income includes the savings of business corporations and other business organizations, which are not paid out or withdrawn, but aside from that difference and some minor adjustments they are very much the same.

The CHAIRMAN. It is very nearly 12:30. I do not want, Mr. Paul, to leave the impression on your mind that I do not regard the national income as a factor, and an important factor, in determining what taxes may be borne by the people, but I do think when national income is artificial, as it must be in wartime, that you have got to take that into account and give very great weight to it.

Mr. PAUL. Senator, I was not saying that this was the only factor to take into consideration.

The CHAIRMAN. No, no.

Mr. PAUL. I was really rebutting a great many arguments that have been made that there is not the capacity to pay.

Senator, you made a point about how personal taxes have increased, and I might say that I agree with your estimate. Personal taxes, that is, Federal, State, and local, as a percentage of income before taxes, were about 4½ percent in 1939, and about 15 percent in 1944, or somewhat more than three times as high.

The CHAIRMAN. About three times? I thought that was about your net increase.

Mr. PAUL. That is right.

The CHAIRMAN. I also think the rapidity with which taxes have gone up has an important bearing on determining what the tax rate should be.

Mr. PAUL. I agree with that, because people have made commitments.

The CHAIRMAN. Yes; they have made commitments, they have their obligations to meet.

We will recess to 2:30.

(Whereupon, at 12:25 p. m., the committee recessed to 2:30 p. m. of the same day.)

AFTERNOON SESSION

(The committee reconvened at 2:30 p. m., upon the expiration of the recess.)

The CHAIRMAN. The committee will please come to order. All right, Mr. Paul.

STATEMENT OF RANDOLPH PAUL—Resumed

Mr. PAUL. I think, Senator, I left off with a discussion of capacity to pay and I have just a little more on that subject.

The CHAIRMAN. Yes, sir.

Mr. PAUL. In an attempt to prove that American taxes are too high, it is argued that taxes in the United States are higher in terms of dollars per capita than in the United Kingdom and Canada.[11] This argument is, of course, grossly misleading, since it gives absolutely no indication of real burdens. How burdensome a given tax will be is determined by the ratio of the tax to the income from which the tax is paid. Personal incomes here are larger than in either Canada or Great Britain. Furthermore, the rates of income tax and excise taxes are higher in the Allied countries than here. Practically any citizen of the United States, if given the choice of paying American, Canadian, or British taxes, would choose the American tax system, since his tax here would be the lowest.

(c) *The argument of confiscation.*—In connection with the argument that taxes will exceed capacity to pay, it is contended that our existing income tax rates are confiscatory. Those who make this contention point to the combined burden of current taxes, uncanceled 1942 liabilities, and State income taxes. It is said that this combination will exceed 100 percent of income in 1944.

Such statements are grossly misleading. They ignore two facts. The first is that the Federal income tax allows for the deduction of State income taxes in computing net income. This deduction protects the taxpayer from a confiscatory combination of State and Federal taxes, even if the State tax does not permit the deduction of the Federal tax.

The second fallacy lies in comparing 2 years' taxes, or 1¼ year's taxes, with 1 year's income. The uncanceled part of the 1942 tax is in no sense a tax on 1944 income. This becomes entirely clear when it is realized that a person having no 1942 income has no uncanceled tax to pay in 1944, and would therefore not be covered by the schedules combining the 2 years' taxes. As a matter of fact, when the taxes for 2 years are combined with the net income for 2 years, as they should be, it becomes apparent that the 75 percent cancelation is a windfall which has made it easier, not harder, to pay taxes on 1944 income.

[11] See p. 8, H. Rept. No. 871 on the revenue bill of 1943.

D. CORPORATION TAXES

The Treasury suggested to the Ways and Means Committee (*a*) that the surtax on larger corporations (those with net income in excess of $25,000) be increased by 10 percentage points and on smaller corporations by 4 percentage points; (*b*) that no change be made in the excess-profits-tax rates; and (*c*) that certain changes be made in the existing provisions for carry-back of losses and unused excess-profits credits. The Treasury proposals would increase corporate tax revenues by $1,138 million.

The bill passed by the House (*a*) makes no change in the surtax rate; (*b*) raises the excess-profits-tax rate to 95 percent; (*c*) reduces the excess-profits credit for some corporations by lowering the percentages allowed on invested capital; (*d*) raises the specific exemption for excess-profits taxes from $5,000 to $10,000; (*e*) makes no change in the carry-back of losses and unused excess-profits credits; and (*f*) provides special tax treatment for certain natural resources industries.[12] The House bill increases corporate tax revenues by $468 million. I should like to discuss these matters in detail.

1. COMPARATIVE EFFECTS OF INCREASES IN SURTAX AND INCREASES IN EXCESS-PROFITS TAX

Unlike an increase in surtax rates, which would increase the net tax liability (after post-war credit) of all taxpaying corporations, the increase in the excess-profits-tax rate under H. R. 3687 will increase liabilities for comparatively few corporations. Corporations not subject to the excess-profits tax and those already subject to the 80-percent ceiling on corporate taxes will have no added tax to pay. Of 263,000 taxable corporate returns estimated for 1944, 71,000, or about 27 percent will be subject to excess-profits tax. Moreover, the 80-percent ceiling will apply to 4,300 corporations or approximately 6 percent of all excess-profits taxpayers. This 6 percent, however, will pay about 40 percent of total excess-profits taxes in 1944. An additional 3,200 corporations will become subject to the 80-percent ceiling as a result of the 5-percentage-point increase in the excess-profits-tax rate. The effect will be to limit still further the range of corporations to whom the full increase would apply. It would apply only to the residual class, namely, corporations that pay excess-profits taxes, but will not become subject to the 80-percent-tax ceiling.

In contrast with the House bill, the Treasury proposal would increase the net liability of all corporations. For those subject to the 80-percent ceiling, an increase in the surtax would mean a decrease in the share of their 80-percent tax represented by excess-profits taxes. As a result, their post-war credit would be smaller and their net liabilities correspondingly larger, even though their gross-tax payments were unaffected. For all other corporations, both the gross payment and the net liability would be increased.

From the foregoing analysis it is apparent on the one hand that the House bill will not strike corporate profits generally, but only a restricted segment of corporate profits. On the other hand, it will not strike approximately one-half of the excess profits, nor will it touch the most profitable corporations. To reach corporate profits

[12] A comparison of corporation income and excess profit tax rates is shown in exhibit 11.

generally, an increase in surtax rates would be necessary. To reach the bulk of excess profits and the most profitable corporations, added excess-profits taxes would have to be coupled with an upward revision of the 80 percent limitation.

Because of its broad coverage, the corporate surtax affords an instrument for tapping war profits that are not defined as excess profits in our tax law. At best, it is extremely difficult to single out excess profits and war profits by legal definition. An excess-profits tax cannot be a perfect instrument; a 90 percent or a 95 percent excess-profits-tax rate does not mean that the Government will recapture 90 or 95 percent of the war profits of corporations. In the area labeled "normal profits" there are bound to be some war profits. For example, many corporations with large invested capital but low normal earnings, receive substantial war profits without becoming subject to excess-profits taxes. The same is true of corporations with high base-period earnings now engaged in the production of war materials. Other corporations have had their excess-profits tax liabilities substantially reduced by the special relief provisions in the tax law. Still others will ultimately have a substantial proportion of their excess-profits taxes refunded to them under the operation of the carry-back provisions.

The surtax thus offers greater assurance that all corporations which have benefited from the war will make an additional tax contribution.

A further reason in favor of a surtax-rate increase, as distinguished from an excess-profits-tax rate increase, may be found in the comparative effect on managerial profit incentives. Financial incentives to efficient management depend upon the number of cents the corporation retains out of each additional dollar of profit. The House bill would increase the net tax (after postwar credit) on each dollar of excess-profits from 81 to 85½ cents. Under the Treasury proposal for an increase in surtax rates, not more than 50 cents would ordinarily be taken out of each dollar of normal profits, and the present figure of 81 cents for excess profits would not be touched.[13] The increase in surtax proposed by the Treasury is less likely to impair financial incentives than would an increase in the excess-profits-tax rate. With corporate rates at their present levels, the impact on incentives cannot be ignored in making tax decisions.

The Treasury agrees that our corporations should be kept "in a sound financial condition so that they may be able to convert to peacetime production and provide employment for men leaving the armed forces after the war."[14] But figures on corporate earnings, dividends, and accumulations make it clear that added taxes can be levied without unduly burdening profits and profit incentives, and without impairing the sound financial condition of corporations generally. Corporate profits (excluding dividends received) will reach an estimated level of $22.6 billion for 1943. This is more than four times the corporate profits for the year 1937, one of the most prosperous years of the thirties. Taxes have also risen sharply during this period, both because of increases in corporate income and because of increases in rates. But they have failed to keep pace with earnings. In 1937, corporations had left less than $4,000,000,000, after paying

[13] Corporations with income between $25,000 and $50,000 will, of course, be subject to higher marginal surtax rates as a result of the notch provision.

[14] See p. 5, H. Rept. No. 871 on the revenue bill of 1943.

one and one-fourth billion dollars of taxes. In 1943, corporations will have left nearly $9.2 billion, even after paying $13.5 billion of taxes. In 1944, corporate profits, after taxes at present rates are expected to reach $9.9 billion, or three times the average annual profits after taxes from 1936 through 1939.

Figures on dividends and undistributed profits are also impressive.[15] Average dividends from 1936 to 1940 were $4.1 billion, 1937 being the peak year, when $4.8 billion were distributed.[16] In spite of war taxes, dividends for 1941, 1942, and 1943 are estimated at $4.5 billion, $4.1 billion, and $4 billion, respectively. It is estimated that even after paying taxes and dividends, American corporation will accumulate over $12,000,000,000 of undistributed profits for the 3 years 1941, 1942, and 1943.

Recent studies show that liquid assets of corporations have risen even faster than retained earnings. Nonfinancial corporations increased their holdings of currency, bank deposits, and United States Government securities by $12,000,000,000 during the two years 1941 and 1942 according to an estimate prepared by the Securities and Exchange Commission. If the accumulation of liquid assets in the first half of 1943 should continue at the present rate through the year, the total increase would be $25,000,000,000 for the 3 years 1941, 1942, and 1943. A study just released by the Federal Reserve Board indicates that business deposits, both corporate and noncorporate, totalled $30,000,000,000 on July 31, 1943.

It is recognized that the combined corporate and individual taxes on dividend income are higher in this country than in England and in Canada, and that steps must be taken after the war to relieve corporate stockholders of their disproportionate tax burden. However, so long as the war continues and corporations generally are able to maintain present abnormally high levels of earnings, the discrimination against this class of income recipient will continue to be more apparent than real. The taxation of the excessive profits of corporation imposes no real burden on corporate stockholders.

I have indicated why the Treasury prefers to raise additional revenue by means of an increase in surtax rather than an increase in excess-profits tax. However, if your committee should decide in favor of an increase in the excess-profits-tax rate, the Treasury suggests an upward revision of the 80-percent limitation on corporate taxes. Without this revision the increase in excess-profits tax rates will reach only a limited range of excess profits.[17]

Senator VANDENBERG. Would you have available any figure which would indicate what increase of 80 percent, or say 85 percent, would mean in revenue to the Treasury?

Mr. PAUL. I haven't that figure offhand, but I would be very glad to get it for you, Senator.

Senator VANDENBERG. I would like to have it.

Mr. PAUL. Let me see if I understand your question. You mean raising the limitation?

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[15] See exhibit 12.

[16] Dividend payments in 1936 and 1937 are generally conceded to have been abnormally high as a result of the undistributed profits tax in effect during those years.

[17] A revision of the 80-percent limitation will improve the relationship of net taxes payable by corporations not subject to the tax ceiling and those which are subject to the tax ceiling. In appendix C to this statement, there are outlined three alternative methods of revising the 80-percent limitation to gain these advantages, which would still prevent net corporate taxes from exceeding 80 percent of net income.

Senator VANDENBERG. Yes.

Mr. PAUL. I will get you that figure and insert it in the record at this point.

Senator VANDENBERG. I am referring to your ceiling. I want to know what that means.

Mr. PAUL. Yes. It is estimated, at levels of income estimated for the calendar year 1944, that the net increase in revenue to the Federal Government of increasing the maximum effective rate of tax from the 80 percent contained in H. R. 3687 to 85 percent of the corporation surtax net income, computed under section 15 or supplement G, as the case may be, but without regard to the credit provided in section 26 (e), would amount to $224.2 millions.

The CHAIRMAN. If you raise that ceiling on certain types of business you are going to destroy them.

Mr. PAUL. I think it is a very serious matter. You notice we didn't suggest any such increase.

The CHAIRMAN. There certainly are some that could not stand up under it.

Mr. PAUL. I think it is a very serious matter and that is why we did not recommend the 95-percent rate, but assuming you have that rate or want to reach some excess profits you have got to revise that ceiling upward.

The CHAIRMAN. I get your point.

2. CHANGES IN EXCESS-PROFITS TAX EXEMPTIONS AND CREDITS UNDER THE HOUSE BILL

Mr. PAUL. The House bill provides for an increase from $5,000 to $10,000 in the specific excess-profits-tax exemption.[18] This provision, which was recommended by the Treasury last year, will distribute the excess-profits-tax burden more equitably between large and small business enterprises.

The profits of small business are likely to fluctuate more widely than profits of large business. Base-period earnings under the average-earnings method are, therefore, a less reliable index of normal earnings for small business than for large. An increase in exemption tends to avoid a penalty on extreme fluctuations of earnings without forcing a resort to the relief provisions of section 722.

Moreover, profits of small business are more likely to reflect a return on managerial efforts than a return on invested capital. Consequently, the increased exemption also aids small corporations using the invested capital base for determining excess profits.

The Treasury also agrees with the provisions reducing by 1 percentage point the invested capital credit in each of the brackets above $5,000,000. Invested capital is generally used as a base for computing excess-profits credits only by those corporations which earned a low rate of return during the base period. Where such earnings were abnormally low, corporations are protected by the remedy in section 722. But corporations the base-period earnings of which were normally low should not be provided an escape from taxes on war-increased profits. Since a large invested-capital credit unrelated to base-period earnings tends to provide such an escape, the proposed reduction will reduce an unfair advantage gained by large corporations having a history of low normal earnings.

[18] See p. 57, H. Rept. No. 871, on the revenue bill of 1943.

The proposed reduction of the invested capital credit will also reduce the advantage gained by large corporations on borrowed capital. Because 50 percent of borrowed capital is included in invested capital, corporations can get a tax advantage by borrowing at rates of interest below the percentages allowed on invested capital. The large corporation generally has a higher credit standing than the small and therefore gets larger tax benefits from borrowing than the small corporation. This advantage will be reduced by the reduction in percentage allowances on invested capital.[19]

3. SPECIFIC RELIEF MEASURES IN THE HOUSE BILL

The House bill provides special tax treatment for certain mine owners and operators. It extends percentage depletion and excess-profits-tax exemption to several minerals as a means of stimulating their wartime production. Insofar as these fall within the category of strategic minerals designated by the War Production Board, the Treasury concurs with tax measures which will accelerate their output. But for minerals not so designated it is believed that the proposed treatment is unwarranted. A further statement on the Treasury position is contained in appendix D.

The House bill also extends to the natural gas industry the special excess-profits-tax treatment now granted with respect to the accelerated output of depletable natural resources. Insofar as this treatment is extended to nonproducers of natural gas, this provision in the House bill appears to be undesirable. This point is further developed in appendix E. This appendix also contains a statement of the Treasury position with respect to the broadening of the excess-profits-tax relief for coal and iron miners and timber tracts.

Tax relief measures can serve very useful purposes. But unless they are handled very carefully, they may simply become tax loopholes. If tax relief is distributed without regard to need, it deprives the Government of much needed revenue, and distributes tax burdens inequitably among business enterprises. It must not be forgotten that reduction in the tax liabilities of especially favored taxpayers means increased tax burdens on all other taxpayers.

4. ACQUISITIONS TO AVOID INCOME OR EXCESS-PROFITS TAX

At this point I would like to discuss one technical amendment which is of major importance. Section 115 of the House bill is intended to curb the development of a public market in which alleged tax benefits may be bought and sold. The currently advertised schemes are designed to enable a taxpayer with large war profits to avoid income and excess-profits taxes by purchasing for such purpose a losing or defunct corporation having large current, past, or prospective losses, deficits, or large current or unused profits credits. The utilization and advertisement of such devices has disturbed responsible taxpayers and their attorneys who have refused to use these schemes. It is also disturbing to the Government in its effort to administer the revenue laws equitably and uniformly.

The amendment disallows the part of the deduction or credit involved in the tax-avoidance device, but only if the acquisition of an interest in or control of a corporation or property has occurred on or

[19] An illustration of the effect of borrowing on net income after taxes of an excess-profits taxpayer using the invested-capital credit will be found in exhibit 13.

after October 8, 1940, and then only if one of the principal purposes "for which (the) * * * acquisition was made or availed of is the avoidance of * * * tax by securing the benefit of" such deduction or credit. The amendment is directed solely at those devices which distort or pervert the natural business relationship between a deduction or credit and the enterprise which produced it, and for the benefit of which the deduction or credit was provided by law. The gist of the distortion is the circumstance that such natural relationship has in whole or in part ceased, and that a taxpayer seeks to use the deduction or credit as an offset to the profits of an enterprise to which the deduction or credit does not bear a reasonable business relationship. The amendment in no way abridges the privilege of doing business in individual, partnership, or corporate form, or the privilege of filing a separate or a consolidated return, or any of the numerous choices which the structure of the tax system is intended to afford. But the amendment does operate whenever under any of these privileges or choices such a distortion or perversion of a deduction or credit appears. Hence the scope of the amendment in its field is precisely the same as that of sections 45 and 141 of the present law, where analogous distortions or perversions have been frequently described by the committee as "milking" or shifting of deductions and credits. The Treasury believes with the House that the amendment is a significant part of an equitable tax structure and that it is well adapted to accomplish its purpose.

E. ESTATE AND GIFT TAXES

In seeking sources of additional wartime revenue, we cannot afford to overlook estate and gift taxes. Increases in these taxes have not kept pace with tax increases generally. Small as their relative contribution to the total has been in the past, it has fallen during the war. Estate and gift tax collections for the fiscal year 1944 are expected to represent a smaller proportion of total tax receipts than at any time during the past 10 years. (See exhibit 16.)

In a period when huge additional revenues are needed, the beneficiaries of estates and gifts should contribute their full share to the cost of the war along with other groups of taxpayers. Yet, relatively few estates are subject to tax, and rates in the lower and middle brackets continue to be moderate. The Treasury has, therefore, recommended that the estate-tax exemption be reduced from $60,000 to $40,000 and that estate-tax rates be raised. Corresponding increases in the gift tax are also suggested.[20] For a comparison of rates and tax under the present law and the proposals, see exhibits 14, 15, and 17. These changes would add $400,000,000 to our revenues on a full-year basis. The proposed changes in the estate and gift tax provisions should be permanent, rather than simply for the duration of the war.

[20] Two technical estate and gift-tax provisions of the House bill deserve comment. As passed by the House, the bill contains an estate-tax amendment which provides that in valuing stock or securities the value of which cannot be determined by reference to bid and asked prices or to sales prices by reason of the absence of listing for sales, there shall be considered, in addition to all other factors, the value of stock or securities of comparable corporations which are listed on an exchange. It is believed that this amendment is highly undesirable because it can only lead to contentious, unnecessary and costly litigation, and harbors dangerous potentialities for imposing unjust tax burdens upon the recipients of closely held stock.

The House bill also provides that in certain instances the appointment of a trustee, the vesting of discretion in a trustee as to the selection of beneficiaries or the distribution of benefits, or the exercise by a trustee of such discretion shall not be deemed a taxable gift. This provision is completely divorced from any reasonable classification of trusts and is enmeshed in ambiguities which can only produce manifold administrative difficulties and increase the litigation burden of taxpayers.

I should like to report to the committee that the Treasury is now making an extensive study of all phases of estate and gift taxation. For example, we are investigating the possibility of integrating the estate and gift taxes and correlating them with the income tax. An advisory committee, comprising some of the leading tax practitioners in the estate and gift tax field, is aiding us in this study. It is hoped that the study will lead to recommendations which will simplify these taxes and make them more effective and more equitable. It is anticipated that this study will be completed before the Congress considers the next tax bill.

F. EXCISE TAXES

The Treasury recommended that an additional $2.5 billion be raised through increases in the rates and changes in the base of several existing excise taxes and through the enactment of two new excises. (See exhibit 18.) It is further recommended by the Treasury that the tax on transportation of property be repealed. In selecting specific items for heavier taxation and in setting the proposed rates, the Treasury gave careful consideration to the demand and supply conditions in affected industries and to the impact on producers and consumers. The $2.5 billion excise tax recommendation was designed to be a part of a balanced over-all program.

Selected excises have much to commend them as a source of wartime revenue. They involve little increase in administrative machinery and compliance costs. At the same time, in most cases the higher levies would be shifted to consumers, thus avoiding undue burdens on business concerns. Since only a few nonessentials are affected, and since the tax can be avoided or reduced by cutting consumption of the taxed items, the excises will not cause hardship for consumers.

Excise taxes are far superior to a sales tax. They involve only a small fraction of the administrative and compliance effort demanded by a sales tax. Second, they bear on nonessentials rather than necessities. Third, they support rather than jeopardize the Government program to stabilize the cost of living.

For an elaboration of the points just made, I should like to refer you to appendix F. This appendix also compares the Treasury excise-tax proposals with the House bill provisions, analyzes those provisions, and indicates why it is desirable to terminate excise-tax exemptions on sales to the Federal Government, as recommended by the President.

G. THE SALES TAX

The Treasury proposals do not include a general sales tax. I should like briefly to state the reasons for our decision.

The form of sales tax which would produce the most revenue and cause the least rupturing of price ceilings is the retail sales tax. The highest rate I have heard mentioned is 10 percent. That is over three times as high as the rate now in force in any State.

A 10 percent sales tax with no exemptions for necessities of life would raise at current sales levels about $6,000,000,000, or about one-tenth of this year's estimated deficit.

Such a tax would be very harsh, especially on low-income families with children. It is completely lacking in any relation to ability to

pay because it hits families much harder than single individuals at the same income levels and it hits people with small incomes much harder than people with larger ones. Such a tax would be opposed to every principle of tax equity and would in my opinion interfere with the war effort.

There are many proponents of the sales tax who would agree with these criticisms and who propose to meet them by allowing exemptions of the necessities of life. Such exemptions would indeed improve the character of the tax, although they would still leave the discrimination against large families. However, the exemptions would quickly remove so much of the tax base as to leave little more than an empty shell.

The exemption of food would reduce the yield by $2.4 billion; the exemption of medicine would reduce the yield another $200,000,000; the exemption of clothing would reduce the yield by another $1.1 billion. Those exemptions do not include all of the necessities of life, but let us stop at that point. A sales tax with such exemptions would yield about $2.6 billion. However, of that amount about $1.2 billion would come from goods and services already subject to Federal excise taxes. The tax yields from the sale of these commodities can be increased or decreased by adjusting the excise-tax rates. No sales tax is needed to produce revenue from them. All that is left after excluding such commodities is $1.4 billion. Nearly $600,000,000 of the $1.4 billion would come from equipment, chemicals, and materials used in business and thus entering into the costs of doing business with resultant increases in the costs of doing business and in prices to the Government and to the public.

Most of the remaining $800,000,000 tax would be on items that might properly be subject to sales taxation. It is hardly necessary to point out that the expenses to two and one-half million businessmen and increased costs to Government, as well as the use of precious manpower, would not be justified by yields of this kind when there are other methods of raising money at hand which do not call for heavy increases in costs of administration and compliance.

It is very doubtful whether a general sales tax without the exemption of necessities of life would really be helpful in financing the war or restraining inflationary price rises. The imposition of a substantial sales tax would almost surely be the signal for widespread demands for higher wages and farm prices which, if allowed, would result in large additional costs to Government and increases in the cost of living over and beyond the amount of the tax. These dangers are much greater in the sales tax than in excise taxes or income taxes. Excise taxes touch in only minor respects commodities that are necessities of life, while income taxes have personal exemptions which protect minimum living standards.

Personal exemptions could be introduced into the sales tax, but the inconvenience of distributing and using exemption coupons and the resultant reduction in revenue would be serious factors. Even the most simple sales tax would require the use of much precious manpower and machines by Government and business. It is doubtful whether that manpower and those machines could be secured without interfering with the war effort.

H. RENEGOTIATION OF CONTRACTS

I think the agencies principally concerned may wish to present their views on the renegotiation provisions of the House bill. However, I should like to present the Treasury position on one of the renegotiation provisions that vitally affects the revenue system. I refer to the provision permitting aggrieved contractors to secure a redetermination of excessive profits by The Tax Court of the United States. I think it cannot be too strongly emphasized that the choice of The Tax Court as a forum for renegotiation litigation is an unwise one. For many years it has been recognized that the volume and complexity of Federal tax cases require a specially qualified and skilled tribunal, such as The Tax Court, which shall devote its entire time and efforts to their consideration and disposition. This need threatens to become even more pressing after the war. The inevitable accumulation of cases during the war and the development of many excess-profits tax cases, particularly those arising under the general relief provisions of section 722, make it obvious that The Tax Court faces a possible post-war crisis, without the addition of complex renegotiation-of-contracts issues to its calendar.

The renegotiation statute is not a taxing statute, but this proposal would tend to confuse renegotiation with taxes. It is also to be recognized that renegotiation cases, under the terms of the House amendments, will demand a large part of the time of any tribunal. Many issues will be presented, often difficult of proof; take for example the issue of a large contractor's efficiency or lack of it, which might occupy the court for weeks. It seems inevitable that few cases will be susceptible of quick disposition.

It is my very firm conviction that if the trial of renegotiation cases is added to the task that will confront The Tax Court, the prompt collection of revenue will be impaired, the rights of the Government and of taxpayers will be prejudiced, and the deservedly high reputation of the court may greatly suffer. Any impairment of the reputation and efficiency of the court would constitute a most serious blow to the proper administration of the tax law.

Senator VANDENBERG. Have you any suggestion as to an alternative source of appeal?

Mr. PAUL. We suggested in the hearings in executive session of the Ways and Means Committee that the Court of Claims might take on that litigation.

I. CONCLUSION

This statement has dealt largely with the technical aspects of the Treasury proposals and the House bill. I believed that I could be of most assistance to the committee by concentrating on these aspects of the pending bill.

I have given special emphasis to simplification because of the crucial necessity of simplifying our tax laws. Unnecessary complications can put our entire wartime income-tax program in jeopardy.

I hope that the committee will not misunderstand my emphasis upon simplification and technical matters. Total war makes broad demands on our tax system. Present taxes do not meet these demands, either in terms of paying for the war as we go, or in terms of

combating inflation. The legacy of taxes at present levels will be not only a huge debt, but may also be a demoralized price structure both during and after the war. The growth of the public debt, and the imminence of inflation, force the conclusion that the Treasury's 10.5 billion dollars additional revenue goal is much nearer the minimum than the maximum demanded by total war.

Mr. Chairman, I would like to say briefly before any questions are presented to me that we would have suggested, in the tax bill before the House and here also, a number of technical changes, but we have deferred making such suggestions because of the general understanding that we have had that that should be deferred to the revenue bill of 1944.

Senator WALSH. Are there any changes?

Mr. PAUL. There are some, yes, sir, Senator Walsh, but not a very large number, and we have deliberately refrained from making that number any greater. I think that the particular amendment referring to the purchase of deficit corporations was suggested both by the joint staff and the Treasury, but otherwise we have followed the practice of refraining from suggesting amendments because of the limited time available for the consideration of this bill.

Senator WALSH. Are the amendments that have been put in by the House satisfactory to the Treasury?

Mr. PAUL. No. Most of them I think I could say "No" to from memory. I have discussed some of them here in this statement, particularly in the appendixes.

Senator WALSH. Yes.

Mr. PAUL. I would like to submit for the record four tables.

Estimated change in the Budget position of the United States resulting from the excise-tax provisions (title III) of the revenue bill of 1943 (H. R. 3687) as passed by the House of Representatives November 24, 1943, for a full year of operation at levels of business estimated for the calendar year 1944.

The CHAIRMAN. Those tables are not attached to your statement?

Mr. PAUL. They are not attached; no, sir.

The second table shows estimated change in the Budget position of the United States resulting from the revenue bill of 1943 (H. R. 3687), as passed by the House of Representatives November 24, 1943, for a full year of operation at levels of income estimated for the calendar year 1944.

The third table shows estimated change in the Budget position of the United States resulting from the revenue bill of 1943 (H. R. 3687) as passed by the House of Representatives, November 24, 1943, for a full year of operation at levels of income estimated for the calendar year 1944.

The fourth table is a comparison of excise taxes and postal rates under present law, Treasury proposal, and House bill (H. R. 3687).

(The four tables referred to and appendixes A, B, C, D, E, and F, together with exhibits 1 to 18, submitted by Mr. Paul, are as follows:)

Estimated change in the Budget position of the United States resulting from the excise tax provisions (title III) of the revenue bill of 1943 (H. R. 3687) as passed by the House of Representatives Nov. 24, 1943, for a full year of operation at levels of business estimated for the calendar year 1944 [1]

Article or service	Present law	Revenue bill of 1943	Estimated additional revenue from excise tax provisions of the revenue bill of 1943
			Million dollars
1. Distilled spirits	$9 per gallon (draw-back of $3.75 per gallon on nonbeverage alcohol).	$9 per gallon (draw-back of $5 per gallon on nonbeverage alcohol).	[2] 370.1
2. Beer	$7 per barrel	$8 per barrel	70.5
3. Wine:			
(a) Still:			
Under 14 percent alcohol.	10 cents per gallon	15 cents per gallon	20.0
14 to 21 percent alcohol.	40 cents per gallon	60 cents per gallon	
Over 21 percent alcohol.	$1 per gallon	$2 per gallon	
(b) Sparkling	10 cents per half pint	15 cents per half pint	
(c) Other	5 cents per half pint	10 cents per half pint	
4. Electric-light bulbs	5 percent of manufacturers' sales price.	25 percent of manufacturers' sales price.	20.0
5. Jewelry, etc	10 percent of retail price	20 percent of retail price; silver plated flatware excluded.	81.9
6. Fur and fur-trimmed articles.	do	25 percent of retail price	54.8
7. Toilet preparations	do	do	51.4
8. Luggage, handbags, wallets, etc.	10 percent of manufacturers' sales price on luggage only.	do	53.4
9. Communications:			
(a) Toll service	20 percent of charge	25 percent of charge	30.0
(b) Telegraph, radiograms, etc.:			
(1) Domestic	15 percent of charge	do	
(2) International.	10 percent of charge	15 percent of charge	
(c) Leased wires, etc.	15 percent of charge	20 percent of charge	
(d) Wire and equipment service.	5 percent of charge	7 percent of charge	
10. Local telephone service	10 percent of charge	15 percent of charge	48.0
11. Transportation of persons	do	do	70.9
12. General admissions	1 cent per 10 cents	2 cents per 10 cents	163.5
13. Cabarets	5 percent of charge	30 percent of charge	91.3
14. Club dues and initiation fees.	11 percent of charge	20 percent of charge	5.1
15. Bowling alleys, billiard parlors.	($10 per alley per annum ($10 per table per annum	do $20 per table per annum	27.0
16. Pari-mutuel wagering	None	5 percent of total amount wagered.	20.1
Total additional revenue, items 1 to 16			1,191.8

[1] The estimates are intended to reflect the net improvement in the Budget position of the United States resulting from the bill. Therefore, the portion of the bill which increases Federal receipts and expenditures to the same extent by terminating certain governmental excise-tax exemptions (title III, sec. 307, of the bill) does not enter into the present estimate of the net yield of the bill over present law.

[2] Estimated Federal net revenue yield after allowance for increased draw-back on nonbeverage alcohol of 4.0 million dollars.

Source: Treasury Department, Division of Research and Statistics, Nov. 20, 1943.

Estimated change in the Budget position of the United States resulting from the revenue bill of 1943 (H. R. 3687), as passed by the House of Representatives Nov. 24, 1943, for a full year of operation at levels of income estimated for the calendar year 1944 [1]

[In millions of dollars]

	Net yield of tax program in excess of certain increased expenditures resulting from the revenue bill of 1943 [1]	Yield of present law	Increase (+) or decrease (−) over yield of present law [1]
1. Internal revenue:			
(1) Income and excess profits taxes:			
Corporation:			
Income	4,787.6	4,734.6	+53.0
Excess profits tax	11,349.6	10,888.8	+460.8
Declared value excess profits tax	105.6	105.6	.....
Total corporation (gross)	16,242.8	15,729.0	+513.8
Less post-war credit	1,134.8	1,088.9	+45.9
Total corporation (net)	15,108.0	14,640.1	+467.9
Individual:			
Net income tax	17,589.8	14,105.5	+3,484.0
Victory tax (gross)	.....	8,324.1	−8,324.1
Less post-war credit	.....	−2,095.0	+2,095.0
Victory tax (net)	.....	3,259.1	−3,259.1
Total individual	17,589.5	17,365.5	+296.0
Total income and excess profits taxes	32,697.5	32,003.6	+693.9
(2) Miscellaneous internal revenue:			
Capital stock, estate, and gift taxes:			
Capital stock tax	400.0	400.0	.....
Estate tax	522.4	522.4	.....
Gift tax	40.2	40.2	.....
Total capital stock, estate, and gift taxes	962.6	962.6	.....
Taxes on commodities and services:			
Liquor taxes:			
Distilled spirits (domestic and imported) (excise tax) [2]	1,108.3	738.2	+370.1
Fermented malt liquors [3]	574.5	504.0	+70.5
Rectification tax [3]	11.5	11.5	.....
Wines (domestic and imported) (excise tax) [3]	56.6	36.6	+20.0
Special taxes in connection with liquor occupations	11.0	11.0	.....
Container stamps	9.4	9.4	.....
Floor stocks taxes	.6	.6	.....
All other	1.6	1.6	.....
Total liquor taxes [4]	1,770.5	1,309.9	+460.6
Tobacco taxes:			
Cigarettes (small) [3]	892.8	892.8	.....
Tobacco (chewing and smoking) [3]	45.0	45.0	.....
Cigars (large) [3]	31.7	31.7	.....
Snuff	7.0	7.0	.....
Cigarette papers and tubes	1.3	1.3	.....
All other [3]	.1	.1	.....
Total tobacco taxes	977.9	977.9	.....
Stamp taxes:			
Issues of securities, bond transfers, and deeds of conveyance	25.0	25.0	.....
Stock transfers	19.0	19.0	.....
Playing cards [3]	7.5	7.5	.....
Silver bullion sales or transfers	(5)	(5)	.....
Total stamp taxes	51.6	51.6	.....

See footnotes at end of table.

Estimated change in the Budget position of the United States resulting from the revenue bill of 1943 (H. R. 3687), as passed by the House of Representatives Nov. 24, 1943; for a full year of operation at levels of income estimated for the calendar year 1944—Continued

[In millions of dollars]

	Net yield of tax program in excess of certain increased expenditures resulting from the revenue bill of 1943	Yield of present law	Increase (+) or decrease (−) over yield of present law
I. Internal revenue—Continued.			
(2) Miscellaneous internal revenue—Continued.			
Taxes on commodities etc.—Continued.			
Manufacturers' excise taxes:			
Gasoline	251.1	251.1	
Lubricating oils	54.3	54.3	
Passenger automobiles and motorcycles	.9	.9	
Automobile trucks, busses, and trailers	3.5	3.5	
Parts and accessories for automobiles	25.0	25.0	
Tires and inner tubes	40.0	40.0	
Electrical energy	48.5	48.5	
Electric, gas, and oil appliances	3.6	3.6	
Electric light bulbs	25.0	5.0	+20.0
Radio receiving sets, phonographs, phonograph records, and musical instruments	3.5	3.5	
Refrigerators, refrigerating apparatus and air conditioners	1.1	1.1	
Business and store machines	2.8	2.8	
Photographic apparatus	11.9	11.9	
Matches	10.5	10.5	
Luggage[8]		5.0	−5.0
Sporting goods	2.0	2.0	
Firearms, shells, pistols and revolvers	.8	.8	
Total manufacturers' excise taxes	484.5	469.5	+15.0
Retailers' excise taxes:			
Jewelry, etc.	171.1	89.2	+81.9
Furs	93.0	38.2	+54.8
Toilet preparations	86.4	35.0	+51.4
Luggage,[8] handbags, wallets, etc	58.4		+58.4
Total retailers' excise taxes	408.9	162.4	+246.5
Miscellaneous taxes:			
Telephone, telegraph, radio and cable facilities, leased wires, etc	158.1	121.2	+36.9
Telephone bill	146.7	97.8	+48.9
Transportation of oil by pipe line	14.5	14.5	
Transportation of persons	212.7	141.8	+70.9
Transportation of property	[7] 174.8	[7] 120.3	
General admissions	327.0	163.5	+163.5
Cabarets, etc	110.7	19.4	+91.3
Club dues and initiation fees	11.3	6.2	+5.1
Leases of safe-deposit boxes	6.5	6.5	
Use of motor vehicles and boats	115.5	115.5	
Coconut and other vegetable oils processed[9]	2.0	2.0	
Oleomargarine, etc., including special taxes and adulterated butter	3.1	3.1	
Sugar tax	61.0	61.0	
Coin-operated amusement and gaming devices	12.2	12.2	
Bowling alleys and billiard and pool tables	28.8	1.8	+27.0
Pari-mutuel wagering	29.1		+29.1
All other, including repealed taxes[8]	1.2	1.2	
Total miscellaneous taxes	1,410.7	938.0	+472.7
Total taxes on commodities and services	5,104.1	3,909.3	+1,194.8
Total miscellaneous internal revenue	6,058.7	4,871.9	+1,194.6

See footnotes at end of table.

Estimated change in the Budget position of the United States resulting from the revenue bill of 1943 (H. R. 3687), as passed by the House of Representatives Nov. 24, 1943; for a full year of operation at levels of income estimated for the calendar year 1944—Continued

[In millions of dollars]

	Net yield of tax program in excess of certain increased expenditures resulting from the revenue bill of 1943	Yield of present law	Increase (+) or decrease (−) over yield of present law
1. Internal revenue—Continued.			
(3) Employment taxes:			
Employment by other than carriers:			
Federal Insurance Contributions Act	2,799.0	2,799.0	.....
Federal Unemployment Tax Act	207.0	207.0	.....
Total	3,006.0	3,006.0	.....
Taxes on carriers and their employees (ch. 9, subch. B of the Internal Revenue Code)	262.7	262.7	.....
Total employment taxes	3,268.7	3,268.7	.....
Total internal revenue	42,032.9	40,144.2	+1,888.7
2. Railroad unemployment insurance contributions	12.1	12.1	.....
3. Customs	400.0	400.0	.....
4. Miscellaneous receipts [6]	739.8	581.0	+158.8
Total yield, general and special accounts	43,184.8	41,137.3	+2,047.5

[1] The estimates are intended to reflect the net improvement in the Budget position of the United States resulting from the revenue measures contained in the bill. Therefore the portion of the bill which increases Federal receipts and expenditures to the same extent by terminating certain governmental excise tax exemptions (title III, sec. 307 of the bill) does not increase the present estimate of the net yield of the bill over present law.

[2] Collections for credit to trust funds are not included.

[3] These estimates are after allowances for drawbacks of $19.7 millions under the proposal and of $11.8 millions under present law.

[4] Excludes nonrecurring collection of tax on floor stocks held on Jan. 1, 1944, the effective date of the revenue bill of 1943, in the amount of $61 millions.

[5] Less than $0.5 million.

[6] The tax on lubricating oil has been changed from a manufacturers' excise to a retailers' excise tax.

[7] Includes the effects of H. R. 3598, Public Law 150, approved Nov. 1, 1943.

[8] Includes collections for Taxes on narcotics; taxes under the National Firearms Act; and the tax on hydraulic mining. Net of refunds of taxes currently collected from receipts from repealed taxes not reflected by the Revenue Act of 1943 and collections from the following excise taxes repealed by the Revenue Act of 1943: Radio sets, electric refrigerators, and washing machines.

[9] The increase in postal revenues, estimated at $383.8 millions, will not, in any case, reduce any deficit in postal operations that may exist. Only the net surplus, if any, from postal operations will be reflected in the Budget receipts. It is estimated that the postal deficit for the fiscal year 1944 will be $2,500 millions, the same as was estimated in the Budget of the U. S. Government for the fiscal year ending June 30, 1944.

Source: Treasury Department, Division of Research and Statistics, Nov. 29, 1943.

NOTE.—Figures are rounded and will not necessarily add to totals.

Estimated change in the Budget position of the United States resulting from the revenue bill of 1943 (H. R. 3687) as passed by the House of Representatives, Nov. 24, 1943, for a full year of operation at levels of income estimated for the calendar year 1944 [1]

[In millions of dollars]

		Increase over present law [2]
Individual income tax: Eliminate the earned-income credit; increase the normal tax rate from 6 percent to 10 percent; deny deduction for Federal excise taxes except as incurred in trade or business; provide a special deduction for blind individuals; alter surtax rates applicable above $6,000 surtax net income; repeal the Victory tax; provide for a minimum tax of 3 percent of the excess of net income over $500 for a single person or a married person filing a separate return, $700 for a head of a family or a married couple filing one return, and $100 for each dependent; require a married person filing a separate return to take personal exemption of $500; limit tax to 90 percent of taxpayer's net income		226.0
Corporation income and excess-profits taxes: Increase excess-profits tax rate from 90 percent to 95 percent; increase excess-profits tax specific exemption from $5,000 to $10,000; reduce excess-profits credit based on invested capital in brackets over $5,000,000; allow relief under sec. 735 of the Internal Revenue Code to coal and iron properties and timber tracts not in operation during the base period and to natural-gas pipe lines; and limit the scope of the act pertaining to renegotiation of war contracts:		
Total (gross)	513.8	
Less post-war credit	45.9	
Total corporation (net)		467.9
Excise taxes		[3] 1,191.8
Miscellaneous receipts:		
Increase postal rates		183.8
Limit the scope of the act pertaining to renegotiation of war contracts		-25.0
Total increase		2,047.5

[1] The estimates are intended to reflect the net improvement in the Budget position of the United States resulting from the bill. Therefore, the portion of the bill which increases Federal receipts and expenditures to the same extent by terminating certain governmental excise-tax exemptions (title III, Sec. 307, of the bill) does not increase the present estimate of the net yield of the bill over present law.

[2] The net Victory tax after post-war credit, rather than the gross Victory tax, is contained in the yield of the present law.

Source: Treasury Department, Division of Research and Statistics, Nov. 29, 1943.

Comparison of excise taxes and postal rates under present law, Treasury proposal, and House bill (H. R. 3687)

EXCISES

Article or service	Present law	Treasury proposal	House bill	Estimated additional revenue [1] (in millions)	
				Treasury proposal	House bill
1. Distilled spirits	$6 per gallon (drawback of $3.75 per gallon on nonbeverage alcohol).	$10 per gallon (drawback of $7 per gallon on nonbeverage alcohol).	$9 per gallon (drawback of $5 per gallon on nonbeverage alcohol).	[2] $457.2	[2] $370.1
2. Beer	$7 per barrel	$10 per barrel	$8 per barrel	210.5	70.5

See footnotes at end of table.

Comparison of excise taxes and postal rates under present law, Treasury proposal, and House bill (H. R. 3687)—Continued

EXCISES—Continued

Article or service	Present law	Treasury proposal	House bill	Estimated additional revenue (in millions)	
				Treasury proposal	House bill
3. Wine:					
(a) Still:					
Under 14 percent alcohol.	10 cents per gallon	50 cents per gallon	15 cents per gallon	61.1	20.0
14-21 percent alcohol	40 cents per gallon	$1 per gallon	60 cents per gallon		
Over 21 percent alcohol.	$1 per gallon	$2 per gallon	$2 per gallon		
(b) Sparkling	10 cents per half pint.	20 cents per half pint.	15 cents per half pint.		
(c) Other	5 cents per half pint.	10 cents per half pint.	10 cents per half pint.		
4. Cigarettes:					
(a) Small	$3.50 per M	$5 per M	No increase	371.3	
(b) Large	$8.40 per M	$12 per M			
5. Cigars	Intended retail price: Over / Not over / Tax per M Cents / Cents — / 2½ / $2.50 2½ / 4 / 3.00 4 / 6 / 4.00 6 / 8 / 7.00 8 / 15 / 10.00 15 / 20 / 15.00 20 / / 20.00	Intended retail price: Over / Not over / Tax per M Cents / Cents — / 3½ / $12.50 3½ / 5 / 13.00 5 / 7 / 14.00 7 / 9 / 17.00 9 / 17 / 30.00 17 / 22 / 35.00 22 / / 40.00	do	67.7	
6. Chewing, smoking tobacco, and snuff.	18 cents per pound	34 cents per pound	do	65.2	
7. General admissions, lease of boxes or seats, etc.	1 cent per 10 cents 11 percent of charge.	3 cents per 10 cents 30 percent of charge.	2 cents per 10 cents. 20 percent of charge.	327.0	153.5
8. Cabarets	5 percent of charge	do	30 percent of charge.	91.3	91.3
9. Club dues and initiation fees.	11 percent of charge.	30 percent of charge.	20 percent of charge	5.1	5.1
10. Bowling alleys, billiard parlors.	$10 per alley $10 per table	do $30 per table	do $30 per table	27.0	27.0
11. Transportation of persons.	10 percent of charge.	25 percent of charge.	15 percent of charge.	219.4	70.9
12. Communications:					
(a) Toll service	20 percent of charge.	do	25 percent of charge.		
(b) Telegraph, etc.:					
(1) Domestic	15 percent of charge.	30 percent of charge.	do		
(2) International	10 percent of charge.	10 percent of charge.	15 percent of charge.	31.5	30.9
(c) Leased wires, etc.	15 percent of charge.	20 percent of charge.	20 percent of charge.		
(d) Wire and equipment services.	5 percent of charge	No increase	7 percent of charge.		
13. Local telephone service	10 percent of charge.	15 percent of charge.	15 percent of charge.	65.9	65.9
14. Jewelry	10 percent of retail price.	30 percent of retail price.	20 percent of retail price (exempts silverplated flatware).	167.3	81.9
15. Fur and fur-trimmed articles.	do	25 percent of retail price.	5 percent of retail price.	54.5	54.5
16. Luggage, handbags, wallets, etc.	10 percent of manufacturer's sales price on luggage only.	do	do	53.4	53.4
17. Toilet preparations	10 percent of retail price.	do	do	51.4	51.4

Comparison of excise taxes and postal rates under present law, Treasury proposal, and House bill (H. R. 3687)—Continued

EXCISES—Continued

Article or service	Present law	Treasury proposal	House bill	Estimated additional revenue (in millions)	
				Treasury proposal	House bill
18. Electric-light bulbs and tubes.	5 percent of manufacturers sales price.	No increase	25 percent of manufacturers sales price.	.....	20.0
19. Soft drinks	None	Bottled drinks, 1 cent per each 5 cents of intended retail price; the equivalent taxes of $1 per gallon on sirup and 25 cents per pound on carbonic acid gas used in unbottled soft drinks.	None	177.0	.....
20. Candy and chewing gum.	....do.....	Articles intended to retail from 5 to 15 cents per bar or package, 1 cent per each 5 cents of intended retail price; other items, the equivalent tax of 33 percent of manufacturers sales price.	....do.....	190.0	.....
21. Pari-mutuel wagering	....do.....	None	5 percent of amount wagered.	.....	29.1
22. Transportation of property.	3 percent of charges (4 cents per short ton on coal).	Repeal	No change	−170.3	.....
Additional revenue from excises.				2,511.1	1,194.9

POSTAL RATES

(a) First-class, local	2 cents per ounce	No change	3 cents per ounce	.....	$56.6
(b) Air mail	6 cents per ounce	.....do.....	8 cents per ounce	.....	10.4
(c) Third-class	1 and 1½ cents per 2 ounces.	.....do.....	2 and 3 cents per 2 ounces.	.....	73.8
(d) Fourth-class	Various	.....do.....	3 percent of present law rate or 1 cent, whichever is greater.	.....	4.7
(e) Registered mail	15 cents to $1 per article.	.....do.....	20 cents to $1.35 per article.	.....	4.3
(f) Insured mail	5 to 35 cents per article.	.....do.....	10 to 70 cents per article.	.....	12.1
(g) C. O. D. mail	12 to 45 cents per article.	.....do.....	24 to 90 cents per article		
(h) Money orders	6 to 22 cents per article.	.....do.....	10 to 37 cents per article.	.....	21.9
Additional revenue from postal rates.				.....	183.8
Additional revenue from excise taxes and postal rates.				$2,511.1	1,378.6

[1] Estimated change in budget position of the United States for a full year of operation at levels of income for the calendar year 1944.

[2] Estimated additional net revenue yield after allowance for increased draw-back on nonbeverage alcohol of 12.8 million dollars.

[3] Estimated additional net revenue yield after allowance for increased draw-back on nonbeverage alcohol of 4.9 million dollars.

Source: Treasury Department, Division of Research and Statistics, Nov. 26, 1943.

LIST OF APPENDIXES

APPENDIX A. SUMMARY COMPARISON OF THE TREASURY PROPOSALS WITH THE HOUSE BILL

It may be helpful to the committee to compare in summary form the major provisions of the Treasury proposals with those of the House bill as background for its consideration of that bill. While the Treasury proposals rely heavily on the individual income tax for additional revenue, the income tax changes in the House bill are designed primarily to integrate the Victory tax with the income tax. Both would repeal the Victory tax and the earned-income credit. The Treasury proposal would effect a small reduction in the credit for dependents and the exemption for married persons; it would increase surtax rates substantially, both to replace the Victory tax and to increase revenues. The House bill imposes a 3-percent minimum tax with lower exemptions than the regular tax; it also increases normal tax rates and adjusts surtax rates, primarily in order to replace the Victory tax burden.

The Treasury recommended increases in corporate surtax rates, but no change in the amount of excess-profits taxes. The House bill does not change surtax rates. It increases the revenue from excess-profits taxes by increasing the rate from 90 to 95 percent and by making changes in the excess-profits credit.

The Treasury recommended an increase in estate and gift tax rates and a reduction in exemptions. The House bill does not change the estate and gift taxes.

In the case of excise taxes, the House bill differs from the Treasury's recommendations in that (1) it does not increase tobacco taxes, (2) it does not tax soft drinks, candy, and chewing gum, (3) its rate increases generally are lower than those recommended, and (4) it retains the tax on transportation of property.

Finally, the House bill provides for increases in postal rates on which the Treasury made no recommendations.

APPENDIX B. INTEGRATION OF THE VICTORY TAX WITH THE INCOME TAX UNDER THE HOUSE BILL AND THE TREASURY INTEGRATION PROPOSAL, COMPARED WITH PRESENT LAW

1. Both integration plans, the one contained in the House bill and the Treasury proposal, would repeal the Victory tax and the earned income credit. The House bill increases the normal tax rate from 6 percent to 10 percent, reduces the surtax rates by 1 percentage point in some brackets and increases them by 1 to 3 percentage points in others. A taxpayer would be required to pay the tax computed on

the basis of these changes but not less than a minimum tax of 3 percent on net income in excess of exemptions of $500 for a single person or a married person filing a separate return, $700 for a married couple filing a joint return, and $100 for each dependent. Under the Treasury integration proposal exemptions are reduced from $500, $1,200, and $350 to $500, $1,100 and $300, and the surtax rates are increased by 3 to 7 percentage points.

2. The administration of the income tax would be much easier under the simpler Treasury integration plan than under the House bill. For one thing, there would be a large reduction in the number of returns involving a small amount of tax. Under the present income tax and Victory tax the estimated number of taxpayers for calendar year 1944 is approximately 52.3 million. Under the House bill the number of taxpayers would remain approximately the same as under present law. Because of the filing of joint returns, the number of taxable returns is less than the number of taxpayers. The number of taxable returns would be reduced from 44.1 million under present law to 41.7 million under the House bill. Compared with the 8.2 million joint returns under present law there would be 10.7 million joint returns under the House bill.

Under the simpler integration plan suggested by the Treasury, there would be 43.2 million taxpayers, a reduction of 9.1 million. The total number of taxable returns would be 36.5 million, of which 6.7 million would be joint returns.

3. Married taxpayers would find it much easier to comply with the income tax under the simpler Treasury integration plan than under the House bill, since under the bill the determination of whether a joint return or separate return would be more advantageous may involve numerous complications.

Under present law it is ordinarily to the advantage of a married couple to file separate returns only if their combined surtax net income exceeds $2,000. If their surtax net income is below that amount, it is ordinarily a matter of indifference to them whether they file separate or joint returns. The House bill, however, makes it advantageous for some such couples to file joint returns and for others to file separate returns. At the same time, however, it makes the determination of whether a joint return or separate returns should be filed, a complex problem for many of these taxpayers. Instead of one breaking point fixed in terms of surtax net income, as under present law, the House bill results in two sets of breaking points. On incomes above the higher breaking point and on incomes below the lower breaking point separate returns are advantageous. In the area between, joint returns are advantageous. Moreover, the breaking points are not fixed. Because no part of the $500 exemption on a separate return may be shifted between husband and wife, the breaking points vary with the division of income between husband and wife and also with the number of dependents. For individuals filing under supplement T the calculation can be simplified, but for those required to use the regular income tax form, complexities could not be avoided. The breaking points are difficult to compute and would not be known to most taxpayers unless the Treasury undertook to supply a complicated series of tables indicating the zones of advantage under joint and separate returns. A sample of this type of table, relating only to

one assumed division of income (50–50) between husband and wife, and only to a married couple with one dependent, follows:

Combined net income:	Type of return resulting in lesser tax
$800.00 to $1,070.60	Separate.
$1,070.60 to $5,166.67	Joint.
Over $5,166.67	Separate.

Under the simple integration plan suggested by the Treasury, there is only one breaking point which can be stated in terms of surtax net income for all taxpayers, just as under present law. The accompanying chart relating to a married couple without dependents illustrates the difference in this respect between the Treasury proposal and the House bill.

The complexities with respect to joint or separate returns under the House bill follow from (*a*) the provision that a married couple filing separate returns shall each be allowed an exemption of $500 in contrast with the $1,200 allowed on a joint return under the ordinary income tax, (*b*) the provision that no part of the personal exemption allowed on a separate return may be transferred from one spouse to another, and (*c*) the variation between the personal exemption and dependent credit under the minimum tax as compared with the regular tax.

The relationship between the personal exemptions and dependent credits under the minimum tax and the regular tax may result in much confusion. For example, a husband and wife having two dependents may file separate returns, each claiming one dependent. Under the House bill one spouse may have an exemption of $100 for each dependent and be subject to a 3-percent tax rate, while the other spouse may have an exemption of $350 for the other dependent and be subject to a 23 percent tax rate.

4. A further complication for many taxpayers introduced by the House bill is the necessity, if separate returns are filed, to allocate the dependent exemption in such a manner as to reduce the tax liability to a minimum. Many computations may be needed by taxpayers with several dependents to find the procedure that will result in the least tax for a couple. It is true that in many cases it would be possible for information to be provided to guide married couples to the expeditious determination of their tax liability under either the minimum tax or the regular tax. Nonetheless, the problem of complying with the income-tax law will be much more complicated for many couples with low incomes under the House bill than under the present law or under the Treasury integration plan. Many couples with low incomes in the area where it is now a matter of indifference whether they filed joint or separate returns or how they divided the dependent credit would, under the House bill, need to make numerous computations before reaching the most advantageous tax result. For example, a married couple with an aggregate net income of $2,125 and with three dependents could, depending upon the procedure that happened to be selected, reach 10 different tax results (5 using form 1040 and 5 using form 1040A) after making 18 different computations of tax liability for the husband and the wife before ascertaining the least combined tax liability. (See illustration, attached.) Under the Treasury integration plan and under the present law the multiplicity of computations is not necessary.

5. Another difficulty under the House bill is that some taxpayers who may now file a simplified return would be precluded from doing so. Under the regular income tax, the exemptions which would be allowed on separate returns are lower than those on a joint return. Many married couples with a combined gross income of more than $3,000, wishing to file a joint return to take advantage of the higher exemptions, will therefore not be able to file a simplified form, since form 1040A is limited to a return with a gross income of $3,000 or less.

6. It is clear that the House bill would make the income tax more complicated and would impose greater administrative burdens than the Treasury integration plan. The repeal of the Victory tax is an important step toward simplification but under the House bill this is offset to a large extent by other complications introduced by the bill, which would not exist under the Treasury plan.

7. The House bill would exempt only about 130,000 taxpayers who now pay a net Victory tax of about $600,000. Including these taxpayers, a total of approximately 26,000,000 taxpayers would obtain a reduction in tax of 370.3 million dollars. On the other hand, another 26,000,000 taxpayers would pay an increase in tax aggregating 459.2 million dollars.

The Treasury plan would exempt 9.1 million taxpayers who now pay a net Victory tax of 274.9 million dollars. Including these, there would be 18,000,000 taxpayers with a total reduction in tax of 435.9 million dollars. The Treasury plan would increase the liability of approximately 34,000,000 taxpayers by 711.3 million dollars.

The following table shows the number of taxpayers and the amount of tax increase or tax decrease and the net change, by net income classes under the House bill and the Treasury integration plan:

REDUCED TAXES

Net income class (in thousands)	House bill		Treasury integration plan	
	Number of taxpayers (millions)	Amount (millions)	Number of taxpayers (millions)	Amount (millions)
$0 to $3	23.0	−$342.3	15.7	−$357.2
$3 to $5	2.7	−24.5	1.8	−27.9
Over $5	.3	−3.5	.5	−50.7
Total	26.0	−370.3	18.0	−435.9

INCREASED TAXES

$0 to $3	20.3	189.5	27.5	406.0
$3 to $5	4.1	52.7	5.0	99.0
Over $5	2.1	217.1	1.9	206.3
Total	26.4	459.2	34.4	711.3

NET CHANGE

$0 to $3	2.7	−152.7	11.8	48.8
$3 to $5	1.4	28.2	3.2	71.1
Over $5	1.7	213.6	1.4	155.6

NOTE.—Due to rounding the sum of the individual items may not add to totals.

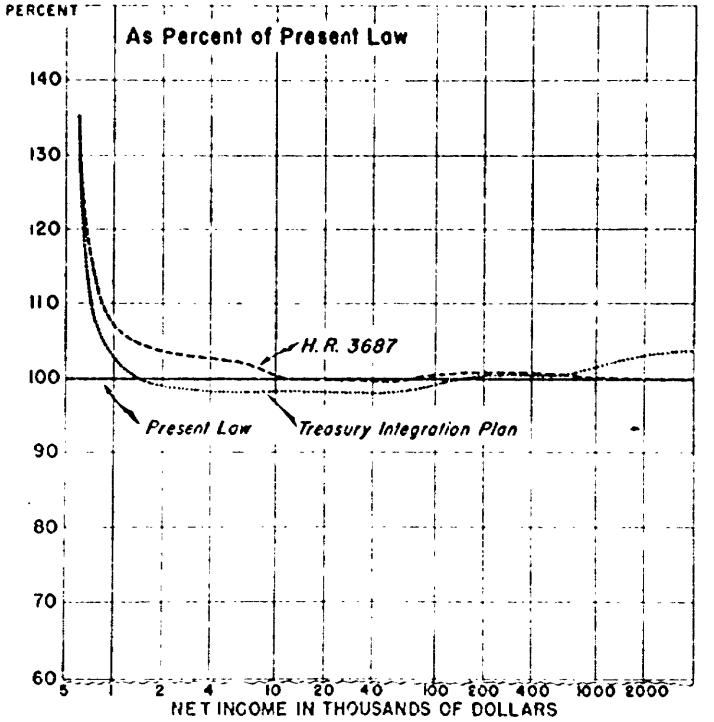
Illustration.—Possible computations on Form 1040 under the House bill, for a married couple with three dependents, to determine the smallest tax liability where the husband has $1,250 net income and the wife has $875 net income

	Net income (1)	Regular personal exemption and credit for dependents (2)	Income subject to regular rates (3)	Regular tax (4)	Personal exemption and credit for dependents for purpose of minimum tax (5)	Income subject to minimum tax (6)	Minimum tax (7)	Tax liability (the larger of column 4 or 7 for each numbered line) (8)
JOINT RETURN								
(1) Husband and wife	$2,125	$2,250	None	None	$1,000	$1,125	$33 75	$33.75
SEPARATE RETURNS								
Husband claiming credit for 3 dependents, wife claiming credit for no dependents:								
(2) Husband	1,250	1,350	None	None	800	450	13 50	13 50
(3) Wife	875	500	$375	$56 25	500	375	11 25	56 25
Total	2,125	2,050	375	56.25	1,300	825	24 75	99 75
Husband claiming credit for 2 dependents, wife claiming credit for 1 dependent:								
(4) Husband	1,250	1,200	50	11.50	700	550	16.50	16.50
(5) Wife	875	850	25	5.75	600	275	8.25	8.25
Total	2,125	2,050	75	17 25	1,300	825	24.75	24.75
Husband claiming credit for 1 dependent, wife claiming credit for 2 dependents:								
(6) Husband	1,250	850	400	92.00	650	650	19.50	92 00
(7) Wife	875	1,200	None	None	700	175	5.25	5.25
Total	2,125	2,050	400	92 00	1,300	825	24 75	97.25
Husband claiming credit for no dependents, wife claiming credit for 3 dependents:								
(8) Husband	1,250	500	750	172 50	500	750	22 50	172 50
(9) Wife	875	1,350	None	None	800	75	2 25	2 25
Total	2,125	2,050	750	172 50	1,300	825	24 75	174 75

Source. Bureau of Internal Revenue, Nov. 10, 1943.

COMPARISON OF TAX UNDER H.R. 3687 AND TREASURY INTEGRATION PLAN

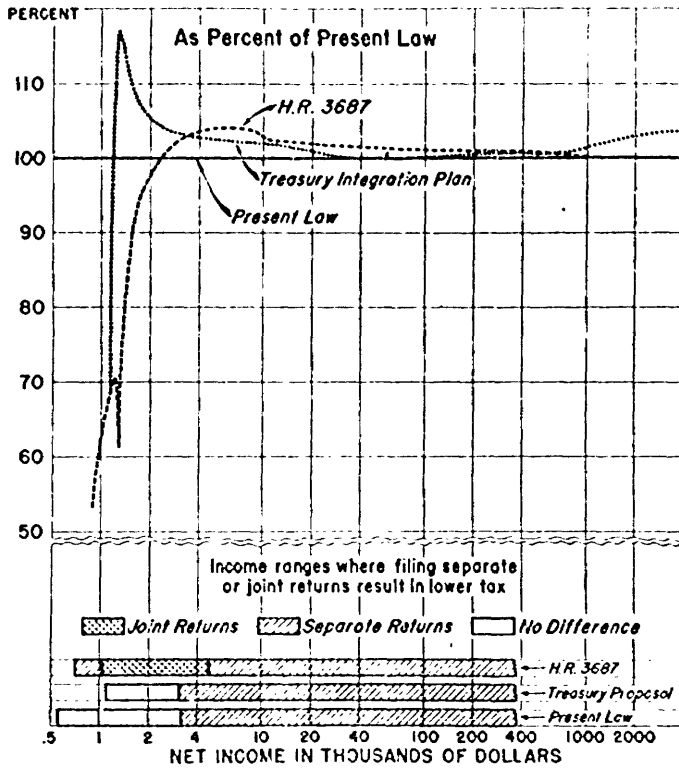
Single – No Dependents



Treasury Department, Division of Tax Research, Nov. 5, 1943.

COMPARISON OF TAX UNDER H.R. 3687 AND TREASURY INTEGRATION PLAN

Married - No Dependents



Treasury Department, Division of Tax Research, Nov. 29, 1943.

APPENDIX C. POSSIBLE REVISIONS IN THE 80-PERCENT LIMITATION TO EFFECT A MORE SATISFACTORY GRADUATION IN EFFECTIVE RATES

The Revenue Act of 1942 provided for a limitation on the excess-profits tax so that in combination with the normal tax and surtax it will not exceed 80 percent of surtax net income. This limitation was imposed on gross taxes before deducting the post-war refund of 10 percent of excess-profits taxes as limited.

The excess-profits tax as limited is computed by taking 80 percent of surtax net income and subtracting normal taxes and surtaxes from this figure. The balance is termed excess-profits taxes and is used in computing the post-war refund of 10 percent of excess-profits taxes.

Thus on a given level of income subject to the 80-percent limitation, effective tax rates after the post-war refund decrease as the percentage of that income represented by taxable excess profits increases. Since normal profits (normal-tax net income) are determined by subtracting taxable excess profits from total income, an increase in taxable excess profits reduces taxable normal profits. A reduction in normal profits, and, therefore, a reduction in normal taxes and surtaxes, increases the portion of total tax liabilities (80 percent of surtax net income which remains unchanged) called excess-profits taxes and increases the post-war credit. Although gross taxes remain at 80 percent of income, net taxes after the post-war refund are thus reduced.

Therefore, increases in the excess-profits-tax base will reduce taxes on corporations subject to the 80-percent limitation, and increases in the excess-profits-tax rate will leave them unaffected. Only increases in the normal tax or surtax rate, by reducing their post-war refunds, can increase the over-all tax burden on these corporations without a change in the limitation.

Under a 95-percent excess-profits tax, or 85½ percent after deducting the post-war refund, a still greater limitation in the excess-profits tax results. In order that an increase in excess-profits taxes will apply to those corporations earning the largest excess profits, and in order that a smoother graduation in effective tax rates may be provided as taxable excess profits represent a larger and larger percentage of total income. Three possible revisions could be made in the 80-percent limitation.

Revision A would substitute an 85-percent excess-profits tax with no post-war refund for the 95-percent excess-profits tax and 10-percent post-war refund in the House bill. The 80-percent limitation would remain in effect.

Revision B would leave the 80-percent limitation as applied to gross taxes but taxes after the post-war refund would be determined as if there were no 80-percent limit.[1] This would have the effect, in most instances, of charging the reduction in taxes resulting from the 80-percent limitation against the taxpayer's post-war refund, rather than against gross taxes.

Revision C would raise the present limit of 80 percent to 85 percent, but would not change the basic structure of the limitation.

The effective tax rates which would result from these changes are presented in table I, both before and after the post-war refund, if any. In chart I the effective tax rates after the post-war refund are shown.

[1] However, in no case would total taxes after the post-war refund exceed 80 percent of surtax net income.

TABLE I.—*Effective tax rates on corporation income as the proportion of taxable excess profits varies, under present law, H. R. 3687, and suggested revisions in the 80-percent limitation*

Taxable excess profits as a percent of taxable income	Total taxes as a percent of income under									
	Present law		H. R. 3687		Revision A		Revision B		Revision C	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net
0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0
10	44.0	44.1	43.8	44.6	44.3	44.8	43.8	44.6	43.8	44.6
20	50.0	48.2	51.0	49.1	49.0	49.0	51.0	49.1	51.0	49.1
30	55.0	52.3	54.5	53.7	53.5	53.5	54.5	53.7	54.5	53.7
40	60.0	56.4	62.0	58.2	58.0	58.0	62.0	58.2	62.0	58.2
50	65.0	60.5	67.5	62.8	62.5	62.5	67.5	62.8	67.5	62.8
60	70.0	64.6	73.0	67.3	67.0	67.0	73.0	67.3	73.0	67.3
70	75.0	68.7	78.5	71.9	71.5	71.5	78.5	71.9	78.5	71.9
80	80.0	72.8	80.0	72.8	76.0	76.0	80.0	76.4	84.0	76.4
90	80.0	72.4	80.0	72.4	80.0	80.0	80.0	80.0	85.0	76.9
100	80.0	72.0	80.0	72.0	80.0	80.0	80.0	80.0	85.0	76.5

NOTE.—Gross and net refer to taxes before and after the post-war refund, respectively. The capital-stock and declared-value excess-profits tax are not included in this computation. Normal-tax and surtax net income are assumed equal and greater than $50,000.

APPENDIX D. ADDITIONAL TAX RELIEF FOR CORPORATIONS ENGAGED IN THE MINING OF CERTAIN STRATEGIC MINERALS

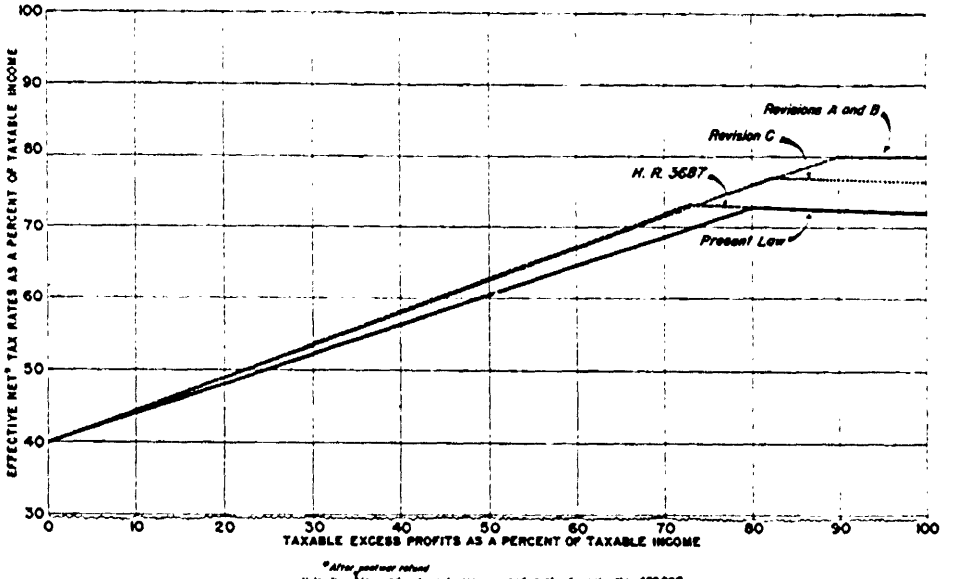
The Treasury recognizes the importance of encouraging the discovery and development of mines capable of yielding minerals of high strategic value in the production of war materials. In those cases where the exemption from excess-profits taxation and the allowance of more liberal depletion allowances will increase the output of these strategic minerals, the Treasury believes that such additional tax-relief measures are proper. However, the Treasury believes it undesirable to extend relief to minerals which, in the opinion of the War Production Board, cannot be designated as strategic minerals. Tax relief should not be permitted to become tax avoidance.

A year ago the Treasury, after consultation with officials of the War Production Board, recommended that the income from the production of 11 strategic minerals be exempt from excess-profits taxes. The addition of fluorspar, and flake graphite, to this list of minerals is proper; both of these minerals are of strategic importance However, we see no possible reason for the inclusion of vermiculite among these strategic minerals. Although this mineral has some uses in connection with war production, it is the opinion of officials in the War Production Board that the present supply is more than adequate. The bulk of this mineral is used for building insulation in competition with rock wool and asbestos, products which no one would presume to say were of strategic importance.

The Treasury's position with respect to the extension of percentage depletion to strategic minerals as a wartime measure is the same as that with respect to the exemption of these minerals from excess-profits taxes. If, but only if, the allowance of percentage depletion for the duration of hostilities will contribute to the war effort, the Treasury recognizes the advantages of such allowances despite our firm conviction that the percentage depletion provisions in the present law have, in general, enabled many individual and

EFFECTIVE NET* TAX RATES ON CORPORATION INCOME AS THE PROPORTION OF TAXABLE EXCESS PROFITS VARIES

Under Present Law, H. R. 3687 and Suggested Revisions in 80 Percent Limitation



Treasury Department, Division of Tax Research, Dec. 17, 1943.

corporate taxpayers to avoid their fair share of the Nation's tax burden. Generally, our position with respect to percentage depletion is the same as was expressed in hearings on the 1942 revenue bill.[1]

However, on the basis of the representations of the War Production Board that percentage depletion for these metals for the duration of the war will contribute to the war effort, we concur in the action taken in the House bill in granting percentage depletion to fluorspar, flake graphite, sheet mica, and beryl.

On the other hand, the Treasury does not believe that the extension of percentage depletion to vermiculite, feldspar, lepidolite, spodumene, and potash can be justified even as a war measure. Although these minerals are used to a greater or lesser extent in war production, we have been informed by the War Production Board that the current output of all of them is adequate to meet present wartime requirements. Consequently, these minerals stand in no different position from all the other minerals which have important wartime uses but with respect to which no critical supply situation exists. It should be noted that most of the potash reserves in this country are found on public lands. The largest known deposits are found on Federal land where production is controlled by the Department of the Interior.

Appendix E. Special Excess-Profits Tax Treatment With Respect to the Accelerated Output of Certain Natural Resources

A. The extension of the coal and iron rule of section 735 to the natural gas industry

The House bill provides special excess-profits tax treatment for natural gas companies with respect to income from the production, storage, and transportation by pipe lines of natural gas. The treatment given would be the same as that now granted under section 735 (b) (2) with respect to income from coal and iron mines.

The Treasury recognizes that natural gas is a depletable resource, the production of which has greatly increased since the beginning of the war. It would not be opposed to the amendment of section 735 to include producers of natural gas. However, the natural gas companies which will benefit most under the provisions of the House bill are primarily engaged in the operation of pipe lines. Some of these companies produce no natural gas, and all of them buy a substantial percentage of the gas carried in their pipe lines. The Treasury believes it would be undesirable to extend the relief now afforded to depletable resource industries to these companies.

Our reasons are twofold. First, from an examination of the tax returns of a number of the representative companies in this industry it appears that the industry, as a whole, is now earning as much per unit of output after excess-profits taxes but before corporation income taxes as it earned during the base period years. It is our belief that the excess-profits tax cannot be said to be injuring an industry, if this tax allows the industry to retain its normal unit profits.

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[1] See Secretary Morgenthau's statement, p. 8, and testimony of Randolph Paul, pp. 84, 2988, 3438, hearings before Ways and Means Committee, 77th Cong., 2d sess.

Second, we believe that the problem faced by the natural gas industry as a result of accelerated output is primarily a depreciation rather than a depletion problem. The relief given in the House bill does not appear to provide an appropriate remedy for the wartime problems of this industry. The Treasury is of the opinion that the position of the natural gas industry is not so unique with respect to accelerated depreciation that it should be relieved of the wartime taxes which Congress has imposed upon industry as a whole.

B. EXTENSION OF THE COAL AND IRON RULE IN SECTION 735 TO NEW PROPERTIES AND TO CORPORATE LESSORS

The House bill extends the treatment accorded by section 735 to operators of coal and iron mines and of lumber tracts in two respects: (1) Corporate lessors are given the same treatment as operators; and (2) new mines and timber properties are allowed to treat one-third of their output as excess output.

Last year, when the revenue bill of 1942 was being considered by your committee, the Treasury pointed out the undesirability of the special formula which was made applicable to producers of coal, iron, and timber. We believed then, as we believe today, that a measure which distributes tax relief without regard to need not only deprives the Government of much needed revenues, but also results in an inequitable distribution of the wartime tax burden among business enterprises.

However, if the coal, iron, and timber rule is to be retained in section 735, the amendments introduced in the House bill are appropriate. In the case of coal mines and timber blocks, the distinction between new and old properties appears to be a tenuous one which has resulted in some inequities. As to the other amendment, corporate lessors of coal, iron, and timber properties should be entitled to the same relief now granted by the law to the operators of such properties.

APPENDIX F. EXCISE TAXES

1. GENERAL BASIS FOR RECOMMENDATIONS

We have recommended that an additional 2½ billion dollars be raised through increases in the rates and changes in the basis of several existing excise taxes and through enacting two new excises. In addition, it is recommended that the tax on the transportation of property be repealed. The specific items selected for heavier taxation, as well as the level of the proposed rates, were determined after detailed analyses had been made of the demand and supply conditions in the different industries, and after consideration had been given to the manner in which producers and consumers would be affected. Moreover the Treasury recommendations on excises are part of a balanced tax program.

Substantial wartime increases in our excise taxes on consumer goods and services are justified on several grounds. The additional administrative costs would be relatively small for the Government, as would

the taxpayers' costs of compliance. There is every reason to believe that few, if any, of the business concerns affected would be unduly burdened, since the higher levies generally could be shifted to consumers with little difficulty. Wartime supply shortages are troublesome for many industries, to be sure, but these very shortages, coupled with the high level of consumer income, create a market situation extremely favorable to forward shifting of excise taxes.

Similarly, there is every reason to believe that the higher taxes would not cause hardship for consumers. The prices of only a relatively few nonbasic commodities and services would be affected. Consumers in a difficult economic situation would be given a real choice between paying the higher taxes and decreasing their purchases of these nonessentials and thereby relieving themselves of part or all of the taxes.

While formulating the Treasury's excise program, we made comparisons with a sales tax proposal designed to yield an equivalent amount of revenue. To raise 2½ billion dollars by means of a sales tax would require about a 4-percent rate on all retail sales, on basic living needs as well as on nonessentials and luxuries. If food sales were exempted, the required rate would be more than 6 percent, and if the exemption were extended to cover also medicines and clothing, the required rate would be over 9 percent.

There are at least three fundamental reasons why the selective excise method is to be preferred. First, the added administrative and compliance effort would be only a small fraction of what would be entailed by a retail sales tax. There would be no substantial enlargement of Bureau of Internal Revenue staff. Few new administrative procedures would have to be established, and the added number of taxpayers would be far less than the 2½ million firms that would be covered by a retail sales tax.

Second, the lower income groups would not be forced to reduce their consumption of the necessities of life as they inevitably would under a sales tax. A retail sales tax, applying to the bulk of consumer purchases, does not give these groups any real choice between paying the tax and escaping it by cutting their taxable purchases. Higher prices for the things they buy, whether induced by a sales tax or any other cause, simply mean that many low-income consumers must exist at a still lower living standard.

Third, under the excise method, we would be certain that a net gain, rather than a loss, would be achieved on the anti-inflation front. The excise tax proposals would not affect the farm parity index, while a general retail sales tax designed to raise the same amount of revenue would increase the index by more than 2 percent. The excise proposals would increase the cost-of-living index by about 1 percent, while an equivalent sales tax would raise it by almost 3 percent. These increases would occur at a time when vigorous action is being taken along many fronts to keep living costs down. The net effect on business costs would be minor under the excise method, particularly if the recommended repeal of the tax on transportation of property is accepted. Under the sales-tax method, price-ceiling adjustments to compensate for the sales tax on various business-cost items would be unavoidable. From the standpoint of the effects on the parity index, the cost-of-living index, and on business costs, therefore, the excise method offers significant advantages. There

would be no risk of upsetting the Government's wartime stabilization program, particularly because the costs of basic necessities would not be affected.

2. GENERAL COMPARISON OF TREASURY RECOMMENDATIONS AND THE HOUSE ACTION ON EXCISE TAXES AND POSTAL RATES

The Treasury's excise tax proposals to the Committee on Ways and Means were designed to raise an additional 2½ billion dollars of revenue. The excise tax changes embodied in the House bill are estimated to raise an additional 1.2 billion dollars of revenue. The bill also provides for higher postal rates estimated to produce an increase of 184 million dollars in postal revenues.

In most cases the items selected for heavier taxation in the House bill are the same as those in the Treasury's recommendations. Some of the rate increases in the House bill, however, are not as great as those suggested by the Treasury. As a result the House bill would raise an additional 1.1 billion dollars from items included in the Treasury's proposals, whereas the Treasury suggested raising about 1.8 billion dollars from these same sources.

Excise tax changes included in the House bill, but not in the Treasury's proposals, are the increases in rates on electric light bulbs, international telegraph messages, and wire equipment services, and the new excise on pari-mutuel betting. The additional revenue from these changes is estimated to be about 51 million dollars.

The Treasury also proposed to raise an additional 852 million dollars from rate increases in the tobacco taxes and from new taxes on soft drinks and candy and chewing gum. None of these proposals is included in the House bill.

Finally, the House bill does not provide for repeal of the tax on transportation of property.

A detailed comparison of the Treasury's excise tax proposals and the existing rates, together with the estimated revenue effects, is shown in exhibit 18.

3. ANALYSIS OF EXCISE TAX PROVISIONS IN HOUSE BILL

The magnitude of our war finance requirements and the need for absorbing excess consumer spending power to the greatest extent possible demand that every effort be made to reach the 2½ billion dollars excise tax goal recommended by the Treasury. The provisions in the House bill would go only about half the way toward meeting the Treasury's goal. There are two principal reasons for this difference.

The first reason is that the recommended increases in tobacco taxes and the proposals for taxing soft drinks and candy and chewing gum were not adopted in the House. These recommendations would raise $852,000,000. Failure to provide for wartime increases in the tobacco taxes cannot be justified on the basis of the prevailing demand and supply conditions in the industries involved. The proposed tax increases could be passed forward to consumers without burdening tobacco growers, manufacturers or distributors. From the standpoint of the probable effects on consumers and the industries, there are just as good reasons for obtaining additional revenue from the tobacco taxes as from the other excise taxes included in the House bill.

Taxing soft drinks and candy and chewing gum, as recommended by the Treasury, would raise $367,000,000. The supplies of these items are appreciably below the wartime demands of consumers and, consequently, the proposed taxes could be shifted forward to consumers without reducing the total volume of sales. While vending machine operators probably could not find a satisfactory method of shifting the taxes on these products, it is believed that they generally could continue to operate profitably by distributing nontaxable products such as nuts, raisins, cookies, and nonaerated soft drinks.

The second reason why the House bill does not meet the Treasury's 2½ billion dollars excise tax goal is that it includes rate increases below the levels recommended by the Treasury for the taxes on distilled spirits, fermented malt liquors, wines, general admissions, transportation of persons, and jewelry. The higher rates proposed by the Treasury would raise 689 million dollars more than those in the House bill. The Treasury again recommends the wartime increase originally proposed for these taxes. These increases are fully warranted in view of the great wartime increases in demand for these articles and services and the prevailing scarcities in their supply.

A further difference between the House bill and the Treasury's excise proposals is the failure to repeal the tax on transportation of property which was enacted last year. This tax is undesirable, since it disturbs existing price and competitive relationships and results in discrimination among competing producers. It conflicts with the Government's efforts to stabilize prices and the advantages which would follow its repeal would more than offset the $170,000,000 decrease in revenue.

Finally, special problems are raised by the excise-tax provisions in the House bill. The first relates to the amount of tax increase on fermented malt liquors. An increase of $1 per barrel as provided in the House bill would represent 0.2 cent per 8-ounce glass and 0.3 cent per 12-ounce bottle. If distributors were permitted to increase their unit selling prices by a full cent they would gain larger profits because of the tax and the Treasury would not get the full benefit of the higher consumer outlays. On the other hand, if price increases were not permitted, distributors would be compelled to absorb a part of the higher tax. A $3 per barrel tax increase as originally recommended by the Treasury would more nearly approximate full cent price increases on customary units of sale.

The Federal Communications Commission has indicated the desirability of maintaining the present 10-percent rate on international cable and radio-telegraph messages in order to facilitate its efforts in promoting international communications. The Commission has also indicated the desirability of continuing the existing tax differential between the taxes on telephone toll message charges and domestic telegraph charges. The House bill proposes to tax these two services at 25-percent rates. It should also be noted that because of competitive relationships existing between domestic telegraph messages and leased wire services, the taxes on these two types of services should preferably be at the same level. The House bill provides for a 25-percent tax on domestic telegraph messages and a 20-percent tax on leased wire, teletypewriter, and talking circuit special services.

Another consideration involves the retailers' excise taxes. At the present time these are levied at 10-percent rates. The House bill follows the Treasury's proposals in providing for 25-percent rates on fur and fur-trimmed articles, toilet preparations, and luggage and related goods. With respect to the jewelry excise, however, the bill provides for a 20-percent rate, compared to the 30-percent rate recommended by the Treasury. In the light of the optional character of the bulk of the items covered by the jewelry tax, the unprecedentedly high demand for these items, and the limited supplies that are available, the Treasury believes that the jewelry tax should be at least as high as the other retailers' excises.

4. TERMINATION OF CERTAIN GOVERNMENTAL EXCISE TAX EXEMPTIONS

Section 307 of the House bill provides for the termination of numerous excise tax exemptions on sales of goods and services to the Federal Government as requested by the President in a letter dated August 11, 1943, to the chairman of the Committee on Ways and Means. The chief taxes affected are the manufacturers' and retailers' excise taxes, the taxes on the transportation of persons and property, and those upon charges for the use of communication facilities. It is believed that this amendment would achieve considerable savings in the manpower now used by the Federal Government and private business to administer these exemptions.

The exemption provisions required the determination of the questions whether sales are made to governmental agencies and whether the articles or services are for the exclusive use of these agencies. Because of the numerous types of contracts under which sales are made to the Government and the greatly expanded scope of its activities, considerable work is required to establish proof of the conditions upon which the exemptions depend. The services of employees taking care of these details could be better utilized in other activities. Repeal of the exemption privileges also may well increase the net revenues of the Federal Government because it is believed that the present system results in considerable loss of revenue through carelessness, errors, and possible fraud. The tremendous volume of paper work involved makes it impossible for the personnel now available to check adequately transactions for which tax exemptions are requested.

LIST OF EXHIBITS

LIST OF EXHIBITS—Continued

EXHIBIT 1

Estimated increase of the revenue program of the Treasury presented to the Committee on Ways and Means of the House of Representatives on Oct. 4, 1943, over the yield of the present law assuming a full year of operations at levels of income estimated for the calendar year 1944

[In billions of dollars]	Increase over present law [1]
Individual income tax: Increase surtax rates; reduce the personal exemption of married couples and heads of families to $1,100 and reduce the dependent credit to $300; repeal the Victory tax and repeal the earned-income credit	6.53
Corporation income taxes: Increase surtax rates, the combined normal and surtax rate reaching a maximum of 50 percent as compared with the present maximum of 40 percent on corporations with income in excess of $50,000	1.14
Estate and gift taxes: Increase estate tax rates, reduce specific exemption from $60,000 to $40,000, and increase gift tax rates to three-quarters of the new and higher estate tax rates	.40
Excise taxes	2.51
Total increase	10.58

[1] The net Victory tax after post-war credit, rather than the gross Victory tax, is contained in the yield of the present law.

Source: Treasury Department, Division of Research and Statistics, Nov. 29, 1943.

EXHIBIT 2

Estimated tax liability under the Treasury proposal as presented to the Committee on Ways and Means of the House of Representatives on Oct. 4, 1943, as compared with the tax liability under the present law for a full year of operation [1]

[In millions of dollars]

General and special accounts	Yield of tax program	Yield of present law	Increase or decrease (−) over yield of present law
1. Internal revenue:			
(1) Income and excess-profits taxes			
Corporation:			
Income	5,872.7	4,734.6	1,138.1
Excess-profits tax	10,888.8	10,888.8	.....
Declared value excess-profits tax	105.6	105.6	.....
Total corporation (gross)	16,867.1	15,729.0	1,138.1
Less post-war credit	1,088.9	1,088.9	.....
Total corporation (net)	15,778.2	14,640.1	1,138.1

See footnotes at end of table.

EXHIBIT 2—Continued

Estimated tax liability under the Treasury proposal as presented to the Committee on Ways and Means of the House of Representatives on Oct. 4, 1948, as compared with the tax liability under the present law for a full year of operation—Con.

General and special accounts	Yield of tax program	Yield of present law	Increase or decrease (—) over yield of present law
1. Internal revenue—Continued.			
(1) Income and excess-profits taxes—Continued.			
Individual:			
Net income tax (gross)	23,892.1	14,105.5	9,786.6
Victory tax (gross)	.....	5,324.1	−5,324.1
Less post-war credit	.....	−2,066.0	2,066.0
Victory tax (net)	.....	3,258.1	−3,258.1
Total individual	23,892.1	17,363.5	6,528.5
Total income and excess-profits taxes	30,670.3	32,003.6	7,666.6
(2) Miscellaneous internal revenue:			
Capital stock, estate, and gift taxes:			
Capital-stock tax	400.0	400.0	.....
Estate tax	902.1	522.4	379.7
Gift tax	62.1	40.2	21.9
Total capital stock, estate, and gift taxes	1,364.2	962.6	401.6
Taxes on commodities and services:			
Liquor taxes:			
Distilled spirits (domestic and imported) (excise tax)[2] [3]	1,222.4	735.2	487.2
Fermented malt liquors [3]	714.5	504.0	210.5
Rectification tax [3]	11.5	11.5	.....
Wines (domestic and imported) (excise tax)[3]	97.7	36.6	61.1
Special taxes in connection with liquor occupations	11.0	11.0	.....
Container stamps	9.4	9.4	.....
Floor stocks taxes	.6	.6	.....
All other	1.6	1.6	.....
Total liquor taxes	2,068.7	1,300.9	758.8
Tobacco taxes:			
Cigarettes (small) [3]	1,264.1	892.8	371.3
Tobacco (chewing and smoking) [3]	85.0	45.0	40.0
Cigars (large) [3]	99.5	31.7	67.7
Snuff	13.2	7.0	6.2
Cigarette papers and tubes	1.3	1.3	.....
All other [3]	.1	.1	.....
Total tobacco taxes	1,463.2	977.9	485.2
Stamp taxes:			
Issues of securities, bond transfers, and deeds of conveyance	25.0	25.0	.....
Stock transfers	19.0	19.0	.....
Playing cards [3]	7.5	7.5	.....
Silver bullion sales or transfers	(4)	(4)	.....
Total stamp taxes	51.6	51.5	.....
Manufacturers' excise taxes:			
Gasoline	251.1	251.1	.....
Lubricating oils	54.3	54.3	.....
Passenger automobiles and motorcycles	.9	.9	.....
Automobile trucks, busses, and trailers	3.5	3.5	.....
Parts and accessories for automobiles	25.0	25.0	.....
Tires and inner tubes	40.0	40.0	.....
Electrical energy	48.5	48.5	.....
Electric, gas, and oil appliances	3.6	3.6	.....
Electric light bulbs	5.0	5.0	.....
Radio receiving sets, phonographs, phonograph records, and musical instruments	3.5	3.5	.....
Refrigerators, refrigerating apparatus, and air-conditioners	1.1	1.1	.....
Business and store machines	2.8	2.8	.....
Photographic apparatus	11.9	11.9	.....
Matches	10.5	10.5	.....
Luggage [3]	.....	5.0	−5.0
Sporting goods	2.0	2.0	.....
Firearms, shells, pistols, and revolvers	.8	.8	.....
Candy and chewing gum	190.0	.....	190.0
Soft drinks	177.0	.....	177.0
Total manufacturers' excise taxes	831.5	469.5	362.0

See footnotes at end of table.

EXHIBIT 2—Continued

Estimated tax liability under the Treasury proposal as presented to the Committee on Ways and Means of the House of Representatives on Oct. 4, 1943, as compared with the tax liability under the present law for a full year of operation—Con.

General and special accounts	Yield of tax program	Yield of present law	Increase or decrease (−) over yield of present law
1. Internal revenue—Continued.[1]			
(2) Miscellaneous internal revenue—Continued.			
Retailers' excise taxes:			
Jewelry, etc.	256.5	89.2	167.3
Furs	93.0	38.2	54.8
Toilet preparations	86.4	35.0	51.4
Luggage,[2] handbags, wallets, etc.	58.4	.....	58.4
Total retailers' excise taxes	494.3	162.4	331.9
Miscellaneous taxes:			
Telephone, telegraph, radio and cable facilities, leased wires, etc.	152.7	121.2	31.5
Telephone bill	146.7	97.8	48.9
Transportation of oil by pipe line	14.5	14.5	.....
Transportation of persons	354.5	141.8	212.7
Transportation of property	.....	[3] 170.3	−170.3
General admissions	490.4	163.5	327.0
Cabarets, etc.	110.7	19.4	91.3
Club dues and initiation fees	11.3	6.2	5.1
Leases of safe deposit boxes	6.5	6.5	.....
Use of motor vehicles and boats	115.5	115.5	.....
Coconut and other vegetable oils processed [4]	2.0	2.0	.....
Oleomargarine, etc., including special taxes and adulterated butter	3.1	3.1	.....
Sugar tax	61.0	61.0	.....
Coin-operated amusement and gaming devices	12.2	12.2	.....
Bowling alleys and billiard and pool tables	28.8	1.8	27.0
All other, including repealed taxes [5]	1.3	1.3	.....
Total miscellaneous taxes	1,511.1	938.0	573.2
Total taxes on commodities and services	6,420.4	3,909.3	2,511.1
Total miscellaneous internal revenue	7,784.6	4,871.9	2,912.7
(3) Employment taxes:			
Employment by other than carriers:			
Federal Insurance Contributions Act	2,799.0	2,799.0	.....
Federal Unemployment Tax Act	207.0	207.0	.....
Total	3,006.0	3,006.0	.....
Taxes on carriers and their employees (ch. 9, subch. B of the Internal Revenue Code)	262.7	262.7	.....
Total employment taxes	3,268.7	3,268.7	.....
Total internal revenue	50,723.6	40,144.2	10,579.3
2. Railroad unemployment-insurance contributions	12.1	12.1	.....
3. Customs	400.0	400.0	.....
4. Miscellaneous receipts	581.0	581.0	.....
Total yield, general and special accounts	51,716.7	41,137.3	10,579.3

[1] Estimates of the yield of the tax program and of present law are at levels of income estimated for the calendar year 1944.
[2] Collections for credit to trust funds are not included.
[3] These estimates are after allowances for drawbacks of 27.6 million dollars under the proposal and of 14.8 million dollars under present law.
[4] Less than 0.05 million dollars.
[5] The tax on luggage has been changed from a manufacturers' excise to a retailers' excise tax.
[6] Including the effects of H. R. 3338, Public Law 180, approved Nov. 4, 1943.
[7] Includes collections from taxes on narcotics; taxes under the National Firearms Act, and the tax on hydraulic mining, all of which are effective currently. In addition includes collections from repealed taxes not reinstated by the Revenue Act of 1941 and collections from the following excise taxes repealed by the Revenue Act of 1942: Rubber articles, electric signs, optical equipment, and washing machines.

Source: Treasury Department, Division of Research and Statistics, Nov. 29, 1943.
NOTE.—Figures are rounded and will not necessarily add to totals

Exhibit 3

Comparison of combined normal and surtax rates under present law, under the proposal to integrate the Victory tax, and under H. R. 3687 [1]

Surtax net income	Present law [2]	Proposal to integrate Victory tax [3]	H. R. 3687 [3]	Surtax net income	Present law [2]	Proposal to integrate Victory tax [3]	H. R. 3687 [3]
	Percent	*Percent*	*Percent*		*Percent*	*Percent*	*Percent*
Not over $2,000	19	22	23	$26,000 to $32,000	61	64	65
$2,000 to $4,000	22	25	26	$32,000 to $38,000	64	67	68
$4,000 to $6,000	26	29	30	$38,000 to $44,000	67	71	72
$6,000 to $8,000	30	33	33	$44,000 to $50,000	69	74	75
$8,000 to $10,000	34	37	37	$50,000 to $62,000	72	77	78
$10,000 to $12,000	38	41	41	$62,000 to $74,000	75	81	81
$12,000 to $14,000	42	45	46	$74,000 to $86,000	78	84	84
$14,000 to $16,000	46	49	50	$86,000 to $98,000	81	87	87
$16,000 to $18,000	49	52	53	$98,000 to $110,000	83	90	90
$18,000 to $20,000	52	55	56	$110,000 to $150,000	85	92	92
$20,000 to $22,000	55	58	59	$150,000 to $200,000	87	93	93
$22,000 to $26,000	58	61	62	Over $200,000	88	94	94

[1] The present exemptions of $500 for a single person, $1,200 for a married couple, and $350 for each dependent are retained in H. R. 3687. Under the proposed integration plan, they are $500, $1,200, and $100, respectively. The earned income credit is eliminated under both H. R. 3687 and the proposed integration plan.
[2] Includes 6 percent normal tax. However, under present law the earned income credit reduces the normal tax rate by 0.6 percent with respect to earned net income up to $11,000.
[3] Includes 10 percent normal tax.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

Exhibit 4

Table 1.—*Amounts of individual income tax and effective rates under present law, under the proposal to integrate the Victory tax and under H. R. 3687*

SINGLE PERSON—NO DEPENDENTS

[Exemptions: Present law, $500; proposal, $400]

Net income before personal exemption	Amounts of tax					Effective rates				
				Increase					Increase	
	Present law, including net Victory tax [1]	Proposal to integrate Victory tax	H. R. 3687	Proposal to integrate Victory tax	H. R. 3687	Present law, including net Victory tax [1]	Proposal to integrate Victory tax	H. R. 3687	Proposal to integrate Victory tax	H. R. 3687
						Percent	*Percent*	*Percent*	*Percent*	*Percent*
$600	$17	$22	$23	$5	$6	2.8	3.7	3.8	0.8	1.0
$800	62	66	69	4	7	7.8	8.3	8.6	.5	.9
$1,000	107	110	115	3	8	10.7	11.0	11.5	.3	.8
$1,200	153	154	161	1	8	12.8	12.8	13.4	.1	.7
$1,500	220	220	230	0	10	14.7	14.7	15.3	0	.7
$1,700	265	261	276	−1	11	15.6	15.5	16.2	−.1	.6
$1,900	310	308	322	−2	12	16.3	16.2	16.9	−.1	.6
$2,000	333	330	345	−3	12	16.7	16.5	17.3	−.2	.6
$2,300	401	396	414	−5	13	17.4	17.2	18.0	−.2	.6
$2,500	448	443	460	−5	14	17.9	17.7	18.4	−.2	.6
$3,000	554	545	569	−9	15	18.4	18.2	19.0	−.3	.5
$4,000	836	815	859	−14	21	20.7	20.4	21.3	−.4	.5
$5,000	1,135	1,095	1,130	−20	25	22.1	21.7	22.6	−.4	.5
$10,000	2,783	2,735	2,795	−48	12	27.8	27.4	28.0	−.5	.1
$25,000	10,651	10,445	10,630	−199	−14	42.6	41.8	42.5	−.8	−.1
$50,000	28,068	27,570	27,965	−508	−73	56.1	55.1	56.0	−1.0	−.1
$100,000	64,665	64,270	64,910	−395	245	64.7	64.3	64.9	−.4	.2
$250,000	207,974	208,750	209,300	776	1,326	83.2	83.5	83.5	.3	.6
$500,000	441,863	443,250	444,500	1,387	2,637	88.4	88.6	88.9	.4	.5
$1,000,000	[2] 899,500	913,750	[2] 900,000	14,250	500	[2] 90.0	91.4	[2] 90.0	1.4	(3)

[1] Maximum earned net income assumed. For Victory tax purposes, gross income is assumed to be 1⅓ of net income.
[2] Taking into account maximum effective rate limitation of 90 percent.
[3] Less than 0.05 percent.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

TABLE 2.—*Amounts of individual income tax and effective rates under present law, under the proposal to integrate the Victory tax and under H. R. 3687*

MARRIED PERSON—NO DEPENDENTS

[Exemptions. Present law and H. R. 3687, $1,200; integration proposal, $1,100]

Net income before personal exemption	Amounts of tax					Effective rates				
				Increase					Increase	
	Present law, including net Victory tax [1]	Proposal to integrate Victory tax	H. R. 3687	Proposal to integrate Victory tax	H. R. 3687	Present law, including net Victory tax [1]	Proposal to integrate Victory tax	H. R. 3687	Proposal to integrate Victory tax	H. R. 3687
						Percent	*Percent*	*Percent*	*Percent*	*Percent*
$600	$1	.....	.....	−$1	−$1	0.2	.....	.....	−0.2	−0.2
$800	8	.....	[2] $3	−8	−5	1.0	.....	[2] 0.4	−1.0	−.6
$1,000	15	.....	[2] 9	−15	−6	1.5	.....	[2] .9	−1.5	−.6
$1,200	21	$22	[2] 15	1	−6	1.8	1.8	[2] 1.3	.1	−.5
$1,500	79	88	69	9	−10	5.3	5.9	4.6	.6	−.7
$1,700	123	132	115	9	−8	7.2	7.8	6.8	.5	−.5
$1,900	166	176	161	10	−5	8.7	9.3	8.5	.5	−.3
$2,000	188	198	184	10	−4	9.4	9.9	9.2	.5	−.2
$2,300	253	264	253	11	0	11.0	11.5	11.0	.5	0
$2,500	297	308	299	11	2	11.9	12.3	12.0	.4	.1
$3,000	405	418	414	13	9	13.5	13.9	13.8	.4	.3
$4,000	647	665	668	18	21	16.2	16.6	16.7	.5	.5
$5,000	894	915	928	21	34	17.9	18.3	18.6	.4	.7
$10,000	2,467	2,513	2,536	46	69	24.7	25.1	25.4	.5	.7
$25,000	10,035	10,079	10,196	44	161	40.1	40.3	40.8	.2	.6
$50,000	27,075	27,106	27,460	31	385	54.2	54.2	54.9	.1	.8
$100,000	58,584	58,730	59,280	146	696	58.6	58.7	59.3	.1	.7
$250,000	206,558	208,186	208,732	1,628	1,874	82.7	83.3	83.5	.6	.7
$500,000	440,747	443,186	443,732	2,439	2,985	88.1	88.6	88.7	.5	.6
$1,000,000	[3] 859,000	913,186	[3] 900,000	14,186	1,000	[3] 89.9	91.3	[3] 90.0	1.4	(4)

[1] Maximum earned net income assumed. For Victory tax purposes, gross income assumed to be 1⅓ of net income.
[2] Minimum tax.
[3] Taking into account the maximum effective rate limitation of 90 percent.
[4] Less than 0.05 percent.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

TABLE 3.—*Amounts of individual income tax and effective rates under present law, under the proposal to integrate the Victory tax, and under H. R. 3687*

MARRIED PERSON—TWO DEPENDENTS

[Exemptions: Present law and H. R. 3687, $1,200, $350; integration proposal, $1,100, $300]

Net income before personal exemption	Amounts of tax					Effective rates				
				Increase					Increase	
	Present law, including net Victory tax [1]	Proposal to integrate Victory tax	H. R. 3687	Proposal to integrate Victory tax	H. R. 3687	Present law, including net Victory tax [2]	Proposal to integrate Victory tax	H. R. 3687	Proposal to integrate Victory tax	H. R. 3687
						Percent	*Percent*	*Percent*	*Percent*	*Percent*
$600	$1			−$1	−$1	0.2			−0.2	−0.2
$800	7			−7	−7	.9			−.9	−.9
$1,000	14		[3] 3	−14	−11	1.4		[3] 0.3	−1.4	−1.1
$1,200	20		[3] 9	−20	−11	1.7		[3] .8	−1.7	−.9
$1,500	29		[3] 18	−29	−11	1.9		[3] 1.2	−1.9	−.7
$1,700	35		[3] 24	−35	−11	2.1		[3] 1.4	−2.1	−.6
$1,900	42	$44	[3] 30	2	−12	2.2	2.3	[3] 1.6	.1	−.6
$2,000	55	66	[3] 33	8	−25	2.9	3.3	[3] 1.7	.4	−1.3
$2,400	116	132	92	16	−24	5.1	5.7	4.0	.7	−1.0
$2,500	150	176	138	17	−21	6.4	7.0	5.5	.7	−.8
$3,000	267	286	253	19	−14	8.9	9.5	8.4	.6	−.5
$4,000	455	815	456	30	1	12.1	12.9	12.2	.8	(4)
$5,000	730	765	746	35	16	14.6	15.3	14.9	.7	.3
$10,000	2,208	2,291	2,277	83	69	22.1	22.9	22.8	.8	.7
$25,000	9,574	9,713	9,762	139	188	38.3	38.9	39.0	.6	.8
$50,000	26,392	26,662	26,935	270	543	52.8	53.3	53.9	.5	1.1
$100,000	67,803	68,190	68,650	387	847	67.8	68.2	68.7	.4	.8
$250,000	208,042	207,622	208,074	1,580	2,032	82.4	83.0	83.2	.6	.8
$500,000	439,931	442,622	443,074	2,691	3,143	88.0	88.5	88.6	.5	.6
$1,000,000	[5] 898,800	912,622	[5] 900,000	13,822	1,200	[5] 89.9	91.3	[5] 90.0	1.4	(4)

[1] Maximum earned net income assumed. For Victory tax purposes, gross income is assumed to be 1¼ of net income.
[2] Minimum tax.
[3] Taking into account maximum effective rate limitation of 90 percent.
[4] Less than 0.05 percent.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

EXHIBIT 5

Comparison of individual surtax rate schedule under present law and the Treasury proposal [1]

Surtax net income	Bracket rate		Total surtax cumulative		Surtax net income	Bracket rate		Total surtax cumulative	
	Present law	Proposal	Present law	Proposal		Present law	Proposal	Present law	Proposal
	Percent	*Percent*				*Percent*	*Percent*		
Not over $500	13	21	$65	$105	$22,000 to $26,000	52	74	$9,020	$15,350
$500 to $1,000	13	24	130	225	$26,000 to $32,000	55	77	12,320	19,970
$1,000 to $1,500	13	27	195	360	$32,000 to $38,000	58	79	15,800	24,710
$1,500 to $2,000	13	33	260	510	$38,000 to $44,000	61	81	19,460	29,570
$2,000 to $4,000	16	35	580	1,210	$44,000 to $50,000	63	83	23,240	33,550
$4,000 to $6,000	20	40	980	2,010	$50,000 to $60,000	66	85	29,840	42,050
$6,000 to $8,000	24	45	1,460	2,910	$60,000 to $70,000	69	86	36,740	50,450
$8,000 to $10,000	28	49	2,020	3,900	$70,000 to $80,000	72	87	43,940	59,350
$10,000 to $12,000	32	53	2,660	4,960	$80,000 to $90,000	75	88	51,440	68,150
$12,000 to $14,000	36	57	3,380	6,100	$90,000 to $100,000	77	89	59,140	77,050
$14,000 to $16,000	40	61	4,180	7,310	$100,000 to $150,000	79	90	98,640	122,050
$16,000 to $18,000	43	65	5,040	8,610	$150,000 to $200,000	81	90	139,140	167,050
$18,000 to $20,000	46	68	5,900	9,970	Over $200,000	82	90	.....	.....
$20,000 to $22,000	49	71	6,940	11,390	Normal tax	6	6	.....	.....

[1] Under the proposal, the Victory tax and earned income credits are eliminated. The proposed exemptions are $500 for a single person, $1,100 for a married couple, and $300 for each dependent; under present law the exemptions are $500, $1,200, and $350, respectively.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

EXHIBIT 6

TABLE 1.—*Amounts of individual income tax and effective rates under present law and the Treasury proposal*

SINGLE PERSON—NO DEPENDENTS

(Exemptions: Present law, $500; proposal, $500)

Net income before personal exemption	Amounts of tax			Effective rates		
	Present law, including net Victory tax [1]	Proposal [2]	Increase	Present law, including net Victory tax [1]	Proposal [3]	Increase
				Percent	*Percent*	*Percent*
$600	$17	$27	$10	2.8	4.5	1.7
$800	62	81	19	7.8	10.1	2.4
$900	85	108	23	9.4	12.0	2.6
$1,000	107	135	28	10.7	13.5	2.8
$1,100	130	165	35	11.8	15.0	3.2
$1,200	153	195	42	12.8	16.3	3.5
$1,500	220	285	65	14.7	19.0	4.3
$1,600	243	318	75	15.2	19.9	4.7
$2,000	333	450	117	16.7	22.5	5.9
$2,500	446	630	184	17.8	25.2	7.4
$3,000	574	835	261	19.1	27.8	8.7
$4,000	829	1,245	416	20.7	31.1	10.4
$5,000	1,105	1,680	575	22.1	33.6	11.5
$6,000	1,401	2,140	739	23.4	35.7	12.3
$8,000	2,052	3,135	1,083	25.7	39.2	13.5
$10,000	2,783	4,215	1,432	27.8	42.2	14.3
$12,500	3,802	5,670	1,868	30.4	45.4	14.9
$15,000	4,968	7,265	2,297	33.1	48.4	15.3
$20,000	7,626	10,800	3,174	38.1	54.0	15.9
$25,000	10,644	14,710	4,066	42.6	58.8	16.3
$50,000	28,058	36,105	8,047	56.1	72.2	16.1
$75,000	45,001	59,025	14,024	60.0	78.7	14.7
$100,000	60,665	82,575	12,910	60.7	82.6	12.9
$500,000	441,593	466,300	24,707	88.4	93.3	4.9
$1,000,000	[3] 899,500	946,570	47,070	[3] 90.0	94.7	4.7
$5,000,000	[3] 4,199,500	4,486,570	287,070	[3] 90.0	95.7	5.7

[1] Maximum earned net income assumed. Victory tax net income assumed to be 1/6 of net income.
[2] Victory tax and earn-income credit eliminated.
[3] Taking into account maximum effective rate limitation of 90 percent.

Source: Treasury Department, Division of Tax Research, Nov. 20, 1943.

TABLE 2.—*Amounts of individual income tax and effective rates under present law and the Treasury proposal*

MARRIED PERSON—NO DEPENDENTS

[Exemptions: Present law, $1,200; proposal, $1,100]

Net income before personal exemption	Amounts of tax			Effective rates		
	Present law, including net Victory tax[1]	Proposal[2]	Increase	Present law, including net Victory tax[1]	Proposal[3]	Increase
				Percent	*Percent*	*Percent*
$1,000	$15		−$15	1.5		−1.5
$1,250	29	$41	12	2.3	3.3	1.0
$1,500	79	108	29	5.3	7.2	1.9
$1,750	134	179	45	7.7	10.3	2.6
$2,000	188	255	67	9.4	12.8	3.4
$2,250	242	335	93	10.8	14.9	4.1
$2,500	297	417	120	11.9	16.7	4.8
$2,750	351	504	153	12.8	18.3	5.6
$3,000	405	594	189	13.5	19.8	6.3
$4,000	647	999	352	16.2	25.0	8.8
$5,000	894	1,409	515	17.9	28.2	10.3
$6,000	1,171	1,864	693	19.5	31.1	11.5
$8,000	1,783	2,829	1,046	22.3	35.4	13.1
$10,000	2,467	3,885	1,418	24.7	38.9	14.2
$15,000	4,533	6,867	2,334	30.2	45.8	15.6
$20,000	7,100	10,376	3,276	35.5	51.9	16.4
$25,000	10,035	14,230	4,195	40.1	56.9	16.8
$50,000	27,075	35,571	8,496	54.2	71.1	17.0
$75,000	46,955	58,477	11,522	62.6	78.0	15.4
$100,000	68,588	82,009	13,421	68.6	82.0	13.4
$500,000	440,747	465,994	25,247	88.1	93.2	5.0
$1,000,000	889,000	936,944	47,944	88.9	93.6	4.7
$5,000,000	4,500,000	4,785,994	285,994	90.0	95.7	5.7

[1] Maximum earned net income assumed. Victory tax net income assumed to be [illegible] of net income.
[2] Victory tax and [illegible]
[3] Taking into account maximum effective rate limitation of 90 percent.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

TABLE 3.—*Amounts of individual income tax and effective rates under present law and the Treasury proposal*

MARRIED PERSON—2 DEPENDENTS

[Exemptions: Present law—$1,200, $350; proposal—$1,100, $300]

Net income before personal exemption	Amounts of tax			Effective rates		
	Present law, including net Victory tax [1]	Proposal [2]	Increase	Present law, including net Victory tax [1]	Proposal [2]	Increase
				Percent	*Percent*	*Percent*
$1,800	$39	$27	−$12	2.2	1.5	−0.7
$2,000	58	81	23	2.9	4.1	1.2
$2,500	116	165	49	5.0	7.2	2.1
$3,000	159	225	66	6.4	9.0	2.6
$3,500	267	384	117	8.9	12.8	3.9
$4,000	455	758	306	12.1	18.8	6.7
$5,000	730	1,163	433	14.6	23.3	8.7
$6,000	970	1,583	609	16.3	26.5	10.2
$8,000	1,553	2,823	970	19.4	31.5	12.1
$10,000	2,208	3,555	1,347	22.1	35.6	13.5
$12,500	3,144	4,962	1,818	25.2	39.7	14.5
$15,000	4,207	6,459	2,252	28.0	43.3	15.2
$20,000	6,693	9,912	3,219	33.5	49.6	16.1
$27,000	9,574	13,750	4,176	38.3	55.0	16.7
$50,000	26,392	35,037	8,645	52.8	70.1	17.3
$75,000	65,209	87,919	11,710	61.6	77.2	15.6
$100,000	67,803	81,435	13,632	67.8	81.4	13.6
$500,000	439,931	465,418	25,487	88.0	93.1	5.1
$1,000,000	[3] 898,800	943,418	46,618	[3] 89.9	94.5	4.7
$5,000,000	[3] 4,498,800	4,755,418	256,618	[3] 90.0	95.7	5.7

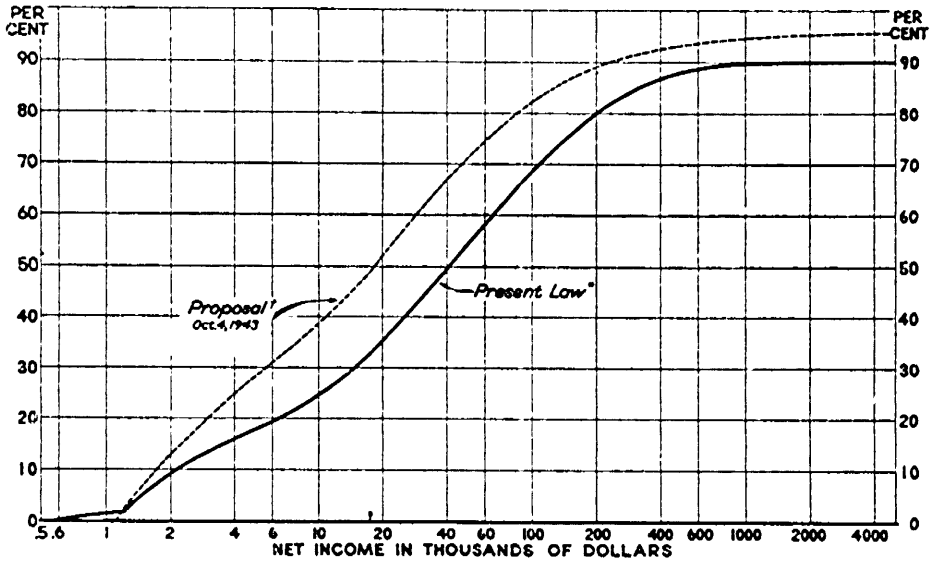
[1] Maximum earned net income assumed. Victory tax net income assumed to be 4% of net income.
[2] Victory tax and 5 percent income credit eliminated.
[3] Taking into account maximum effective rate limitation of 90 percent.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

Exhibit 7

INDIVIDUAL INCOME TAX

Effective Rates for Married Person without Dependents



Treasury Department, Division of Tax Research, Nov. 29, 1943.

EXHIBIT 8

Comparison of surtax rates under present law, the Treasury proposal of Oct. 4, 1943, and 2 alternative schedules [1]

Surtax net income	Present law	Treasury proposal, Oct. 4, 1943	Treasury alternative proposal A	Treasury alternative proposal B	Surtax net income	Present law	Treasury proposal, Oct. 4, 1943	Treasury alternative proposal A	Treasury alternative proposal B
	Per cent	*Per cent*	*Per cent*	*Per cent*		*Per cent*	*Per cent*	*Per cent*	*Per cent*
Not over $500	13	21	22	24	$22,000 to $26,000	52	74	64	55
$500 to $1,000	13	24	25	26	$26,000 to $32,000	55	77	66	58
$1,000 to $1,500	13	27	28	28	$32,000 to $38,000	58	79	68	61
$1,500 to $2,000	13	30	31	31	$38,000 to $44,000	61	81	70	64
$2,000 to $4,000	16	35	36	36	$44,000 to $50,000	63	83	72	66
$4,000 to $6,000	20	40	40	40	$50,000 to $60,000	66	85	74	69
$6,000 to $8,000	24	45	43	40	$60,000 to $70,000	69	64	76	72
$8,000 to $10,000	28	49	46	44	$70,000 to $80,000	72	87	78	75
$10,000 to $12,000	32	53	49	44	$80,000 to $90,000	75	88	80	78
$12,000 to $14,000	36	57	52	47	$90,000 to $100,000	77	89	82	81
$14,000 to $16,000	40	61	55	47	$100,000 to $150,000	79	90	84	84
$16,000 to $18,000	43	63	58	50	$150,000 to $200,000	81	90	86	87
$18,000 to $20,000	46	66	60	50	Over $200,000	82	90	87	88
$20,000 to $22,000	49	71	62	53	Normal tax	6	6	6	6

[1] Under each of the proposals, the Victory tax and earned-income credit are eliminated and the exemptions are $500, $1,100, and $300.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

EXHIBIT 9

TABLE 1.—*Amounts of individual income tax under present law, the Treasury proposal of Oct. 4, 1943, and 2 alternative schedules*

SINGLE PERSON—NO DEPENDENTS

[Exemptions: Present law, $500; proposals, $500]

Net income before personal exemption	Amounts of tax				Increase		
	Present law, including 5% Victory tax [1]	Treasury proposal, Oct. 4, 1943	Treasury proposal A	Treasury proposal B	Treasury proposal, Oct. 4, 1943	Treasury proposal A	Treasury proposal B
$500							
$600	$17	$27	$28	$30	$10	$11	$13
$800	42	61	64	68	19	22	26
$1,000	85	108	112	120	23	27	35
$1,100	107	135	140	150	28	33	43
$1,200	130	165	171	182	35	41	52
$1,400	173	205	202	214	42	49	61
$1,600	220	265	265	310	65	75	90
$1,800	243	318	329	344	75	53	101
$2,000	338	450	455	480	112	132	147
$2,500	546	630	650	665	184	204	219
$3,000	774	935	960	975	261	286	301
$4,000	1,229	1,245	1,280	1,295	416	451	466
$5,000	1,905	1,680	1,720	1,735	575	615	630
$6,000	1,401	2,160	2,190	2,195	759	789	794
$8,000	2,052	3,135	3,145	3,115	1,083	1,093	1,063
$10,000	2,783	4,215	4,170	4,095	1,432	1,387	1,312
$12,500	3,502	5,670	5,530	5,345	1,868	1,728	1,543
$15,000	4,968	7,265	6,995	6,670	2,297	2,027	1,702
$20,000	7,626	10,800	10,180	9,425	3,174	2,554	1,799
$25,000	13,644	14,710	13,820	12,410	4,066	2,976	1,766
$50,000	28,056	34,105	32,280	29,345	8,047	4,222	1,287
$75,000	46,091	59,035	52,450	46,650	11,034	4,619	619
$100,000	63,655	82,575	74,230	63,770	12,910	4,565	105
$500,000	341,563	468,570	414,215	343,235	24,707	2,342	1,372
$1,000,000	1,890,500	943,570	889,205	913,235	47,070	9,765	13,735
$5,000,000	[2] 4,499,500	4,786,570	4,629,205	4,673,235	287,070	129,705	173,735

[1] Maximum earned net income assumed. Victory tax net income assumed to be 1/4 of net income.

[2] Taking into account maximum effective rate limitation of 90 percent.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

TABLE 1A.—*Effective rates of individual income tax under present law, the Treasury proposal of Oct. 4, 1943, and 2 alternative schedules*

SINGLE PERSON—NO DEPENDENTS

[Exemptions: Present law, $500; proposals, $500]

Net income before personal exemption	Effective rates				Increase		
	Present law, including net Victory tax [1]	Treasury proposal, Oct. 4, 1943	Treasury proposal A	Treasury proposal B	Treasury proposal, Oct. 4, 1943	Treasury proposal A	Treasury proposal B
	Percent	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
$500							
$600	2.8	1.5	4.7	5.0	1.7	1.8	2.2
$800	7.8	10.1	10.5	11.3	2.4	2.8	3.5
$900	9.4	12.0	12.4	13.3	2.6	3.0	3.9
$1,000	10.7	13.5	14.0	15.0	2.8	3.3	4.3
$1,100	11.8	15.0	15.5	16.5	3.2	3.7	4.7
$1,200	12.8	16.3	16.8	17.8	3.5	4.1	5.1
$1,500	14.7	19.0	19.7	20.7	4.3	5.0	6.0
$1,600	15.2	19.9	20.6	21.5	4.7	5.4	6.3
$2,000	16.7	22.5	23.3	24.0	5.9	6.6	7.4
$2,500	17.8	25.2	26.0	26.6	7.4	8.2	8.8
$3,000	19.1	27.8	28.7	29.2	8.7	9.5	10.0
$4,000	20.7	31.1	32.0	32.4	10.4	11.3	11.7
$5,000	22.1	33.6	34.4	34.7	11.5	12.3	12.6
$6,000	23.4	35.7	36.3	36.6	12.3	13.0	13.2
$8,000	25.7	39.2	39.3	38.9	13.5	13.7	13.3
$10,000	27.8	42.2	41.7	41.0	14.3	13.9	13.1
$12,500	30.4	45.4	44.2	42.8	14.9	13.8	12.3
$15,000	33.1	48.4	46.6	44.5	15.3	13.5	11.3
$20,000	38.1	54.0	50.9	47.1	15.9	12.8	9.0
$25,000	42.6	58.8	54.5	49.6	16.3	11.9	7.1
$50,000	56.1	72.2	64.6	58.7	16.1	8.4	2.6
$75,000	64.0	78.7	70.2	64.9	14.7	6.2	.9
$100,000	69.7	82.6	74.2	69.8	12.9	4.5	.1
$500,000	88.4	93.3	88.8	88.6	4.9	.5	.3
$1,000,000	[2] 90.0	94.7	90.9	91.3	4.7	1.0	1.4
$5,000,000	[2] 90.0	95.7	92.6	93.5	5.7	2.6	3.5

[1] Maximum earned net income assumed. Victory tax net income assumed to be 13% of net income.
[2] Taking into account maximum effective rate limitation of 90 percent.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

TABLE 2.—*Amounts of individual income tax under present law, the Treasury proposal of Oct. 4, 1943, and 2 alternative schedules*

MARRIED PERSON—NO DEPENDENTS

[Exemptions: Present law, $1,200; proposals, $1,100]

Net income before personal exemption	Amounts of tax				Increase		
	Present law, including net Victory tax [1]	Treasury proposal, Oct. 4, 1943	Treasury proposal A	Treasury proposal B	Treasury proposal, Oct. 4, 1943	Treasury proposal A	Treasury proposal B
$1,100	$18	.....	.....	.....	−$18	−$18	−$18
$1,200	21	$27	$28	$30	6	7	9
$1,300	79	108	112	120	29	33	41
$1,400	101	135	139	150	34	39	49
$1,500	144	195	202	214	51	58	70
$1,900	166	225	233	246	59	67	80
$2,000	188	255	264	278	67	76	90
$2,500	297	417	431	446	120	134	149
$3,000	405	594	613	628	189	208	223
$4,000	647	999	1,028	1,043	352	381	396
$5,000	894	1,409	1,448	1,463	515	554	569
$6,000	1,173	1,964	1,994	1,919	691	731	746
$8,000	1,750	2,829	2,881	2,839	1,049	1,061	1,089
$10,000	2,467	3,885	3,958	3,795	1,418	1,531	1,328
$12,500	3,437	5,316	5,390	5,045	1,879	1,753	1,608
$15,000	4,523	6,857	6,812	6,352	2,334	2,099	1,829
$20,000	7,100	10,356	9,784	9,089	3,256	2,684	1,989
$25,000	10,035	14,230	13,210	12,044	4,195	3,165	2,009
$50,000	27,075	35,571	31,812	28,913	8,496	4 737	1,838
$75,000	46,955	58,477	52,165	48,164	11,522	5,191	1,209
$100,000	68,554	82,005	73,702	69,245	13,421	5,118	664
$500,000	443,747	468,994	443,647	442,471	25,247	2,900	1,924
$1,000,000	[2] 809,000	943,994	908,617	912,671	45,091	9,617	13,671
$5,000,000	[2] 4,499,000	4,785,994	4,628,647	4,612,671	286,994	129,647	113,671

[1] Maximum earned net income assumed. Victory tax net income assumed to be 1⅓ of net income.
[2] Taking into account maximum effective rate limitation of 90 percent.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

TABLE 2A.—*Effective rates of individual income tax under present law, the Treasury proposal of Oct. 4, 1943, and 2 alternative schedules*

MARRIED PERSON—NO DEPENDENTS

[Exemptions: Present law, $1,200; proposals, $1,100]

Net income before personal exemption	Effective rates				Increase		
	Present law, including net Victory tax [1]	Treasury proposal, Oct. 4, 1943	Treasury proposal A	Treasury proposal B	Treasury proposal, Oct. 4, 1943	Treasury proposal A	Treasury proposal B
	Percent	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
$1,100	1.6				−1.6	−1.6	−1.6
$1,200	1.8	2.3	2.3	2.5	.5	.6	.8
$1,500	5.3	7.2	7.5	8.0	1.9	2.2	2.7
$1,600	6.3	8.4	8.8	9.4	2.1	2.4	3.1
$1,800	8.0	10.8	11.2	11.9	2.8	3.2	3.9
$1,900	8.7	11.8	12.3	12.9	3.1	3.5	4.2
$2,000	9.4	12.8	13.2	13.9	3.4	3.8	4.5
$2,500	11.9	16.7	17.2	17.8	4.8	5.4	6.0
$3,000	13.5	19.8	20.4	20.9	6.3	6.9	7.4
$4,000	16.2	25.0	25.7	26.1	8.8	9.5	9.9
$5,000	17.9	28.2	29.0	29.3	10.3	11.1	11.4
$6,000	19.6	31.1	31.7	32.0	11.5	12.2	12.4
$8,000	22.3	35.4	35.6	35.5	13.1	13.4	13.2
$10,000	24.7	38.9	38.6	38.0	14.2	13.9	13.3
$12,500	27.5	42.5	41.6	40.4	15.0	14.1	12.9
$15,000	30.2	45.8	44.2	42.3	15.6	14.0	12.1
$20,000	35.5	51.8	48.9	45.4	16.3	13.4	9.9
$25,000	40.1	56.9	52.8	48.2	16.8	12.7	8.0
$50,000	54.2	71.1	63.6	57.8	17.0	9.5	3.7
$75,000	62.6	78.0	69.5	64.2	15.4	6.9	1.6
$100,000	68.6	82.0	73.7	69.2	13.4	5.1	.7
$500,000	88.1	93.2	88.7	88.5	5.0	.6	.4
$1,000,000	[2] 89.9	94.6	90.9	91.3	4.7	1.0	1.4
$5,000,000	[2] 90.0	93.7	92.6	93.5	3.7	2.6	3.5

[1] Maximum earned net income assumed. Victory tax net income assumed to be ⅓ of net income.
[2] Taking into account maximum effective rate limitation of 90 percent.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

TABLE 3.—*Amounts of individual income tax under present law, the Treasury proposal of Oct. 4, 1943, and 2 alternative schedules*

MARRIED PERSON—2 DEPENDENTS

[Exemptions: Present law, $1,200, $350; proposals, $1,100, $300]

Net income before personal exemption	Amounts of tax				Amount of increase		
	Present law, including net Victory tax [1]	Treasury proposal, Oct. 4, 1943	Treasury proposal A	Treasury proposal B	Treasury proposal, Oct. 4, 1943	Treasury proposal A	Treasury proposal B
$1,700	$35				−$35	−$35	−$35
$1,800	39	$27	$28	$30	−12	−11	−9
$1,900	42	54	56	60	12	14	18
$2,000	58	81	84	90	23	26	32
$2,500	159	225	232	246	66	74	87
$3,000	267	384	397	412	117	130	145
$4,000	455	753	776	791	298	321	336
$5,000	730	1,153	1,196	1,211	433	466	481
$6,000	979	1,558	1,628	1,643	609	649	664
$8,000	1,553	2,523	2,557	2,563	970	1,004	1,010
$10,000	2,208	3,555	3,546	3,495	1,347	1,338	1,287
$12,500	3,144	4,962	4,870	4,745	1,818	1,726	1,601
$15,000	4,207	6,489	6,284	6,034	2,282	2,077	1,827
$20,000	6,693	9,912	9,388	8,753	3,219	2,695	2,060
$28,000	9,574	13,750	12,780	11,678	4,176	3,206	2,104
$50,000	26,392	35,037	31,244	28,481	8,645	4,852	2,089
$75,000	46,209	57,919	51,642	47,678	11,710	5,433	1,469
$100,000	67,803	81,435	73,174	68,726	13,632	5,371	923
$500,000	439,931	468,418	443,069	442,107	25,487	3,158	2,176
$1,000,000	[2] 898,800	948,418	908,069	912,107	46,618	9,289	13,307
$5,000,000	[2] 4,498,800	4,785,418	4,628,089	4,[illegible]107	286,618	129,289	173,307

[1] Maximum earned net income assumed. Victory tax net income assumed to be 19/9 of net income.
[2] Taking into account maximum effective rate limitation of 90 percent.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

TABLE 3A.—*Effective rates of individual income tax under present law, the Treasury proposal of Oct. 4, 1943, and 2 alternative schedules*

MARRIED PERSON—2 DEPENDENTS

[Exemptions: Present law, $1,200, $350; proposals, $1,100, $300]

Net income before personal exemption	Effective rates				Increase		
	Present law, including net Victory tax [1]	Treasury proposal, Oct. 4, 1943	Treasury proposal A	Treasury proposal B	Treasury proposal, Oct. 4, 1943	Treasury proposal A	Treasury proposal B
	Percent	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
$1,700	2.1				−2.1	−2.1	−2.1
$1,800	2.2	1.5	1.6	1.7	−.7	−.5	−.5
$1,900	2.2	2.8	2.9	3.2	.6	.7	.9
$2,000	2.9	4.1	4.2	4.5	1.2	1.3	1.6
$2,500	6.4	9.0	9.3	9.8	2.6	3.0	3.5
$3,000	8.9	12.8	13.2	13.7	3.9	4.3	4.8
$4,000	12.1	18.8	19.4	19.8	6.7	7.3	7.7
$5,000	14.6	23.3	23.9	24.2	8.7	9.3	9.6
$6,000	16.3	26.5	27.1	27.4	10.2	10.8	11.1
$8,000	19.4	31.5	32.0	32.0	12.1	12.6	12.6
$10,000	22.1	35.6	35.5	35.0	13.5	13.4	12.9
$12,500	25.2	39.7	39.0	38.0	14.5	13.8	12.8
$15,000	28.0	43.3	41.9	40.2	15.3	13.8	12.2
$20,000	33.5	49.6	46.9	43.8	16.1	13.5	10.3
$25,000	38.3	55.0	51.1	43.7	16.7	12.8	8.4
$50,000	52.8	70.1	62.7	57.0	17.3	9.9	4.2
$75,000	61.6	77.2	68.9	63.6	15.6	7.2	2.0
$100,000	67.8	81.4	73.2	68.7	13.6	5.4	.9
$500,000	88.0	93.1	88.6	88.4	5.1	.6	.4
$1,000,000	[2] 89.9	94.8	90.8	91.2	4.7	.9	1.3
$5,000,000	[2] 90.0	95.7	92.6	93.4	5.7	2.6	3.5

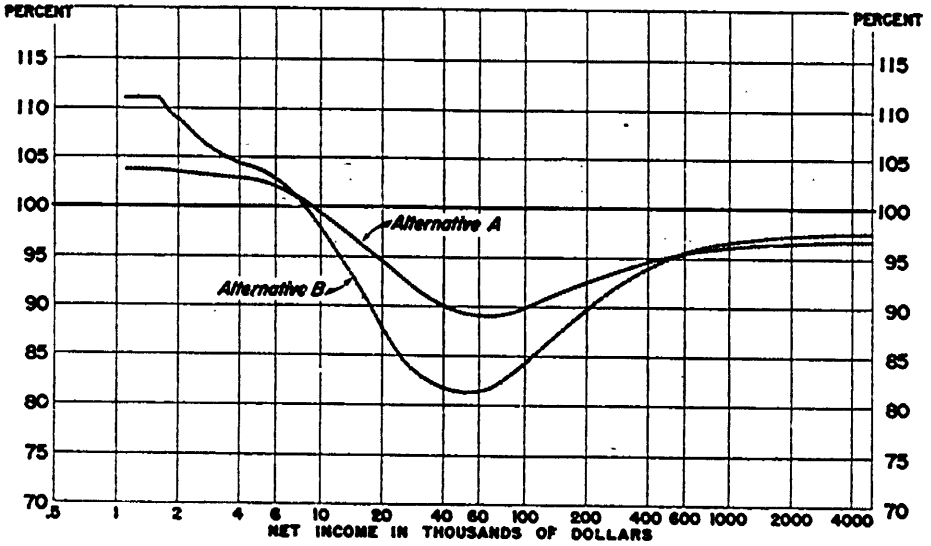
[1] Maximum earned net income assumed. Victory tax net income assumed to be 10/9 of net income.
[2] Taking into account maximum effective rate limitation of 90 percent.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

Exhibit 10

INDIVIDUAL INCOME TAX UNDER TREASURY ALTERNATIVE PROPOSALS A AND B AS A PERCENT OF TAX UNDER THE TREASURY PROPOSAL* OF OCT. 4, 1943

Married Person without Dependents



*Exemptions $1000-$1200 and net Victory Tax and earned income credit eliminated.

Treasury Department, Division of Tax Research, Nov. 29, 1943.

EXHIBIT 11

Corporation income and excess-profits-tax rates

	Present law	Treasury proposal	H. R. 3687
1. Normal tax rates:			
Normal tax net income:			
Not over $25,000:			
First $5,000	15 percent	No change	No change.
Next $15,000	17 percent		
Next $5,000	19 percent		
Over $25,000 to $50,000 (notch)	$4,350 plus 31 percent of excess over $25,000.		
Over $50,000	24 percent		
2. Surtax rates:			
Surtax net income:			
Not over $25,000	10 percent	14 percent	
Over $25,000 to $50,000 (notch)	$2,500 plus 22 percent of excess over $25,000.	$3,500 plus 33 percent of excess over $25,000.	No change.
Over $50,000	16 percent	26 percent	
3. Combined normal and surtax rates:			
Not over $25,000	25 to 29 percent	29 to 33 percent	
Over $25,000 to $50,000 (notch)	53 percent	69 percent	No change.
Over $50,000	40 percent	50 percent	
4. Excess-profits-tax rates	90 percent	No change	95 percent.

Treasury Department, Division of Tax Research, Nov. 20, 1943.

EXHIBIT 12

Corporate net income, income taxes and dividends, 1936–44

[In millions of dollars]

ALL RETURNS

	Actual						Estimated		
	1936	1937	1938	1939	1940	1941 [1]	1942 [2]	1943 [3]	1944
1. Compiled net profit [3]	7,771	7,830	4,131	7,178	9,348	16,675	21,750	24,100	26,100
2. Net operating loss deduction [4]					123	330	350	600	500
3. Net income (line 1 minus line 2) [5]	7,771	7,830	4,131	7,178	9,225	16,345	21,400	23,500	25,600
4. Dividends received [6]	2,677	2,682	1,791	1,906	2,021	2,238	1,550	1,600	1,600
5. Tax-exempt interest [7]	724	741	732	763	783	809	800	800	700
6. Net income excluding dividends received and tax-exempt interest (line 3 minus line 4 minus line 5) [8]	4,370	4,407	1,608	4,508	6,421	13,298	19,050	21,200	23,300
7. Net income excluding dividends received (line 3 minus line 4) [9]	5,094	5,148	2,340	5,272	7,204	14,107	19,850	22,000	24,000
8. Compiled net profit excluding dividends received (line 1 minus line 4)	5,094	5,148	2,340	5,272	7,327	14,437	20,200	22,600	24,500
Income and excess profits taxes:									
9. Income tax	1,025	1,057	554	1,216	2,144	3,745	4,300	4,500	4,700
10. Undistributed profits tax	145	176							
11. Excess profits tax (after deduction of entire post-war credit)					371	3,357	7,350	8,850	9,600
12. Declared value excess-profits tax	22	43	6	16	31	64	100	100	100
13. Total income and excess-profits taxes	1,191	1,276	560	1,232	2,549	[10] 7,166	[10] 11,750	[10] 13,450	[10] 14,600
14. Compiled net profit excluding dividends received, after taxes (line 8 minus line 13)	3,903	3,872	1,480	4,040	4,778	7,271	8,450	9,150	9,900
15. Net dividends paid [6]	4,703	4,832	3,222	3,841	4,068	4,463	4,100	4,000	4,100

See footnotes at end of table.

Corporate net income, income taxes and dividends, 1936–44—Continued

	Actual						Estimated		
	1936	1937	1938	1939	1940	1941 [1]	1942 [2]	1943 [2]	1944
16. Compiled net profit or loss excluding dividends received, after taxes and net dividends paid (line 14 minus line 15)	[10] 800	[10] 960	[10] 1,742	199	710	2,808	4,350	5,150	5,800
17. Net income excluding dividends received, after taxes (line 7 minus line 13) [3]	3,903	3,872	1,480	4,040	4,655	6,941	8,100	8,550	9,400
18. Net income or deficit excluding dividends received, after taxes and net dividends paid (line 17 minus line 15) [4]	[10] 800	[10] 960	[10] 1,742	199	587	2,478	4,000	4,550	5,300
RETURNS WITH NET INCOME									
1. Compiled net profit [5]	9,726	9,848	6,725	9,028	11,406	18,316	22,550	25,300	27,400
2. Net operating loss deduction [6]	.....	.....	.....	.....	123	330	350	600	500
3. Net income (line 1 minus line 2)	9,726	9,848	6,725	9,028	11,283	17,986	22,200	24,700	26,900
4. Dividends received [8]	2,504	2,515	1,625	1,779	1,552	2,092	1,350	1,800	1,400
5. Tax-exempt interest [7]	488	419	420	464	455	502	600	600	500
6. Net income excluding dividends received and tax-exempt interest (line 3 minus line 4 minus line 5)	6,734	6,915	4,680	6,785	8,946	15,391	20,250	22,800	25,000
7. Net income excluding dividends received (line 3 minus line 4)	7,222	7,334	5,100	7,248	9,431	15,894	20,850	23,400	25,500
8. Compiled net profit excluding dividends received (line 1 minus line 4)	7,222	7,334	5,100	7,248	9,554	16,224	21,200	24,000	26,000
Income and excess profits taxes:									
9. Income tax	1,025	1,057	854	1,216	2,144	3,745	4,300	4,500	4,700
10. Undistributed profits tax	145	176	.....	.....	.....	.....	.....	.....	.....
11. Excess profits tax (after deduction of entire post-war credit)	.....	.....	.....	.....	374	3,357	7,350	8,850	9,800
12. Declared value excess-profits tax	22	43	6	16	31	64	100	100	100
13. Total income and excess-profits taxes	1,191	1,276	860	1,232	2,549	[9] 7,166	[11] 11,750	[13] 13,450	[14] 14,600
14. Compiled net profit excluding dividends received, after taxes (line 8 minus line 13)	6,031	6,058	4,240	6,016	7,005	9,058	9,450	10,550	11,400
15. Net dividends paid [8]	4,675	4,794	3,153	3,783	4,036	4,426	4,000	3,900	4,000
16. Compiled net profit excluding dividends received, after taxes and net dividends paid (line 14 minus line 15)	1,356	1,264	1,085	2,233	2,969	4,632	5,450	6,650	7,400
17. Net income excluding dividends received, after taxes (line 7 minus line 13)	6,031	6,058	4,240	6,016	6,882	8,728	9,100	9,950	10,900
18. Net income excluding dividends received, after taxes and net dividends paid (line 17 minus line 15)	1,356	1,264	1,085	2,233	2,846	4,302	5,100	6,050	6,900

See footnotes at end of table.

Corporate net income, income taxes and dividends, 1936–44—Continued

RETURNS WITH NO NET INCOME

	Actual						Estimated		
	1936	1937	1938	1939	1940	1941 [1]	1942 [2]	1943 [2]	1944
1. Compiled net loss or deficit [3]	1,955	2,018	2,504	1,550	2,055	1,641	800	1,200	1,300
2. Dividends received [4]	173	168	166	126	169	146	200	200	200
3. Tax-exempt interest [5]	236	322	312	300	299	307	200	200	200
4. Deficit, excluding dividends received and tax-exempt interest (line 1 plus line 2 plus line 3)	2,364	2,507	3,072	2,276	2,525	2,094	1,200	1,600	1,700
5. Deficit, excluding dividends received (line 1 plus line 2)	2,128	2,186	2,760	1,977	2,226	1,787	1,000	1,400	1,500
6. Net dividends paid [6]	27	33	67	53	32	37	100	100	100
7. Deficit, excluding dividends received after net dividends paid (line 5 plus line 6) [11]	2,155	2,223	2,827	2,035	2,258	1,824	1,100	1,500	1,600

[1] Preliminary figures.
[2] Estimates prepared in connection with the statement by the President on the summation of the 1944 Budget, released Aug. 1, 1943.
[3] Compiled net profit (or loss) as defined in Statistics of Income, equals compiled receipts which include dividends received and tax-exempt interest, minus compiled deductions, which exclude net operating loss deduction.
[4] The first year's net loss allowed to be carried over is for a taxable year beginning on or after Jan. 1, 1939; the first year in which this loss is allowed as a deduction is in a taxable year beginning on or after Jan. 1, 1940.
[5] Cumulation of this item for the years 1940–44 would involve double counting of net operating loss deduction—once in the year in which the net operating loss occurs, and once in the year to which it is carried forward.
[6] Dividends from domestic corporations subject to income taxation under the Federal tax law. This is the amount used for computation of dividends received credit.
[7] Includes both partially and wholly tax-exempt interest.
[8] Excludes the effect of the carry-back of net operating losses and the carry-back of unused excess-profits credit.
[9] Dividends paid to stockholders other than domestic corporations; includes cash and assets other than corporation's own stock.
[10] Compiled net loss or deficit.
[11] Deficit corporations are liable for only the capital stock tax which is included as a deduction in compiled net profit or loss.

Treasury Department, Division of Research and Statistics, Nov. 29, 1943.
NOTE.—Figures are rounded and will not necessarily add to totals. Source for years 1936–41, Statistics of Income, pt. 2.

EXHIBIT 13

THE EFFECT OF BORROWING ON NET INCOME AFTER TAXES OF AN EXCESS-PROFITS TAXPAYER USING THE INVESTED-CAPITAL CREDIT

A corporation with an invested capital of $5,000,000 earns $500,000. It is, therefore, subject to the excess-profits tax which it computes by using the invested-capital credit.

Assume that it borrows $100,000 at 3-percent interest and uses the funds for building up working capital, therefore, actually decreases its net profits before taxes by the amount of interest, $3,000. Yet, its net profits after taxes are increased by this debt. The computation is as follows, ignoring the specific excess profits exemption of $5,000.

	Before borrowing	After borrowing
Excess-profits tax:		
Net income before taxes and before interest deduction	$500,000	$500,000
Interest deduction (50 percent)	0	1,500
Net income before taxes	500,000	498,500
Excess-profits credit:		
$5,000,000X8 percent	400,000	400,000
$100,000X7 percent (50 percent)	0	3,500
Total	400,000	403,500
Taxable excess profits	100,000	95,000
Excess-profits tax (81 percent)	81,000	76,950
Normal tax and surtax:		
Net income before taxes and before interest deduction	500,000	500,000
Interest deduction (100 percent)	0	3,000
Net income before taxes	500,000	497,000
Income subject to excess-profits tax	100,000	95,000
Taxable normal profits	400,000	402,000
Normal tax and surtax (40 percent)	160,000	160,800
Total tax	241,000	237,750
Net income after interest and taxes	259,000	259,250

The taxpayer, therefore, gained $750 after taxes, merely by borrowing and increasing working capital.

This gain may be compared with the effect on net income after taxes if this taxpayer had used the average-earning credit. In this event, net income after taxes would have decreased by $570. The advantage to the corporation with the invested-capital credit is almost 1 percent of the loan.

EXHIBIT 14

Comparison of estate tax rate schedule under present law and the Treasury proposal[1]

Net estate after specific exemption (000)[2]	Bracket rate		Total estate tax cumulative	
	Present law	Proposal	Present	Proposal
	Percent	*Percent*		
Not over $5	3	5	$150	$250
$5 to $10	7	8	500	650
$10 to $15	11	12	1,050	1,250
$15 to $20	11	16	1,600	2,050
$20 to $30	14	20	3,000	4,050
$30 to $40	18	24	4,800	6,450
$40 to $50	22	28	7,000	9,250
$50 to $60	23	31	9,500	12,350
$60 to $70	28	34	12,300	15,750
$70 to $100	26	37	20,700	26,850
$100 to $150	30	40	35,700	46,850
$150 to $200	30	43	50,700	68,350
$200 to $250	30	45	65,700	90,850
$250 to $300	32	48	81,700	114,850
$300 to $350	32	51	97,700	140,350
$350 to $400	32	54	113,700	167,350
$400 to $450	32	57	129,700	195,850
$450 to $500	32	60	145,700	225,850
$500 to $600	35	63	180,700	288,850
$600 to $700	35	66	215,700	354,850
$700 to $800	35-37	69	251,700	423,850
$800 to $900	37	72	288,700	495,850
$900 to $1,000	37	75	325,700	570,850
$1,000 to $1,250	39	78	423,200	765,350
$1,250 to $1,500	42	79	528,200	963,350
$1,500 to $2,000	45	80	753,200	1,363,350
$2,000 to $2,500	49	80	998,200	1,763,350
$2,500 to $3,000	53	80	1,263,200	2,163,350
$3,000 to $4,000	56-59	80	1,838,200	2,963,350
$4,000 to $5,000	63	80	2,468,200	3,763,350
$5,000 to $6,000	67	80	3,138,200	4,563,350
$6,000 to $7,000	70	80	3,838,200	5,363,350
$7,000 to $8,000	73	80	4,568,200	6,163,350
$8,000 to $9,000	76	80	5,328,200	6,963,350
$9,000 to $10,000	76	80	6,088,200	7,763,350
Over $10,000	77	80		

[1] Before deduction of credit for State death taxes.
[2] The specific exemption under present law is $60,000; under the proposal, $40,000.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

EXHIBIT 15

Amount of estate taxes and effective rates under present law and the Treasury proposal [1]

Net estate before specific exemption [2]	Amount of tax			Effective rate		
	Present law	Proposal	Increase in tax	Present law	Proposal	Increase in effective rates
				Percent	*Percent*	*Percent*
$50,000	$0	$650	$650	.....	1.3	1.3
$60,000	0	2,050	2,050	.....	3.4	3.4
$80,000	1,600	6,450	4,850	2.0	8.1	6.1
$100,000	4,800	12,350	7,550	4.8	12.4	7.6
$150,000	17,900	30,850	12,950	11.9	20.6	8.6
$200,000	32,700	51,150	18,450	16.4	25.6	9.2
$400,000	94,500	145,750	51,250	23.6	36.4	12.8
$600,000	150,700	253,650	103,950	25.6	43.9	17.3
$800,000	229,700	396,250	166,550	28.7	49.5	20.8
$1,000,000	303,500	540,850	237,350	30.4	54.1	23.7
$2,000,000	726,200	1,331,350	605,150	36.3	66.6	30.3
$4,000,000	1,802,800	2,931,350	1,128,550	45.1	73.3	28.2
$6,000,000	3,098,000	4,531,350	1,433,350	51.6	75.5	23.9
$10,000,000	6,042,600	7,731,350	1,688,750	60.4	77.3	16.9
$20,000,000	13,742,000	15,731,350	1,989,350	68.7	78.7	9.9
$40,000,000	29,142,000	31,731,350	2,589,350	72.9	79.3	6.5
$100,000,000	75,342,000	79,731,350	4,389,350	75.3	79.7	4.4

[1] Before deduction of credit for State death taxes.
[2] The specific exemption under the present law is $60,000, under the proposal $40,000.

Source: Treasury Department, Division of Tax Research, Nov. 29, 1943.

EXHIBIT 16

Estate and gift tax collections as a percent of net receipts, fiscal years 1917–44

[Dollar amounts in millions]

Fiscal year	Estate tax	Gift tax	Total estate and gift taxes	Net receipts	Total estate and gift taxes as percent of net receipts
1917	$6.1	.....	$6.1	$1,124.3	0.54
1918	47.5	.....	47.5	3,664.6	1.30
1919	82.0	.....	82.0	5,152.3	1.59
1920	103.6	.....	103.6	6,694.6	1.55
1921	154.0	.....	154.0	5,624.9	2.74
1922	139.4	.....	139.4	4,109.1	3.39
1923	126.7	.....	126.7	4,007.1	3.16
1924	103.0	.....	103.0	4,012.0	2.57
1925	101.4	$7.5	108.9	3,780.1	2.88
1926	116.0	3.2	119.2	3,962.8	3.01
1927	100.3	.....	100.3	4,129.4	2.43
1928	60.1	.....	60.1	4,042.3	1.49
1929	61.9	.....	61.9	4,033.3	1.53
1930	64.8	.....	64.8	4,177.9	1.55
1931	48.1	.....	48.1	3,190.0	1.51
1932	47.4	.....	47.4	2,005.7	2.36
1933	29.7	4.6	34.3	2,079.7	1.65
1934	104.0	9.2	113.2	3,115.6	3.63
1935	140.4	71.7	212.1	3,800.5	5.58
1936	218.8	160.1	378.9	4,116.0	9.21
1937	281.6	23.9	305.5	5,028.8	6.08
1938	382.2	34.7	416.9	5,854.7	7.12
1939	332.3	28.4	360.7	5,164.8	6.98
1940	330.9	29.2	360.1	5,387.1	6.68
1941	355.2	51.9	407.1	7,007.2	5.35
1942	340.1	92.2	432.5	12,799.1	3.38
1943	414.5	33.0	447.5	22,071.5	2.03
1944 (estimated)	511.8	44.8	556.6	38,147.9	1.46

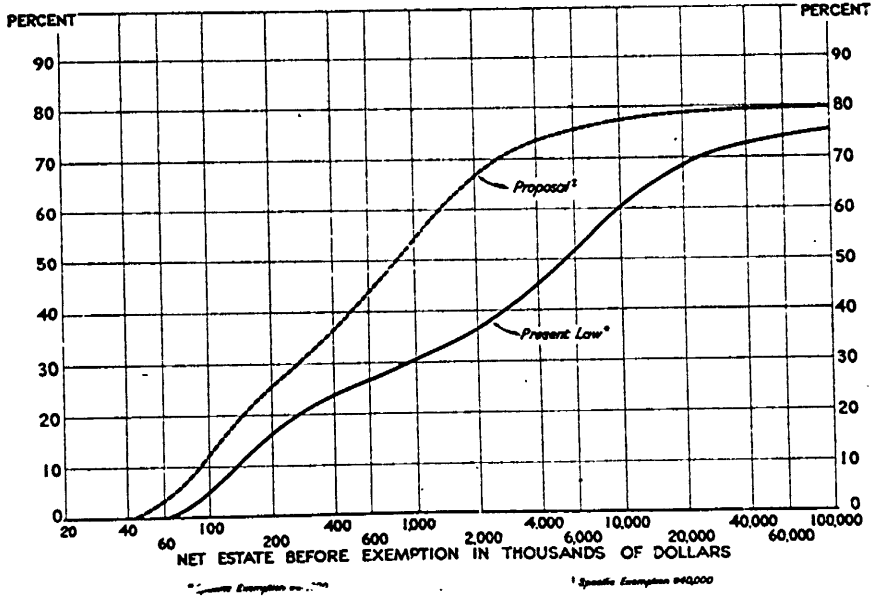
Treasury Department, Division of Tax Research, Nov. 29, 1943.

Source: Annual Report of the Secretary of the Treasury, 1942, and Statement of the President on the Summation of the 1944 Budget, August 1943.

Exhibit 17

FEDERAL ESTATE TAX

Effective Rates, Before Credit for State Death Taxes



Treasury Department, Division of Tax Research, Nov. 29, 1943.

EXHIBIT 18

Estimated excise tax liability under the Treasury proposal as presented to the Committee on Ways and Means of the House of Representatives on Oct. 4, 1943, as compared with present law for a full year of operation [1]

Article or service	Present tax	Proposed tax	Estimated additional revenue from proposals (in millions) [1]
1. Distilled spirits	$6 per gallon (draw-back of $3.75 per gallon on nonbeverage alcohol)	$10 per gallon (draw-back of $7 per gallon on nonbeverage alcohol).	[2] $487.2
2. Beer	$7 per barrel	$10 per barrel	210.5
3. Wine:			
(a) Still:			
Under 14 percent alcohol.	10 cents per gallon	50 cents per gallon	61.1
14 to 21 percent alcohol.	40 cents per gallon	$1 per gallon	
Over 21 percent alcohol.	$1 per gallon	$2 per gallon	
(b) Sparkling	10 cents per half pint	20 cents per half pint	
(c) Other	5 cents per half pint	10 cents per half pint	
4. Cigarettes	$3.50 per thousand	$5 per thousand	371.3
	Intended retail price: Over— / Not over— / Tax per thousand	Intended retail price: Over— / Not over— / Tax per thousand	
	Cents / *Cents* /	*Cents* / *Cents* /	
5. Cigars	— / 2½ / $2.50	— / 3½ / $12.50	67.7
	2½ / 4 / 3.00	3½ / 5 / 13.00	
	4 / 6 / 4.00	5 / 7 / 14.00	
	6 / 8 / 7.00	7 / 9 / 17.00	
	8 / 15 / 10.00	9 / 17 / 30.00	
	15 / 20 / 15.00	17 / 22 / 35.00	
	20 / ... / 20.00	22 / ... / 40.00	
6. Chewing and smoking tobacco and snuff	18 cents per pound	24 cents per pound	46.2
7. General admissions	1 cent per 10 cents	3 cents per 10 cents	[3] 327.0
8. Cabarets	5 percent of charge	30 percent of charge	91.3
9. Club dues and initiation fees	11 percent of charge	20 percent of charge	6.1
10. Bowling alleys, billiard parlors.	$10 per alley $10 per table	do $20 per table	27.0
11. Transportation of persons	10 percent of charge	25 percent of charge	212.7
12. Communications:			
(a) Toll service	20 percent of charge	do	
(b) Telegraph, etc.:			
(1) Domestic	15 percent of charge	20 percent of charge	31.5
(2) International	10 percent of charge	10 percent of charge	
(c) Leased wires, etc	15 percent of charge	20 percent of charge	
13. Local telephone service	10 percent of charge	15 percent of charge	45.9
14. Jewelry	10 percent of retail price	30 percent of retail price	167.3
15. Fur and fur-trimmed articles	do	25 percent of retail price	54.8
16. Luggage, handbags, wallets, etc.	10 percent of manufacturers' sales price on luggage only.	do	33.4
17. Toilet preparations	10 percent of retail price	do	51.4
18. Soft drinks	None	Bottled drinks, 1 cent per each 5 cents of intended retail price: the equivalent taxes of $1 per gallon on sirup and 25 cents per pound on carbonic acid gas used in unbottled soft drinks.	177.0
19. Cane, and chewing gum	do	Articles intended to retail from 5 to 15 cents per bar or package, 1 cent per each 5 cents of intended retail price; other items, the equivalent tax of 35 percent of manufacturers' sales price.	190.0
Total additional revenue, items 1 to 19.			2,681.4

EXHIBIT 18—Continued

Estimated excise tax liability under the Treasury proposal as presented to the Committee on Ways and Means of the House of Representatives on Oct. 4, 1943, as compared with present law for a full year of operation—Continued

Article of service	Present tax	Proposed tax	Estimated additional revenue from proposals (in millions) [1]
20. Less repeal of tax on transportation of property.			[4]—170.3
Total additional revenue, items 1 to 20.			2,511.1

Treasury Department, Division of Research and Statistics, Nov. 29, 1943.

[1] Estimates of additional revenue are for a full year of operation at levels of business estimated for calendar year 1944.

[2] Estimated additional net revenue yield after allowance for increased draw-back on nonbeverage alcohol of 12.8 million dollars.

[3] Including the effects of H. R. 3338, Public Law 180, approved Nov. 4, 1943.

Senator VANDENBERG. Mr. Paul, you referred this morning to some recommendations you made that would bring some measure of relief to static incomes which haven't been improved by the war economy.

Mr. PAUL. Yes. That proposal was put up in the House. I can tell you briefly what it is. The House record will show it in full.

At the Ways and Means hearings the Secretary presented for the study of the committee a proposal that some of the tax, some of the 6½ billion tax be made refundable after the war. That refundable part would be a post-war credit in the ordinary case. That particular credit afforded a mechanism for softening the impact of the tax on stationary incomes. The mechanism was to allow people whose incomes hadn't risen to anticipate that credit and apply it immediately against their tax rather than wait until after the war.

That credit, as I remember it, totaled for all taxpayers around—well, there were alternate credits. One was about 3½ billion and another around two and one-quarter. And, of course, out of that would come the credits available to those incomes which had not increased.

Senator JOHNSON. You are not talking about the windfall provision?

Mr. PAUL. No. This is a post-war credit or refundable tax.

The CHAIRMAN. You will present to the committee again, Mr. Paul, the one or two or more alternative programs, will you not? I mean, by the time we reach executive session.

Mr. PAUL. I will be glad to present anything I can. I did give to the committee this morning the alternative schedules in lieu of the income-tax schedule submitted to the Ways and Means Committee. Only one schedule of taxes, apart from the question of refundable taxes, was submitted to the Ways and Means Committee. Here we submit two other schedules by which approximately 6½ billion of income tax increases are raised. The distribution of the 6½ billion is somewhat different and the alternative schedules we submitted this morning distribute somewhat more of the 6½ billion in the lower income brackets. They are in the record now.

The CHAIRMAN. Mr. Paul, in speaking of your recommendations, Treasury recommendations, on corporate taxes, I don't ask for a detailed statement, perhaps, but perhaps you might indicate—could you briefly indicate without elaboration?

Mr. PAUL. Yes; I will be very glad to do that just very briefly. In a moment I will refer to the testimony before the Ways and Means Committee on that point.

I think Treasury was concerned from the standpoint of the liquid position of corporations after the war. Our suggestion was directed toward improving the liquid positions of corporations from the standpoint of reconversion and from the standpoint of maintaining a high level of employment. To that end we suggested that corporations be allowed to anticipate the effects of lowering their taxes by reason of the loss carry-back.

Let me give you an example. If a corporation made money in 1944 and had a tax to pay on that money in 1945, and then it was discovered in 1945 that there was going to be a loss in that year—say the war has ended, or something of that sort—then instead of immediately paying the tax on 1944 income through the year 1945 the corporation would be able to estimate its loss, and it might take a credit against 1944 income on account of the carry-back of loss to 1944, and thus avoid paying in 1945 the tax which confessedly it wouldn't have to pay because of its loss in 1945. It could be carried back. It was a provision for anticipating the effect of the loss carry-back.

The CHAIRMAN. Are there any questions?

Senator VANDENBERG. In respect to the simplification of the returns, Mr. Paul, have you any additional recommendations to make which might encourage further simplification?

Mr. PAUL. I have none at this time beyond the suggestions which have been made, which include the elimination of the Victory tax, the elimination of the earned-income credit, which has been adopted, and then there are two or three suggestions which were not very much discussed in the Ways and Means Committee.

We suggested consolidation of the normal and surtax schedules with a proper protection to the Government so that there would not be an increase in the exemption benefit to the holders of tax-exempt Government bonds.

We also suggested, but it was not very much discussed, a provision for withholding the tax on a graduated basis. By that I mean instead of withholding at the first bracket, the first 20 percent, that the full tax liability of taxpayers be withheld at the source where they had income, like salary, subject to withholding.

One of the benefits of that suggestion would have been that there would be a very considerable diminution of the number of the quarterly estimates required to be filed. And, by the way, that suggestion has been made to us, the suggestion about the gross withholding, by a great many employers.

Senator VANDENBERG. Is there any way to simplify or to avoid the necessity for estimating the yearly income ahead by individuals by permitting the taxpayer the option of using his income for the previous year as a taxable base?

Mr. PAUL. I think we would have to permit that rather than require it because he might have had a very serious drop in income; and in fact now under the present law he may estimate on the basis of last year.

Senator CLARK. But if he underestimates he has to pay a severe penalty.

Mr. PAUL. It is not very severe, Senator Clark. It is 6 percent. The word "penalty" may be the wrong word to apply.

Senator CLARK. It is the going rate of interest.

Mr. PAUL. In that sense it is a severe penalty. Of course, he has until December to correct his estimate. He is not penalized for a wrong estimate in March or June or September, as many taxpayers erroneously suppose.

We have given consideration to a number of simplification ideas.

The CHAIRMAN. Mr. Paul, on that point, in effect now, after the December 15 estimate, the taxpayer may use his March 15 final return as his estimated tax liability for 1944, may he not? He is not obligated to do it.

Mr. PAUL. He may do it now; yes.

The CHAIRMAN. But he is not obligated to do it.

Mr. PAUL. That is right.

The CHAIRMAN. Wouldn't it be quite feasible to waive that penalty altogether where he used that for 1944?

Mr. PAUL. It might be. I hate to answer that question.

The CHAIRMAN. Let me put it this way: Will you think it over?

Mr. PAUL. I will be glad to do that. There are various ways in which we can improve that part of the picture.

The CHAIRMAN. Yes.

Senator VANDENBERG. I think that would at least seem to be a step in an advance direction.

The CHAIRMAN. Mr. Paul, you have referred to the decision of the Ways and Means Committee, at least of the chairman of that committee, and which was in conformity with the Treasury's recommendation, that this bill be made, as far as possible, a revenue bill. That is right, is it not?

Mr. PAUL. That is right.

The CHAIRMAN. That means that we will have such a bill, and we can speak with some assurance to the witnesses who may come here on purely technical administrative provisions.

Mr. PAUL. So far as the Treasury is concerned, we have expected that those changes would be taken up next year. The sooner the better so far as we are concerned. You may speak with complete assurance.

The CHAIRMAN. I think the taxpayers are entitled to that assurance by this committee as well as by the Ways and Means Committee.

Senator CLARK. We have given it right along. Every time a tax bill comes up we say, "Right after this tax bill is out of the way we will have an administrative bill," but we have never had it.

Mr. PAUL. We had the 1942 act. The 1942 act was a good deal of an administrative bill, Senator Clark.

The CHAIRMAN. Yes.

Senator JOHNSON. We forced it in, that is the only reason. Is there anyone who can give that assurance other than the Ways and Means Committee? The bill must originate in the House. This committee couldn't give any such assurance and I don't know how the Treasury can.

Mr. PAUL. I said, "So far as the Treasury is concerned." We will work on it diligently. We can't do anything if a bill is not initiated in the Ways and Means Committee. I think that committee has

given the assurance. So that we are able to add our assurance to its assurance.

Senator JOHNSON. The fact that the House put a great many administrative amendments into the bill would indicate that they were not planning on it.

Mr. PAUL. I have not heard that. Everything I have heard from that committee is to the effect that they intend to take up a bill next year. The administrative amendments contained in the bill were not put in there in lieu of a bill next year.

Senator JOHNSON. You stated that they did put in changes.

Mr. PAUL. They put in a few; not very many.

The CHAIRMAN. There are a few?

Mr. PAUL. Quite a few, in point of fact.

Senator WALSH. You said also that the Treasury did not approve of some of them.

Mr. PAUL. Most of them; no, sir. I wouldn't want to say offhand that we approved of none of them, but we didn't suggest any of them except this particular one about buying up corporations.

The CHAIRMAN. I believe the House did put a statement in its report that they would proceed with this administrative and technical bill, but, of course, that is not absolute assurance that other things may not intervene.

Are there any further questions?

Senator VANDENBERG. I have just one question, about The Tax Court, to which you made considerable reference, Mr. Paul.

Since we turned that over from a board of appeals to a court, with the assurance that it was not going to involve any of the encumbrances which legalistically might attach to the graduation of these distinguished gentlemen who sit on this panel, is it your observation that The Tax Court has tightened its regulations so that it is more difficult to practice there now than it was before, specifically with reference to accountants?

Mr. PAUL. I couldn't say. I really don't know how to answer that question. I have not been practicing before the court. So far as I know there has been no tightening.

Senator VANDENBERG. I understand they are trying to push accountants out of practicing before them.

Mr. PAUL. I thought the Revenue Act of 1942 had very explicit provisions on that point. I can't recall its exact wording offhand, but I don't see how, under that provision, accountants and nonlawyers could be forced out of practice.

Senator VANDENBERG. Well, lots of things happen that I don't see how they happen under these laws we write, but they happen.

Mr. PAUL. I think the only change made there was that some examination was required before they would be permitted to practice.

Senator VANDENBERG. I understand that in the examination for accountants, no accountant in the United States passed.

Mr. PAUL. I haven t seen the examination so I can't answer.

Senator VANDENBERG. That is probably within the law. The point is, and I am quite serious about it, I think you are right that the burden on The Tax Court will multiply tremendously, particularly with the termination of contracts coming along.

Mr. PAUL I am very much concerned about that.

Senator VANDENBERG. Well, it doesn't seem to me that they ought to narrow the channels of approach. You agree with that, do you not?

Mr. PAUL. I am not in sympathy with any exclusion of any qualified person to practice before the court.

The CHAIRMAN. Are there any other questions?

Senator MILLIKEN. Mr. Chairman, one question.

The CHAIRMAN. Senator Millikin.

Senator MILLIKIN. Mr. Paul, I notice in the last sentence of your formal statement there is a reference to the imminence of inflation. It seems to me that that standing alone might be misunderstood and so I should like to ask you whether you are referring to explosive inflation or to a more gradual increase in prices and wage levels, or just what do you have in mind.

Mr. PAUL. Perhaps that statement is something of an understatement since we have some inflation now of the character we have in mind. I refer you, Senator Millikin to the Secretary's statement. I don't mean inflation involving a complete loss of the purchasing value of the dollar, but I do mean a very serious increase in prices, which may be more or less permanent in character. Rather the type of inflation which occurred after World War I. A very serious increase in prices which affects all our investments.

Senator MILLIKIN. What do you vision along that line?

Mr. PAUL. I have here somewhere the price index figures which were reached after the last war, and certainly I have that in mind. I think wholesale prices jumped as high as 246 percent of their pre-World War I level.

Senator MILLIKIN. Those levels are much higher than the raise reflected in our present level?

Mr. PAUL. Yes. And that inflation took place in large part after the war. When I speak of inflation and its imminence now, I don't mean only during the war but I mean very emphatically after the war as well.

Senator MILLIKEN. You are not intimating that our situation is such that we are confronted with the imminence of loss of control over our price structure?

Mr. PAUL. That is a problem of degree, sir.

Senator MILLIKEN. Well, the loss of control is not a matter of degree, a loss of control is a loss of control.

Mr. PAUL. I think we are threatened with a weakening of the price structure. I don't say we are threatened with a total loss of control over the price structure, but a very serious weakening of that control.

Senator MILLIKEN. Leading up to a price level like after the last war?

Mr. PAUL. Yes, and perhaps higher. One can't measure those things exactly.

Senator MILLIKEN. I had hoped to draw from you a statement that you do not consider what we call explosive inflation as being imminent.

Mr. PAUL. I think explosive inflation depends upon the definition of that term. What might very well be called explosive inflation is a possibility. Not total inflation, which means the complete loss of the purchasing value of the dollar, but inflation that is so serious once the spiral gets started that it might be called by a great many people explosive.

The CHAIRMAN. Mr. Paul, there is in the House bill a deduction, believe, for the blind.

Mr. PAUL. Yes; there is.

The CHAIRMAN. Does the Treasury have any particular opposition to that? I am trying to anticipate some features of the hearings.

Mr. PAUL. Mr. Surrey was present and stated the Treasury's position at the time that was under consideration. Perhaps he ought to state our position at this time.

The CHAIRMAN. Yes. Give us your position on that.

Mr. SURREY. We pointed out to the committee that it was singling out one class of handicapped persons and giving them a special tax treatment. The question for the committee was whether they wanted to embark upon the policy of providing relief in such cases through the mechanism of the income-tax laws. If the committee decided to embark upon such a course, the question then was whether they shouldn't cover all handicapped people. Naturally, this issue raises difficult questions of degree. It is a new policy under the tax laws and it does raise a number of difficult questions.

The CHAIRMAN. I just wanted a preview of that part of it.

Senator VANDENBERG. I would like to ask Mr. Paul whether the Treasury has any comment to make on the provision in the House bill which requires certain nonprofit organizations now to make certain reports to the Treasury.

Mr. PAUL. I have no comment to make. We did not suggest it nor were we consulted about the provision in the House.

The CHAIRMAN. Mr. Paul, you may aid us, if you will. On certain of the excise taxes you recommended a higher rate.

Mr. PAUL. That is in the record.

The CHAIRMAN. That is in the record?

Mr. PAUL. Yes. Exact reports of what we recommended and what the House bill provides.

The CHAIRMAN. All right, we can take it out of the record.

If there are no further questions then from Mr. Paul, that will be all. Thank you very much, Mr. Paul. You will be here.

Mr. PAUL. We will be here; yes.

The CHAIRMAN. Mr. McFarland.

Mr. McFarland, you are speaking on the technical or administrative changes to be made?

Mr. MCFARLAND. Yes, sir.

The CHAIRMAN. You have your brief, have you, on that point?

Mr. MCFARLAND. Yes; I have.

The CHAIRMAN. Will you condense your oral statement as far as you can?

Mr. MCFARLAND. It will be very short.

The CHAIRMAN. All right.

STATEMENT OF ELDEN McFARLAND, WASHINGTON REPRESENTATIVE OF MURPHY, LANIER, AND QUINN

Mr. MCFARLAND. My name is Elden McFarland. I am the Washington representative of Murphy, Lanier, and Quinn, who specialize in tax matters.

My first proposal is that section 113 (b) (1) (B) of the Internal Revenue Code be amended to provide that depreciation taken in prior years in excess of that properly allowable which did not offset taxable income shall be ignored in computing the basis for depreciation.

Let me illustrate the problem involved by reference to a particular case.

From 1930 through 1937 (fiscal years ended March 31) this company had losses in excess of $200,000 each year.

It took depreciation on its factories and equipment in its books of account and in its income-tax returns at the rates which had been prescribed by the examining internal revenue agent in his report for the years 1928 and 1929.

In 1940 the examining revenue agent, examining the 1939 return determined that these prior depreciation rates were excessive; and he reduced the rates for 1939. The Commissioner of Internal Revenue approved his determination.

The company accepted the new rates, but pointed out that inasmuch as no greater depreciation had in fact been sustained in the prior years, its prior depreciation charges for the years 1930–37 had been excessive to the extent of approximately $25,000 per year, and therefore such excessive depreciation should be restored to its depreciation basis, in order to determine its true and correct depreciation for the year 1939 and subsequent years.

It pointed out further that such action was entirely equitable, inasmuch as it had received no tax advantage and no tax benefits whatever from the prior excessive depreciation deductions.

The United States Board of Tax Appeals (now The Tax Court of the United States) had held, in two cases [1] that such treatment as that advocated by the taxpayer, was proper.

But the Supreme Court of the United States in the recent case of *Virginian Hotel Company of Lynchburg* v. *Helvering*, 63 S. Ct. 1260 (decided June 7, 1943, but not finally disposed of on motion for rehearing until its current October 1943 term) held that the depreciable basis could not be thus restored so as to represent the true depreciable basis. The decision was based upon a technical view of section 113 (b) (1) (B) of the Internal Revenue Code. The merits of the question are ably discussed in the dissenting opinion of Chief Justice Stone, concurred in by Justices Roberts, Jackson, and Murphy; and in the dissenting opinion of Mr. Justice Jackson.

The house of delegates of the American Bar Association in August 1943 approved the recommendation of its section of taxation:

> That the law be amended to provide that depreciation in excess of that allowable which did not offset taxable income shall be ignored in computing basis for future years.[2]

This proposal has true merit. It provides for a depreciation deduction which represents the true and correct amount of depreciation sustained in the taxable year.

Senator CLARK. Your contention is that your bill now represents actual depreciation on any consistent theory of theoretical depreciation?

Mr. MCFARLAND. That is right, and it is merely a correction to show what the actual depreciation is for the current year except that if any advantage has been obtained by reason of having taken excessive depreciation in the prior year then the taxpayer cannot get any additional advantage; but except for that it provides merely for the

[1] Kennedy Laundry Co., 46 B. T. A. 70; and Virginian Hotel Corporation, memo. opinion reported at 42 C. C. H. par. 7522D.

[2] P. 657, vol. 29, American Bar Association Journal, November 1943.

taking of the true or correct amount of depreciation to which the taxpayer is properly entitled in the current taxable year.

Senator CLARK. In other words, if a man is taking theoretical depreciation in excess of actual depreciation he wouldn't be able now to use the advantage he had taken then and go into actual depreciation.

Mr. MCFARLAND. That is right.

It provides no unfair advantage to the taxpayer, because, if he has derived any advantage whatsoever from his excessive depreciation deductions in the past, he is excluded from further benefit.

On the other hand, under the decision of the Supreme Court in the *Virginian Hotel Company case*, the taxpayer is precluded from receiving his true and correct depreciation deduction merely because of a past error—in our case because of the Commissioner's own past error—when that error has resulted in no benefit whatsoever to him, and when the error can be corrected so as to truthfully reflect his proper current deduction.

In the Revenue Act of 1942 this committee approved a somewhat similar provision having to do with the recovery of bad debts previously charged off as worthless. That provision became section 116 of the Revenue Act of 1942 which amended section 22 (b) of the Internal Revenue Code so as to exclude from gross income recoveries of bad debts which previously had been deducted as bad debts but which deduction did not result in any tax benefit.

Every sound reason supporting the enactment of section 116 of the Revenue Act of 1942 supports the present proposal. It is just; it is fair and equitable. Only by such an enactment can the true and proper income of taxpayers thus situated be determined.

My second point covers double taxation of trust income:

Section 111 of the Revenue Act of 1942 amended section 162 of the Internal Revenue Code to provide that trust income distributed to a beneficiary more than 65 days after the end of a taxable year shall be included in the income of the beneficiary for the year of receipt.

In its new Regulations 111, issued by the Bureau of Internal Revenue October 28, 1943 (sec. 29.161–1 to sec. 29.163–1), the Bureau has construed the amendment so that in such cases the income is taxed to the trust for the year in which such income was earned or received by the trust and also taxes such income as that of the beneficiary in the year when it is distributed to him.

Thus we have double taxation of exactly the same income.

We do not believe that this was the congressional intent. Unquestionably it is inequitable. Prompt clarification of this situation by Congress will eliminate a great deal of litigation which is bound to grow out of the present situation.

The CHAIRMAN. Do you have amendments prepared?

Mr. MCFARLAND. I have no specific amendments prepared but the substance of the amendments and the substance of the resolutions adopted by the house of delegates of the Bar Association sets up very closely what might be adopted.

The CHAIRMAN. You may put them in the record.

Mr. MCFARLAND. Thank you.

The CHAIRMAN. Mr. Nixon, what particular matter do you propose to discuss?

Mr. NIXON. Mr. Chairman, my statement is a general statement. I would like to have the statement which I am passing around put in the record but I would like also to make a few extemporaneous remarks summarizing the nature of the statement which I am putting before you.

The CHAIRMAN. All right, you may proceed.

STATEMENT OF RUSS NIXON, WASHINGTON REPRESENTATIVE, UNITED ELECTRICAL, RADIO, AND MACHINE WORKERS OF AMERICA, CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. NIXON. Senator George, members of the committee, I am Russ Nixon, Washington representative of the United Electrical, Radio, and Machine Workers of America, C. I. O. union. My organization represents approximately 600,000 war workers, specialized industrial establishments as the General Electric Corporation, Westinghouse, R. C. A., and Sperry Gyroscope Corporation. We have a total of around 950 plants under contract to us.

The views which I present to you are the views of my organization, adopted principally in our recent convention in the city of New York, and repeated many times in various regional and local union actions on this subject. Expressing these views, I indicate to the committee at the outset a grave feeling that the House bill which you have before you has serious shortcomings. We feel particularly strongly that this bill does not meet the test of what at least we conceive of as total war tax legislation. We feel that the shortcomings of the bill arise from two particular considerations.

One, the question of its adequacy as an income-raising measure in view of the tremendous war expenditures, and secondly because of its inequitable and regressive impact upon various segments of the American people. For a country that is spending around $92,000,000,000, about two-thirds of its income, in the fiscal year 1943–44, it seems to us that the House bill does not raise sufficient revenue. We draw this conclusion not so much from the consideration of absolute magnitudes but in view of excessive "after taxes" as very considerable sources, potential sources of revenue which are not tapped to pay for the war.

Now, it has been our judgment that an impression has been created, perhaps in some quarters purposely so, that the only source of additional revenue is the adoption of regressive and oppressive burdens on the low-income people of the country. It is on the basis of this, what we believe is a complete false dilemma, that some have consented magnanimously to a tax bill which raises only around $2,000,000,000 additional revenue. They have done this while expressing sympathy for the low-income people and probably, in our view, have inwardly felt a great deal of satisfaction that they have been able to help some of their wealthier friends.

Senator BUTLER. Are you talking about members of the committee?

Mr. NIXON. No, sir.

Senator BUTLER. Who do you mean have "magnanimously agreed to an inadequate tax bill"?

Mr. NIXON. Well, for example, the National Association of Manufacturers has agreed to a bill which does not raise any more money than the House bill.

It is our judgment that that attitude which some of them express with a degree of sympathy for low-income people is more realistically satisfaction that they have not been taxed more themselves.

Senator BUTLER. Well, you are using the word "agreed" in an unusual sense, aren't you, because I don't understand that tax bills are the result of agreements.

Mr. NIXON. No, I guess they are the result of disagreements, but they have, I think, certain attitudes of various groups of people, and I am merely referring to one of those attitudes, sir.

The main point I want to make in this connection is that certainly there has been very widespread creation of the idea that there is only two alternatives before the Congress, either no new taxes or a sales tax. The first basic point I want to make is that there are substantial sources of revenue available to this committee, to the House Ways and Means Committee, to the Congress and the Senate, for additional revenue which do not involve the imposition of a sales tax or a similar regressive measure.

I would like to mention in summary a few of these. I don't need to go into them in detail because I know that this committee has heard these things argued many, many times.

First. With reference to the question of the closing of loopholes in existing laws. These loopholes, the joint-return issue, the tax-exempt securities, the excessive depreciation allowance, and the question of higher rates on estate and gift taxes, are old issues, well known to this committee, but some of these issues and the imposition of these taxes, which it is the judgment of the Treasury, for example, should be issued, there may be raised, from this single source, approximately $1,450,000,000. It is a very rough estimate. I don't have the resources of the Treasury at hand, but I think it is roughly a correct judgment of the potential income from this particular source.

A second very significant source of additional revenue is the increased taxation on corporate income. I did want to say that, willing to take a very conservative view with respect to this question, to adopt the assumption that this committee in drawing the bill would say, "We agree that the American corporations shall increase their total profits 100 percent, but we won't let them increase it any more than that," if you would make that assumption and then proceed to draft a tax bill with regard to corporations which would put into effect that proposition, you would have available to you $2,100,000,000 additional revenue. And mind you that is on the assumption of a 100-percent increase in the total profits of American corporations. Obviously, if you were to adopt an assumption of a 50-percent increase, you could raise around $4,000,000,000. And, of course, if you were to hold them to their pre-war levels on a total picture, you would raise something like $5,500,000,000.

Now, it seems to me in considering these questions of total profits it is not irrelevant to recognize that the risk taken, which is usually

what we think profits are the returns for, is certainly considerably less during the war and under existing safeguards written into Government purchases than under peacetime conditions.

So I think there is a real basis for rational judgment, that it is certainly just and equitable that there should be a limitation, perhaps to the degree I mentioned, on the corporate profits during the war.

The main point I make is that if you did this there would be available to you, if you adopt the 100-percent increase figure, over $2,000,000,000 of additional revenue.

In addition by the adoption of the Treasury rates on incomes above $3,000 there could be raised approximately $4,000,000,000.

Now, these sources added together approximate $7,500,000,000.

I am appreciative of the fact that reasonable men may differ about some of these questions, about whether or not these particular taxes should be levied, but I think there can be no difference of opinion but that these alternative sources of revenue do exist, that it is a false proposition to say that there is only the sales tax or no new taxes. It is more correct to say that there is the proposition of no new taxes, sales tax, or these additional taxes, with their heavy impact upon the wealthier people of the country. I think that is the proper alternative. And, of course, it is our judgment that in equity the burden needs to be put upon the wealthier sources. And particularly I think it should be emphasized that these sources do remain, that they do exist as an offset to an expenditure of $92,000,000,000 in a single year, which is available to us if only we agree that these sources should be tapped.

The other point I wanted to make is with reference to the regressive and oppressive impact potentially of the House tax bill. It seems to us that there have been extraordinary burdens already put upon the low-income people of our country. This is clear from the adoption of the Victory tax last year, and its retention in modified form in the present House bill. It is also evident in our judgment in the agitation for a sales tax. It seems to me it is an elementary proposition that when Congress is considering the lowering of the standards of living of people in these real low-income brackets it should be done on the basis of a very clear and complete picture of just what is being done to the standards of living of the people.

In other words, when you lower exemptions from $1,500 to $1,200, let us say, for a married couple, it would seem to us that it would be highly desirable for the committee to know just what this means in terms of the purchases of a family under that income level.

It has been an astounding thing to me that, with my limited knowledge of the past several years, there has never been presented to this committee, or to the House committee, scientific and objective evidence concerning the impact of lowering income-tax exemptions or of adding income tax burdens on to the tax burdens of the low-income people of the country.

The point I am making here now is not so much the major point that you should not put these taxes on but is a suggestion that these taxes should not be levied until this committee has carefully considered just what it is doing when it puts a 3-percent tax on an individual receiving $500 or a 3 percent tax on an individual receiving, and his

wife receiving $700, and when they give him an exemption of $100 for each additional dependent. I would think, if it is not presumptuous, that that kind of a question would justify calling before this committee expert witnesses from various Government agencies who know nutritional problems, who know the problems of standardizing living.

I emphasize this because I think that if this evidence were to come before this committee it would be shown without any question of a doubt that the existing regressive taxes impose an unjustified burden and that any further taxes would be completely out of step with the basic welfare of our people, which I think involves maintaining the basic health and decent standards of living of at least the low-income people.

In contrast with the views that have been expressed for heavier taxes on these low-income groups there has been in our judgment a continued willingness to accede to the position of those who don't want additional taxes on corporate profits, to accede to those who feel that even in this wartime we should not adopt the drastic proposal of the Treasury with regard to higher incomes, and to accede also to those who wish to preserve the loopholes which benefit not the 60 or 70 or 80 percent of the people in the low-income brackets, but benefit the small percentage of people in the high-income brackets.

For these reasons we feel the impact of the bill is oppressive and certainly is regressive.

One other point I did want to make as I draw to a conclusion and that is this, that in considering the measure which you have before you you must give a certain amount of weight to the action of the House, the action of the other body of the Congress. I think I speak for all labor when I point out to you our grave concern at the lack of full democratic consideration in the House of this measure.

I realize this is a serious thing to say, but I think it has to be said. I think this committee in evaluating the House bill has to recognize that on certain basic issues the vote of 13 men on the House Ways and Means Committee is sufficient to decide an issue, and that vote was taken behind closed doors. We didn't have the benefit, in considering this piece of legislation which affects so vitally our whole population, of a clear, clean-cut debate on issues, out in the open, and the taking of a vote and putting the people, the Members of Congress, definitely on record as to where they stand.

Now, I think this is relevant because obviously you have to give a certain evaluation to the bill which you have before you, and I would be remiss in coming before you if I did not emphasize our grave concern at having this kind of legislation, of such tremendous moment, passed in the House of 435 people where 13 people on a certain committee have the power, under the circumstances that exist there, to make the decision on the basic issues.

Senator CLARK. You understand, of course, that neither this committee nor the Senate have anything to do with the rules of the House. In other words, they are the coordinate branch of the Government and we have to take their rules as we find them. We cannot change them.

Mr. NIXON. Yes, sir. I say in my written statement, "I appreciate the fact that the Senate cannot alter the House procedures." I

realize that. I am not suggesting that you should try. I merely make this point, that in evaluating the bill, a bill which had to originate in the House, you necessarily must judge to what degree it does reflect the will of the people. You must, in my judgment, make some evaluation of the processes by which this bill comes to you. I don't see tnat you can ignore the point that I have made, sir. I realize the limitations of your action.

I don't wish—to summarize—to go into detail into the problems that we in C. I. O. have met with regard to tax legislation. I have indicated the approach on some of the problems. I think later on other representatives of the C. I. O., and the national C. I. O., may go into a great deal of detail with you with regard to our specific proposals. I did want, though, to emphasize the general approach to this tax bill which my organization is taking. I know that you will have the benefit of fuller discussion of our positive proposals. I want to close by saying that it is our conviction that these proposals and this approach are not merely the approach and the proposals of the C. I. O., not merely the approach and proposals of the United Electrical, Radio and Machine Workers of America, but they are basically the approach of the vast majority of the American people who at this time want to have a vigorous and hard-hitting tax bill, and who particularly in this time when so many people are called upon to make such great sacrifices, to have a tax bill which hits hard and proceeds according to ability to pay and along obvious and clear standards of equity.

We have about 13,000,000 people in our labor movement that represent with their families more than 40,000,000 people. We think that this is a significant body of American opinion. We invite you to contrast our views with the views of the National Association of Manufacturers and the Chamber of Commerce when they come to take a basic point of disagreement with us. We invite you to evaluate our views, keeping in mind also the relative number of American citizens that we in labor represent, compared with some of our friends, who will take the opposite side on these basic questions.

Senator CLARK. I am greatly interested in what you say and with many of the views which you have given us I am in entire accord, but reading your summary on page 5, you say that you are in favor of a vigorous hard-hitting tax bill, but at least two of these proposals, proposals 1 and 3, would cut about $9,000,000,000 from the present tax sources of the United States, and I don't believe that all the other proposals you have here would anything like bring in the amount by which you reduce it.

In other words, when you say, "Repeal the so-called Victory tax" you reduce the present tax structure by $6,000,000,000. I voted against it when it was enacted but it is undeniable that it has raised about $6,000,000,000.

Then you say, "Raise income-tax exemptions to $800 for single persons, $1,500 for married persons, and $400 for each dependent." I voted against the reduction of that exemption but it is undeniable that that has raised about $3,000,000,000.

On those two items alone you reduce the present tax structure by $9,000,000,000 and I don't see how these other recommendations would anything like make up for the $9,000,000,000.

Mr. NIXON. There is no question but what two of our suggestions involve taking some of the burden off low-income people. It is a relatively easy thing to adjust the rate so that the impact of that does not go clear through the income-tax structure and will relieve only the lower-income people from their burden.

It is obvious that unless you make some adjustment when you lower these exemptions the man with a $500,000 income benefits as well. That I think can be adjusted rather easily. The rates can be adjusted in that way. That I am sure would produce the amount of income that you are losing.

Likewise with respect to the 5 percent so-called Victory tax. I think that while you would lose a good deal of revenue there, if you eliminated in the House bill the Victory tax except for the 3 percent between—below the income-tax revenues—the income-tax exemptions, excuse me, you would find that in that relatively narrow income-tax level, or, income level, you would be losing a much lesser amount of money than you indicated.

In other words, I think that this committee with its expert knowledge of the questions and with their expert staff of assistants, would have no trouble in drawing a piece of tax legislation for protecting these low-income people by the application of these basic exemptions and the protection of these basic low-income groups without losing the amount of revenue which you mentioned since out of these low incomes you don't get that much revenue.

Senator CLARK. That is true. The great bulk of the revenue comes from the large number of taxpayers that are brought in by that lowering of the exemption. I voted against it, as I said, but nevertheless, it is a part of the tax structure at the present time.

Mr. NIXON. Yes. I think you would find that, if you were to analyze the source of income tax, a very small part of it comes from these low-income groups. Of course, the Treasury can give you that information in detail. However, a tremendous amount of the money is coming, as you mentioned, from people who are below these levels, whom I don't think anyone would contend to have money enough that you and I like to think of as the American standard of living. It seems to me that the problem then is to find alternative sources.

Senator CLARK. I am pointing out that your program does not seem to me on its face to produce as much revenue as the present system does.

Mr. NIXON. I think this committee could very easily follow these principles and make it raise a good deal more.

The CHAIRMAN. Thank you very much.

Mr. Canelli.

STATEMENT OF JOHN CANELLI, ON BEHALF OF NATIONAL BOWLING COUNCIL

Mr. CANELLI. Mr. George, and gentlemen of the committee, my name is John Canelli. I am from Toledo, Ohio, and I happen to be a member of the National Bowling Council.

The National Bowling Council is composed of representatives of the various pin groups, the American Bowling Congress, the Women's

International Bowling Congress, the National Duck Pin Bowling Congress, and the Allied Candle Pin and Rubber Band Pin Associations.

We object to this section of the bill relating to the 20-percent tax proposed to be imposed on bowling. Immediately we heard of this proposed 20-percent tax, we imagined the best way to find out the answer to such a proposed tax would be to determine the reasoning of the Treasury Department, or the body that proposed such a tax. Accordingly, on page 30 of the revenue bill report of 1943, under the heading "Bowling alleys, billiard tables, and pool tables," we find that for bowling alleys it is recommended that the tax of $20 per alley be converted into 20 percent of the charge; that is, 20 percent of the charge for each individual game.

We wish to point out right now that 2 years ago the tax bill carried a new tax of $10 per alley and $10 per billiard table. This year it is sought to change that to 20 percent of the base charge. It is stated in the report:

> For pool and billiards since records of those are very inadequate in most instances, it is recommended the license tax be increased from $10 to $20 per table.

Going along with the reasoning of the committee or of the Treasury Department herein, it would seem to place a premium on not having records, because they say:

> These recreations are in a general way in competition with amusements, and the records of charges are very inadequate.

Further on, under pari-mutuel wagers, it says there shall be a tax on pari-mutuel wagering of 5 percent. Why there should be a 20-percent charge on bowling and a 5-percent charge on mutuel wagering, unless it is anticipated that the Treasury Department, as Mr. Clark said this morning, likes the sum of $27,000,000, we cannot imagine.

Senator CLARK. As a matter of fact, the essential confusion in that statement is that it classes bowling as an amusement where, as a matter of fact, it is a sport. It is the difference between taxing the spectator and taxing the participant.

Mr. CANELLI. That is right, but at the same time we do not think bowling should be classified with theater taxes.

Senator CLARK. That is what I am pointing out, that it taxes the participant. It is not fair to tax the participant in a sport to the same extent you tax someone for amusement.

Mr. CANELLI. I thank you for the observation. That is quite true. As far as we are concerned, that is their reasoning.

As far as our objections are concerned, the National Bowling Council representing more than 16,000,000 citizens from every city, town, and community in every one of the 48 States, comprising the bowling public, on behalf of and for these citizens, respectfully ask the consideration by your honorable committee of their protest against the imposition of a tax of 20 percent on the cost of their recreation as imposed by bill H. R. 3687, the revenue bill of 1943, and submit that this tax should not be imposed for the following reasons:

More than 16,000,000 Americans are proposed to be taxed, who of all people in America are least able to afford a 20 percent tax on what is a

necessary recreation and a relaxation—not a luxury in any sense of the word. It is a fact, as stated in the Statistical Abstract of the United States, United States Department of Commerce, page 348, table 374, that in the last quarter of 1942 (last available figures), only 23 percent of the wage earners of this country had incomes which exceeded $3,000 per year. The figures of the American Bowling Congress, the National Duck Pin Bowling Congress, the Women's International Bowling Congress, and the Allied Candle Pin and Rubber Band Pin Associations of this country, who represent the entire bowling fraternity of the United States and the 16,000,000 heretofore mentioned, conclusively prove that by far the vast majority of the participants in bowling come from the so-called white collar class of wage earners and as such have an income of less than $3,000 per year.

It is an additional fact that a great number of the leading colleges and universities of this country have made bowling a duly accredited part of their physical culture curriculum. Further, high-school leagues, composed of both boys and girls, are rapidly approaching the point of being universal in this country. Pointing out 1 city alone Chicago has a high-school league entry of 15,000 children. Finally, there is no doubt that bowling is the most indulged in of all sports by our millions of servicemen and servicewomen still in this country. Yet, this bill proposes to charge our children and our servicemen and women 20 percent to play.

Compare to this then the statement of the House Ways and Means Committee in recommending a tax of only 5 percent on pari-mutuel betting when they said, "This tax will come from the citizens with surplus cash and best able to pay such a tax." If in the wisdom of your honorable committee you deem it both fair and wise, and necessary, to impose a tax on our citizens who participate in the sport of bowling as a beneficial recreation, then such a tax should certainly not exceed that imposed on those citizens who use their surplus money in pari-mutuel betting.

The proposed tax is discriminatory and grossly unfair, in that it is an unprecedented tax on the participants of a particular sport. This is in direct conflict with the settled policy of the Federal Government to encourage the public to engage in participant sports. No other participant sport, such as golf, tennis, basketball, or soccer, is asked to pay any tax whatsoever. Bowling alone is singled out in spite of the fact that this sport has by far the greatest number of participants and they come mostly from the lower-income groups with strictly limited amounts of money to spend for recreation. In fact, it is the only sport available to millions who, because of some physical disability, advanced age, or other causes, are unable to take part in any other recreational sport.

It is obvious what will happen if the cost of bowling be increased 20 percent by the addition of the proposed tax. We have pointed out that the majority of bowlers are in the small income bracket. These people are already faced with the burden of increased cost of living without additional income to compensate for this increase. A great many bowlers already faced with a serious problem of making ends meet, will undoubtedly be forced to give up the sport entirely.

And the majority of the rest will be compelled to curtail their only regular form of exercise and recreation.

Any tax law must be fair and serve some useful purpose not outweighed by the damage that the bill will do. This tax proposal is unsound and does not serve a useful purpose commensurate with the damage it will do. First, the proposed tax on bowling will not stop any inflationary impetus in that the money proposed to be taxed has not caused any inflation in the past and will not reach any future spending tending to an inflationary impetus, since bowling spent money is not luxury spent money, but money spent on a necessary and essential participant sport. Second, and to the contrary, this tax will impede and restrict a necessary recreational sport with an anticipated but purely conjectural revenue of only $27,000,000 to the United States Treasury.

We submit to this honorable committee that even if this questionable amount of money could be obtained, the harm and the damage done would in no way be compensated for by the amount of good that could be done with such a comparatively small amount of money.

For these reasons we respectfully and earnestly urge that the proposed 20-percent tax on bowling be eliminated entirely from the 1943 revenue bill.

When we heard there was to be $27,000,000 anticipatedly raised from bowling charges, we were quite alarmed because of the amount sought. However, after having sat around here all day and heard astronomical figures such as $100,000,000,000 and $90,000,000,000, I approach with trepidation the request that this portion of the bill seeking to raise $27,000,000 be deleted because, comparatively speaking, it is pin money and I do not mean that as a pun.

It is our contention it would be unwise, unfair, and unobtainable to put this sort of a tax on bowling. It would be unwise for the reason we took into consideration the number of active participants at the figure of 16,000,000 persons. This figure of 16,000,000 was gathered not only from the Department of Commerce in 1941, but also by the actual census and inquiries made by the various bowling fraternities which I represent. That is the only sport in which they can indulge. That is the only sport in which anybody of any age or physical condition can partake.

I do not intend to give you a flag waving speech, but bowling is the only game that provides recreational facilities to all of these millions.

The next reason it would be unwise is the fact an additional tax on bowling at the present time will not result in the money that is anticipated, for the reason that as we put more tax on these people—and I will attempt to show you in a minute the class of people from whom bowlers are drawn—there will be a corresponding decrease in the amount of business the bowling proprietor will do. Following out that line of reasoning, there would be less business and consequently less income tax because his profit would be decreased accordingly. I think it can be taken as a fact that in any certain establishment the overhead is just as great, except for the pin boys, whether it is a 6-alley or a 10-alley or a 12-alley establishment. Therefore, the profit is decreased not one-third, but entirely taken off——

Senator CLARK. To what extent is your business for the coming bowling season already under contract? Do you not have a large portion of your business which is now under contract?

Mr. CANELLI. Not a large portion, Senator, but if those people do not have the money to pay for bowling, they will not bowl and the contract, so far as the proprietor is concerned, means nothing, because they pay week after week.

Senator CLARK. It keeps you from raising the rates on those bowlers who have a contract?

Mr. CANELLI. Oh, yes; we are under O. P. A. ceiling. Prices are stationary as far as the proprietors are concerned.

The next item is the unfairness of the thing. There is no other sport that charges the single participant in this country by way of tax; there is no other sport being taxed today. Of course, golf clubs pay a tax, but if it was the Eagles or the Elks or some other association it would be taxed the same.

Seventy percent of the 16,000,000 bowlers in this country are drawn from the so-called white-collar class, and that is the class that is least able to pay an increase in tax because there has been no corresponding increase in their income.

I would like to read from The National Week of November 26, the following statement, Mr. Chairman——

The CHAIRMAN. You may do so.

Mr. CANELLI [reading]:

> Now consider white-collar workers. This group bulks large among the 15,000,000 family breadwinners who are estimated to have received little or no increase in incomes since the war. It includes clerks in offices and stores, salesmen, teachers, librarians, Government workers. They are more numerous than the union workers in factories, yet they have no organized voice.
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> Already, living costs have begun to pinch. The average employee in a retail store, for example, has managed to raise his salary from $21.17 a week in 1939 to $25.35 a week today—not enough to offset higher prices. The official estimate is that retail employees can buy 3.9 percent fewer things today than they could before the war. Employees of insurance firms have suffered a drop of 6.2 percent in real earnings, and telephone and telegraph workers have 5.9 percent less purchasing power.
>
> This whole white-collar group has few means of demanding higher wages. The War Labor Board will consider only cases brought by unions, and most of these workers have no unions. Their only recourse is to appeal individually to their employers, who now, more often than not, are considering post-war expenses and are wary of raising their costs. Moreover employers must apply to War Labor Board for permission to raise wages and salaries beyond 15 percent above January 1941, levels.
>
> Even executive salaries are pinched. Relatively well-paid white-collar employees perhaps have been able to absorb the rise in living costs without much hardship, but war taxes have bitten deeply into their incomes. A married man with two children and a $5,000 income has $4,270 left under present rates. The Executive with double that salary realizes only $7,792 after taxes.
>
> Taxes, of course, have hit wage earners as well, but tax bills are easier to meet with a rising income than a stable one. Many middle-bracket taxpayers have had to reduce savings and insurance programs and to forego a number of comforts.

We wish to compare the proposed 5-percent tax on pari-mutuel betting with the proposed tax on bowling. The Ways and Means Committee at the time it suggested the 5-percent tax on pari-mutuel betting said it would be taken from the people who are best able to afford such a tax. The 20-percent tax on bowling is certainly not a

tax on a luxury, as is pari-mutuel betting. Further than that, we do not find children betting on horses, but we do find in this country, leagues of children numbering over 500,000, Chicago having 15,000, engaged in bowling. It is a leading recreational sport in the high schools and universities.

The proprietors are trying to do their part by reducing the fee to the children. We also have to consider the fact that soldiers and sailors and the women in our armed services who are getting $50 a day once a month, as they say, are active participants in bowling. I do not think there is any argument it is the leading single participant sport among soldiers and sailors in this country. Are these people who are getting $50 a month going to be asked to pay 20 percent additional to bowl, whereas our race track bettors are only charged 5 percent?

Finally, we think that the amount of money will be unobtainable for the reason the bowling business has already fallen off and it will fall off more if the tax is increased. The National Bowling Council has put out questionnaires to about 3,000 proprietors of the 7,000 in this country, and out of the 3,000, from 900 to 1,000 have been returned within 10 days, and the lowest estimate of the further decrease in business is 20 percent and the highest is 50 percent, if this tax is put into effect.

A further questionnaire sent out by the American Bowling Congress brings the answer from Milwaukee that 50 percent of the establishments will have to close up.

If we take into consideration the fact of the difficulty encountered by proprietors in obtaining pin boys today, and the axiom that there cannot be a bowling game unless there is a man in the front knocking the pins down and a man at the back throwing them back, and if we take into consideration the higher wages that these pin boys are able to obtain in other employment, a conservative estimate is that at least 20 percent of the establishments are well on their way to closing up now.

The third is, even if the pin boys were obtainable, with the increase in bowling fee of 20 percent, which means 5 cents on top of every quarter spent, the fact that the children who have no incomes of their own and the great numbers of soldiers and sailors who are now bowling and who because of the substantial increase in cost would not have the money to pay for bowling, would not be able to continue.

I do not have any other remarks except that this bill as it stands in its present shape, and speaking specifically of the 20-percent proposal on bowling, is going to be known as the triple U bill by the bowlers, for the reason it is unwise, unfair, and unobtainable.

The CHAIRMAN. Your remarks will be read in the record by the full committee. The Senate is having certain votes over there and the Senators have had to leave.

Mr. Sherrard.

STATEMENT OF GLENWOOD J. SHERRARD, PRESIDENT, AMERICAN HOTEL ASSOCIATION

The CHAIRMAN. Mr. Sherrard, I regret the other members of the committee are not here to hear your remarks.

Mr. SHERRARD. Do you want me to wait?

The CHAIRMAN. No, we will have to go ahead; we have certain other witnesses. Your statement will go into the record and the Senators will read it before they begin to pass on these particular provisions of the bill. You may proceed.

Mr. SHERRARD. Senator George and members of the committee, my name is Glenwood J. Sherrard. I am owner and managing director of the Parker House, and three other Boston hotels.

I am also president of the American Hotel Association, which comprises 5,500 of the leading hotels in America, some large, some small, some in big cities, some in small towns. Our membership covers 80 percent of all the hotel rooms in the country.

Some hotels are residential, catering to permanent guests who make the hotel their homes. Others are resort hotels, which are used primarily only part of the year, winter or summer, as recreation hotels. The largest group are the transient hotels, catering to the traveler—right now being used by the Army and Navy personnel as permanent quarters, and while on leave or in transit to another post, and the war worker executive traveling and holding meetings for the furtherance of the war effort. All of these different kinds of hotels are represented in our membership.

Hotels, whether large or small, whether transient, residential, or resort, are primarily in the business of providing housing, and closely allied with this is the business of providing food.

The hotels of America have made, and are making, an outstanding contribution to the war effort by supplying facilities for housing and feeding of military men, Government officials, and war-plant expediters. At the Hotel New Yorker, for example, pre-war military business amounted to one-half of 1 percent, but today it has grown to 34.4 percent of the total. All uniformed men, incidentally, are given a reduced military rate. Add to this what may be called the "friend and relative" business—the wives, mothers, and sweethearts who visit with men in the service, and you will see immediately the additional increase due to military traffic.

Hotels have been active in local community war activities—supplying public space for Red Cross, A. W. V. S., Officers' Service Clubs, and other war related activities. They are cooperating with War bond, salvage, and other drives. They have supported the O. P. A. in the fight against black markets, have done much to cooperate with the Government on its food-conservation program. In fact, high military, naval, and Government officials have voluntarily and frequently testified to the cooperation of hotels in the war effort.

Hotel business, whether large or small, follows the ups and downs of general business. This chart—based on corporation figures from the United States Treasury Department, shows clearly that the trend line of total profits—using 1929 as a base—parallels the trend line of profits all corporations, but with this difference; since 1934 hotel profits have been consistently below other corporations.

Current incomes for hotels, as for all other corporations, are up—directly due to the heavy wartime business.

But along with this increase income has come an increased wear and tear on plants.

During the past 2 years, manufacturers have been forced to work plants and equipment harder and longer than good peacetime practice dictated. To keep up scheduled production, shut-downs for repairs

and maintenance have been postponed. As a result, machinery is wearing out at a too rapid pace.

With the end of the war, these manufacturers will reconvert. The worn-out machinery will be junked because these plants will no longer be making wartime goods, and the cost of this peacetime reconversion will be properly charged against wartime profits.

Hotels too, have been forced by wartime demands to work their plants and equipment harder and longer than good peacetime practice dictates.

To keep rooms and service available, their shut-downs for repairs and maintenance have been postponed. Hotel equipment is wearing out at a too rapid pace.

But, with the end of the war, hotels will not reconvert because they will still be in the hotel business, and still manufacturing and selling the same products—rooms and food.

Their only reconversion will be the bringing back of their properties to at least pre-war standards—of making up for the maintenance they have been forced to defer.

Today, hotels are crowded as never before in their history, and the equipment in all departments is being used up at a rapid rate.

Mr. Randolph E. Paul, general counsel for the Treasury, in a statement before the Committee on Ways and Means, spoke of the two kinds of maintenance outlays—those which do not appreciably increase as output expands, which he terms "fixed" maintenance—and those which are more or less directly related to output, which are termed "variable" maintenance. Examples of the fixed type, he says, are "particularly well illustrated by the hotel industry whose maintenance varies little with output."

Now it is true that some things in a hotel do not wear out faster with increased use. Paint on a ceiling doesn't depreciate twice as fast when a hundred people look at it as when fifty do—although paint on a hotel bedroom wall does wear out quite a lot faster when the rooms are used more constantly, because the paint has to be washed more often to clean off the spots caused by people with greasy hair leaning back in their chairs, marks made where luggage bumps against the wall, and so on. Draperies in a dining room do not wear out faster when viewed by twice as many people—although curtains in bedrooms wear out much faster when the rooms are used more frequently, for they must be washed constantly, not only because they are handled by the guests, but also because the very heating of the rooms spreads a thin film of dust.

It is obvious, though, that many items have a direct ratio of wear and tear with the degree of use.

When rooms are "made up" twice as often, then towels and sheets are washed twice as often, and wear out twice as fast; twice as much soap is used; the hotel's power plants work much longer to provide more power; when a faucet is turned on and off twice as often it wears out twice as fast; and when twice as many people walk across a lobby carpet, it will obviously wear out twice as fast.

These are only a few of many items I could name. There are hundreds of not so obvious small items which, with increased use, wear out much faster. The felt strips on our revolving doors is a good example.

Experienced hotel accountants like Horwath & Horwath, and Harris Kerr Forster, confirm our knowledge that there is a definite percentage ratio that applies between room sales and wear and tear. In the light of today's heavy occupancy, hotels should be spending infinitely more than they spent last year. Many hotels have spent as much money, in dollars, during 1943 as they did during a similar period in 1942, although practically no hotels are spending the same amount percentagewise in relation to room sales. Furthermore, the same number of dollars in 1943 won't buy nearly as much in either service or materials.

To illustrate: Plumbing supplies are up 20 percent in cost, carpets have increased a dollar a yard and more, a rise of more than 45 percent. Kitchen equipment is up 20 to 25 percent, while inferior grade china, known as Victory model china, is up 20 percent. Upholstery fabrics have increased 75 cents a yard, a rise of 50 percent and more, while the cost of painting has risen more than 50 percent. In the Parker House in Boston we used to paint our rooms at an average cost of $30 per room but at present, with outside contractors doing the work, the cost is averaging $48 per room.

When the time comes again in which hotels should be able to spend normally, they will have to spend for the then current maintenance, and in addition will have to spend increased amounts to make up what has been left undone.

These repairs will have to be made sometime.

Post-war? When the present war boom is over, the hotel business will decrease just as fast as general business. If general business drops way off, hotels will again be in a position, as they were in 1932, of not enough business, not enough income, not enough money to pay for maintenance—in many cases, not enough even to pay taxes.

Since hotels are doing war work, why not allow hotels to set up in their operating expense accounts, an amount equal to such maintenance expenditures currently appropriate as they find feasible to defer until the end of the war?

Our proposal is first to calculate the percentage of room income expended for repairs, replacements, and maintenance in a normal year such as 1936-39; second, to apply the same percentage to gross room revenue of a current war year; and, third, to take the difference between this figure and the amount actually expended. This difference represents the sum that should have been expended for normal maintenance, repairs, and replacements, but was not. This sum should constitute the deductible allowance to be invested in non-interest-bearing Government securities deposited in Federal Reserve banks, or other Government depositories, and deductible from taxable income.

With the granting of such deduction for tax purposes it should be provided that the aggregate reserve so created must be spent within a limited post-war period and shall be expended only in addition to the normal repairs and replacements of those years. If the expenditures have not been made within the stipulated post-war period, such reserve shall become taxable at the rate effective in the year the reserve was created.

These reserves create post-war assurance of employment and purchases of repair materials, at a time when this type of encourage-

ment will be essential, and when we will not have the critical shortage of manpower and materials that we have today. What could be fairer?

Expenditures now, for replacements, repairs, and maintenance, use vitally needed men and materials. Present tax laws tend to encourage such expenditures up to the limit—when actually they should be discouraging these expenditures because they add to the inflationary stream.

To summarize: Our plan would benefit the Nation, in conserving manpower and materials, and reducing inflation; it would benefit hotels by permitting them to postpone, but not forego, the maintenance expenditures that must be made; it would benefit the Government by giving it the immediate use of 100 cents on the dollar, instead of the taxable sum that might represent from 90 cents downward; and it would guarantee a sizable sum for post-war hiring of labor, and purchases of materials. A reservoir of cash, in the hands of private business, for post-war rehabilitation of business properties, would also substantially reduce the need for post-war public works, financed by tax dollars.

Senator WALSH. Have you prepared an amendment to submit to the committee?

Mr. SHERRARD. No, sir.

Senator WALSH. You have just made your observations so that it may be prepared by the committee?

Mr. SHERRARD. Yes, sir.

The CHAIRMAN. Are many of the hotel companies in the country in the excess-profits bracket, or do most of them fall in the normal bracket?

Mr. SHERRARD. That would be very difficult to answer. A great many of the hotels went through the wringer in 1932, which makes their base very low.

The CHAIRMAN. You would not be able to answer whether any large number of them are in the excess-profits bracket?

Mr. SHERRARD. I think quite a few are, due to the fact they have such a low base.

The CHAIRMAN. They would have some recourse, but it would not be what you are asking for?

Mr. SHERRARD. No, sir; I do not think it would be helpful. They would need that cash for operating cash. Of course, when a hotel property starts going down, nobody wants to stay at it.

The CHAIRMAN. I notice your chart shows the hotel earnings are running under general business through 1940; does that same trend continued?

Mr. SHERRARD. The trend has always been that way; we have always been behind general business in earnings.

Senator WALSH. I think that is a surprising thing and the general public has a different idea. How long have you been president of the hotel association, Mr. Sherrard?

Mr. SHERRARD. Since October.

The CHAIRMAN. We thank you for your appearance and your statement will be read, and this same subject no doubt will be covered before the committee during the week.

We thank you very much.

Mr. SHERRARD. Thank you.

The CHAIRMAN. Mr. Andrews. Senator Butler asked if Mr. Andrews might be heard at this time.

Senator WALSH. Senator Butler is absent.

The CHAIRMAN. Yes, he has been called to the Senate to vote.

STATEMENT OF FRANK L. ANDREWS, DIRECTOR, AMERICAN HOTEL ASSOCIATION

Mr. ANDREWS. My name is Frank L. Andrews. I am president of the Hotel New Yorker Corporation of New York City and a director of the American Hotel Association.

I thought it might be advisable to give you a specific illustration of what deferred maintenance means. I would like to cite in the case of the New Yorker, that in our light, heat, and power plant, in which we manufacture our own power and light, we have 4 Skinner engines with a capacity of 2,200 kilowatt-hours, and 2 Diesels with a capacity of 850 kilowatt-hours. Under normal procedure we are able to shut down those engines and overhaul them and put in new pistons and rings and do a general overhauling job. Due to the fact our hotel, as hotels are generally, is very busy, we are unable to do that work and therefore our equipment is depreciating rapidly. There will come a time, post-war, when we will be put to a very extraordinary expense to bring this property back to normal condition. The same thing could be illustrated by the elevators. We operate some 30 high-speed elevators. Prior to the war we maintained our own maintenance crew consisting of some 10 elevator mechanics and electricians. We had 3 watches, and during the slow parts of the day, they were constantly repairing and putting those elevators into condition.

During the shortage of manpower we were unable to retain those electricians, so we now have a maintenance contract with the Otis Elevator Co., which is purely a matter of service to insure safe operation of the cars and any ordinary defect is corrected or repaired, but the elevators themselves are not being kept in the condition that they should be. So, again, the same thing applies; we will be faced with a very large expense, post-war, to put these elevators back in condition. I could illustrate deferred maintenance by citing pipe, electric wiring, and a number of different things, but it is too much detail to bother you with; but the principle involved, I would like to present.

You asked Mr. Sherrard about the hotels being in the excess-profits bracket. I would say quite a few are today. But from 1929 until 1940—I would like to correct that—from 1929 to about 1935 or 1936, hotels were in very bad financial position; many of them went through reorganization and most of them were in some form of bankruptcy. In other words, when they came into this present era of business, they came without reserves, many of them having back taxes to build up, and so forth. So hotels had no surpluses of reserves to carry over through a period of depression, and by the same token, now that they are making money, no matter what bracket they are in, they will have to pay out in taxes a large part of their earnings and they will again go back into normal or subnormal business, post-war, without reserves.

So it is very important that some consideration be given to a deferred maintenance plan.

The CHAIRMAN. You have the general problem of shortage of manpower and also the problem of obtaining new machines?

Mr. ANDREWS. We cannot obtain new machines and our manpower is depleted to a large extent. What we have are really unemployables so far as defense or military plants are concerned.

Senator WALSH. Are you allowed any depreciation?

Mr. ANDREWS. We charge depreciation according to the schedules which have been approved by the Treasury, a regular charge.

I thank you.

The CHAIRMAN. Thank you.

(The following letter was submitted for the record:)

NATIONAL APARTMENT OWNERS ASSOCIATION, INC.,
Washington, D. C., December 1, 1943.

THE MEMBERS OF THE FINANCE COMMITTEE,
United States Senate, Washington, D. C.

Gentlemen: This association, representing local associations of owners of rental housing properties throughout the country, request that you write into the Internal Revenue Act for the next fiscal year a provision by which the owners of buildings and equipment used for space-rental purposes may set up as a deductible item for income-tax purposes a reserve for repairs and maintenance which must now be deferred because of wartime conditions.

There are several reasons for our request at this time which may be stated as follows:

1. Because of the need for maximum use of housing accommodations in crowded war-industry areas and due to the shortage of many vital materials and skilled labor, it has become either impossible or inadvisable to perform some of the usual maintenance work to keep rental properties in normal condition. It is necessary to defer until after the war a large portion of usual maintenance expenditures.

2. In many cases in which property owners are able to obtain materials and labor they are doing maintenance work that could be deferred advantageously until after the war. This is being done to avoid paying out in income taxes funds which normally would be used for maintenance purposes. Such competition for labor and materials, to the extent that it is unnecessary, is contrary to the best interests of the war effort and should be discouraged.

3. To the extent that current repair and maintenance items which involve skilled work can be deferred until after the war, a backlog will be created for post-war reemployment and a market will be created for materials now made strategic for war requirements. The best interest of the country will be served by any encouragement which can now be given to such a policy.

4. Setting up of reserves for deferred maintenance can be effected in such manner as to avoid any loss of revenue to the Government. Reserves created at this time merely will permit charging against present income the proper proportion of costs which otherwise must be charged in disproportionate amounts against post-war income.

5. The need for such a policy is immediate. Further delay will cause irretrievable losses to those owners who will adopt such a procedure.

In considering this proposal we suggest that you may wish to avoid many complicating factors which apply to the subject as it relates to industry in general. On the other hand, the creation of these reserves and their supervision by the Bureau of Internal Revenue, can be accomplished readily when related only to buildings used for space rental. To the extent that it may be desirable to experiment with such a policy, its inclusion in the forthcoming revenue act may serve as a guide to determine whether it is practicable to apply similar policy to industry generally.

We suggest as a possible plan to effectuate this program the following:

1. Make the provision of such reserve entirely voluntary on the part of the taxpayer.

2. Require that the taxpayer report annual gross income, average annual maintenance expenses, and the ratio of such expenses to such income for a base period such as 1936–39 or a shorter or later period.

3. Apply the resultant average ratio of such expenses to income to the gross income for the current tax year to determine the amount of normal maintenance for the current period.

4. Deduct the amount actually spent for repair and maintenance items during the current tax year from the normal amount, and set up the remainder in a reserve which will be deductible for income-tax purposes.

5. Require that the amount of this reserve be invested in a nonnegotiable Government security which will be redeemable at any time after the end of the war.

6. Require that the reserve so created be used for maintenance purposes within a stated period (such as 2 years) after the end of the war. Any reserve so created and not used within the required time to be subject to tax at rates in effect for the tax year during which it was created.

While objections to this proposal may be raised on grounds of technical details in administration, creation of such reserves within the limitations here suggested could result, at best, only in deferment of tax payments at this time which, under normal conditions, would not be receivable by the Government in any event. Any temporary abuses which might arise could not be maintained beyond the post-war period when the reserve must be closed out. Therefore, the Government could not lose—but only temporarily defer—money otherwise receivable.

We ask your inclusion of this proposal in the revenue act now before you for consideration.

Respectfully submitted.

EUGENE P. CONSER,
Executive Vice President.

STATEMENT OF ROBERT B. IRWIN, ON BEHALF OF AMERICAN FOUNDATION FOR THE BLIND

Mr. IRWIN. I would like to call your attention to section 111, page 27. The last reduction in exemptions has now brought the income tax down to where it reaches a good many blind people who were not concerned about income tax in the past because their incomes were very low.

Blind people are glad and proud to pay their share of the expense of running the Government, but they feel that the way the income-tax law operates works something of an inequity on them because it does not take into account the special expenses of blind people. By that I mean blind people have to pay more than seeing people in the same economic status, to get along. They usually have to live in a house where they can get to their work in safety, which means near their work, and this frequently means an increase in rent. If the housekeeper is blind, she must do a good deal of her buying over the telephone, and this presupposes telephone charges and also buying from higher-priced stores which deliver.

Blind people also have to pay to have their mail and other matter read to them, and any blind person who can afford it indulges in at least a part-time secretary. If he is fortunate enough to have a car, he has to pay someone to drive it. If he has a lawn in front of his house, he has to pay someone to mow it, whereas his neighbor with a similar income mows his own lawn on Saturday afternoon. Also, the blind person must have a higher operating cost oil furnace rather than coal because the coal furnace is impractical for most blind people to operate. He must hire a good deal more cleaning done than people in the same economic strata. He must pay for minor repairs which a seeing man might make around the house.

Senator WALSH. Is the witness in favor of the provisions of the House bill?

Mr. IRWIN. Yes.

Senator WALSH. I do not think there is any objection to those, is there, Senator?

The CHAIRMAN. I know of none except in extending the same relief to other people who may be suffering from disability. That is the only objection the Treasury has raised.

Mr. IRWIN. The House committee was unanimous on it.

The CHAIRMAN. I think we can assure you if the Senate committee does not follow the House committee on this particular section it would be solely because it would be impossible to give the same treatment to other people suffering from disability. After all, we have some departures in existing law already; we give to the men and women in the armed services a larger exemption than we do to the ordinary taxpayer, and that is substantially all this section does for you, it gives you an additional $500 exemption.

Mr. IRWIN. Yes, sir. It helps to offset some of the other special expenses.

The CHAIRMAN. We appreciate your appearance here and assure you that your views will be considered by the committee when we reach this section in the bill.

Mr. IRWIN. Thank you. I hope you will be able to keep it in the bill.

The CHAIRMAN. There is one other witness, Mr. Corbett, but, Mr. Corbett, the officer in charge of the floor forces advises us we must come over for voting. So you will probably have to wait until in the morning, and we will try to reach you tomorrow morning at some hour.

The committee will recess until 10 o'clock tomorrow morning.

(Whereupon, at 4:45 p. m., the committee recessed until 10 a. m., Tuesday, November 30, 1943.)

REVENUE ACT OF 1943

TUESDAY, NOVEMBER 30, 1943

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

The committee met at 10 a. m., pursuant to adjournment, in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

Present: Senators George (chairman), Walsh, Clark, Gerry, Guffey, Lucas, Vandenberg, Davis, and Taft.

The CHAIRMAN. The committee will please come to order. I think we carried over one witness from yesterday afternoon, Mr. Corbett.

STATEMENT OF JOHN T. CORBETT, ASSISTANT GRAND CHIEF ENGINEER AND NATIONAL LEGISLATIVE REPRESENTATIVE, BROTHERHOOD OF LOCOMOTIVE ENGINEERS

Mr. CORBETT. My name is John T. Corbett. I hold the offices of assistant grand chief engineer and of national legislative representative in the Brotherhood of Locomotive Engineers. The headquarters of the organization is at Cleveland, Ohio. The local office is at 10 Independence Avenue SW., Washington, D. C.

The Brotherhood of Locomotive Engineers is the oldest of the railroad labor organizations, having been organized in 1863, and has been in continuous existence since that time. Its members are in the employ of practically all of the railroads in the United States and in Alaska, the Panama Canal district, and many of the outposts of the Nation.

Shortly after it became organized it found it necessary to organize an insurance organization for the benefit of its members as the insurance and accident insurance organizations then in existence considered those engaged in operating trains as too great risks to provide insurance for. That insurance has provided benefits amounting to nearly $200,000,000 to the families of the deceased members of the organization who have passed away.

Over the many years the brotherhood has been in existence it has generally refrained from making protests against tax proposals that appear necessary for the support of the activities of the Government, and its members are amongst the group found ready to support the Government in its decisions and activities.

At the present time we believe there is no group of workers who are contributing more toward the successful prosecution of the war than are the locomotive engineers for it must be recognized that almost every car that is moved over the railroads of the United States, Can-

ada, Alaska, the Panama Canal territory, and the many outposts being used by the armed forces, is moved by a locomotive operated by a locomotive engineer.

Because of the adverse effects which we believe certain portions of the bill now before this committee and the Congress may have on our organization and its membership, we respectfully request the committee and the Congress to give its consideration to the following:

For many years the provisions of section 101 of the Internal Revenue Code have exempted certain groups and organizations, including fraternal and labor organizations, from the provisions of the Internal Revenue Code's requirements.

On pages 28 and 29 of the bill now under consideration, H. R. 3687, there appears a proposed change from the former exemptions of the Internal Revenue Code and these newly proposed changes would require that all organizations, except certain religious organizations, certain educational organizations, certain charitable organizations, and certain organizations which are operated, supervised, or controlled by or in connection with a religious organization described in paragraph (1).

On inquiry, there appears some uncertainty as to just what organizations paragraph 4, page 29, of the bill is intended to include. It has been our understanding that both the Y. M. C. A. and the Y. W. C. A. might come under the provisions of that paragraph but there is the reference to a "religious organization" and not to the plural "religious organizations" which have been largely instrumental in the organization and support of the Y. M. C. A. and the Y. W. C. A.

The Brotherhood of Locomotive Engineers has given considerable assistance to the Railroad Y. M. C. A. At many railroad terminals the brotherhood holds its meetings in the Y. M. C. A. buildings.

Again, in many other terminals of the different railroads of the country the brotherhood holds its meetings in the rooms of some fraternal organization. I personally know of many places in which the regular meetings of the brotherhood are held in the rooms of the Odd Fellows organization. The local lodge of the brotherhood meets in the Masonic organization's building at Eighth and F Streets, NE.

I mention these conditions because, on inquiry as to the reason for having the proposed changes in section 101 of the Internal Revenue Code inserted in this bill, I have been informed that there are certain organizations which own buildings and charge rentals and they have not been required to make income tax reports. There has been the further report that the proposed changes ate or were presented as "jokers" against labor organizations.

Regardless of the real reason for the proposed changes we know that the present provisions of section 101 of the Internal Revenue Code exempt certain organizations from the requirements of the code and that the present bill endeavors to differentiate between the organizations which have been exempted and demand that a certain number of the exempted organizations shall be required to file annual returns to the Internal Revenue Department of the Treasury Department.

During yesterday's hearing before the committee we heard the counsel of the Treasury Department state that he had no comment on the proposal as he had not been made acquainted with the proposed changes and had not been consulted on those changes.

It would appear that the proposed changes have not been made as a result of the requests of the Treasury Department.

The Brotherhood of Locomotive Engineers has nearly a thousand local lodges, referred to as "divisions" of the organization. The offices in those local divisions are filled by members of the organizations in active service as locomotive engineers on the different railroads of the Nation. There are no salaried officers amongst any of the local offices, except that there are some few places at which some member who has been incapacitated may be given a small weekly or monthly allowance for collecting the insurance payments of the members and attending to such other duties as the accommodation of the members may require.

On many of the larger railroads the different divisions arrange for the employment of one member who is referred to as the "general chairman" and whose services include making efforts to adjust controversies between the management of the railroad and the members of the brotherhood. He is the only salaried employee of that group and is elected for a 3-year period at the one meeting of the group which may be held every 3 years.

It has been found difficult to have the members of the brotherhood who are actively engaged in operating locomotives accept the local offices of the organization under present conditions. To secure the services of the members to fill offices under conditions which would require Federal reports made under penalty of perjury would appear to be impossible.

We believe that the proposal to demand that all of the locals of the many organizations which have been exempted under the provisions of section 101, Internal Revenue Code, shall now be compelled to file an annual return, must create unnecessary hardships on the organization's local officers and those donating their services as officers of those locals.

We respectfully request that the proposed changes presented in section 112, as they appear on pages 28 and 29 of the present bill, be stricken from the bill and that the present exemptions of section 101 of the Internal Revenue Code shall be permitted to remain as they are.

Shortly after the Brotherhood of Locomotive Engineers was organized, the wives of the members organized a ladies auxiliary of the brotherhood for the purpose of providing certain assistance to the widows of the deceased members of the brotherhood who might be in real need of such assistance. It may be that this auxiliary organization might be considered as one of the charitable organizations referred to in paragraph (3) of page 29 of the bill but we shall request that the provisions of that paragraph, if the rest of the section is to be adopted, may be amended so that there may be no question but what the ladies auxiliaries doing a great beneficial work may all be exempted.

Again, on many of the different railroads, and at many of the different terminals of those railroads, the wives of the employees have formed "Ladies' Clubs" for the assistance of the families of the railroad employees. In some instances there are small annual dues collected to pay for room rentals where rummage sales, card parties, or similar cooperative means of raising funds may be held. As we

interpret the present proposed changes in bill H. R. 3687, these might be considered charitable organizations, but we shall hope that there may be no question about the matter and, again, while we shall hope that section 112, as it appears in the bill, may be stricken out of the bill, there appears the further request that the different ladies' clubs which have been organized entirely for the purpose of giving assistance to some unfortunates shall be exempted from the provisions of the Internal Revenue Code under section 101 of that code.

In section 113 there appear certain provisions for the allotment of back pay. Such provisions refer to back-pay allowances which may be received or which may accrue under the provisions of specific acts.

It is requested that these provisions may be extended to include such back-pay allowances as may be allowed under the provisions of the Railway Labor Act.

The provisions of the Railway Labor Act were passed by the Congress and under the provisions of the act there are demands that certain wage controversies shall be submitted to the consideration of the National Adjustment Board. It would appear that if the provisions of the present bill were to be adopted the back pay of railroad employees would be considered as having been paid during the year it was allowed and that the back pay of those coming under the acts referred to in the bill would be assigned to the year in which the claims may have arisen. We respectfully request that these differences be changed and that those coming under the provisions of the Railway Labor Act be brought under the proposed provisions of section 113, as now before the committee for consideration.

The CHAIRMAN. Mr. Corbett, that is not now the rule?

Mr. CORBETT. It is not not the provision in the bill.

The CHAIRMAN. I thought that was the law, though.

Mr. CORBETT. Well, you have a specific reference to it. I believe it is on page 80.

The CHAIRMAN. You are speaking of the language in this particular bill?

Mr. CORBETT. Yes.

Senator VANDENBERG. You are simply asking that this bill treat the Railway Labor Act the same way as it treats the National Labor Relations Act, the Fair Standards Act, and the War Labor Board?

Mr. CORBETT. That is correct; yes.

Senator VANDENBERG. I did not think there was any chance for argument about that.

The CHAIRMAN. I thought that was true. I did not think this act omitted the railway employees. That certainly should hardly provoke controversy, as far as I can see. I do not know what the Treasury might suggest on it. I certainly cannot see any reason immediately why that should not be done.

Mr. CORBETT. I have received requests from officers of the Brotherhood that the proposed changes as they appear on pages 54 and 55 of the bill may not receive the approval of the committee. Full information concerning protests on those portions of the bill have not been received and no exactly worded proposed change has been given me by the officers over me. Under these conditions it appears proper to direct the attention of the committee to the protests and to respectfully request that there may be the privilege of offering

the amendment or proposed change when I have received further information and authority.

Those requests that I have referred to in that last paragraph were telegrams received at the office within the last 24 hours and do not contain any specific wording of what changes may be wanted. That is all I have.

The CHAIRMAN. Thank you very much, unless there are some questions.

Mr. CORBETT. Thank you.

Mr. Johnson, the committee will be glad to hear you. Mr. Johnson is with the Metropolitan Opera Association and wishes to bring to the committee's attention their particular problem.

STATEMENT OF EDWARD JOHNSON, REPRESENTING THE METROPOLITAN OPERA ASSOCIATION

Mr. JOHNSON. As the representative of the Metropolitan Opera Association I come before you to plead for a reconsideration of the admission tax on our tickets. Our secretary and comptroller has prepared a brief which I am presenting. That brief contains all the information. The object of my presence here is merely to speak as a representative of the institution, not as a lawyer, because I am a singer and have had no experience in pleading or making argument. However, as a representative of the institution, I would like to lay before you some of the things that we are doing, that ought to put us in a different class than the commercial theater. Our organization we feel should be classified as an educational institution.

Senator WALSH. How much tax did you pay last year?

Mr. JOHNSON. Something in the neighborhood of $150,000.

Senator WALSH. Admission tax?

Mr. JOHNSON. Admission tax. For years the Metropolitan was exempt from all tax. It was only recently that the 10 percent was added. It was difficult for our public, because our tickets are expensive, and when the tax came and put our tickets up to $7.70 with the tax, we found our public fell off appreciably, to such a point that we were compelled to lower the tickets. We now put the tickets back to $5.50, and the tax puts us more or less in the price range where we were before, which was to the detriment of the public.

The organization has been doing an extraordinary work in the way of preparing young people. Our country is full of talent, which has been lying fallow, and we have started in these recent years through the radio a search for young talent, giving them the opportunity to be trained, prepared, and coached in the languages and in the traditions of the opera.

Senator WALSH. Your patrons have not benefited by the war effort, apparently, through increased incomes.

Mr. JOHNSON. No.

Senator WALSH. You have had to reduce the price of the tickets.

Mr. JOHNSON. Yes; we have had to reduce the price of the tickets.

Senator GERRY. Have you run at a loss?

Mr. JOHNSON. At a great loss. Our loss last year was over $200,000.

Senator TAFT. How much?

Mr. JOHNSON. Over $200,000.

Senator TAFT. Have you ever made a profit in any year?

Mr. JOHNSON. No. The organization is a nonprofit organization. If there were any, it would have to be turned back in. Our problem at the present moment is in new productions. We have no capital on which to work and we feel we should be classified more or less in the way of a depository of the classics and traditions. We are the only sustained theater in the world today, with Europe in the condition it is. We are dependent on ourselves, and at the present moment South America is dependent on us. Our artists were there this past summer, 12 or 15 of them, in Rio and Buenos Aires, and they took not only the art but good will with them. We find the repercussion in those countries, with the appearance of our artists, has been most friendly.

The organization itself has had, in recent years, some serious setbacks in that our productions are getting worn out, they are getting older, and we have no way of replenishing them. We have tried on more than one occasion to put up a production what we speak of as the classic type, which, of course, is not commercial, and when it begins to affect our box office we must remove it, because we must depend on the box office for our living.

Governor Dewey last year tried to help us on our taxes on real estate, but nothing has come of that to date.

Senator TAFT. Is it not true that in foreign countries operas and even orchestras are subsidized by the government rather than taxed?

Mr. JOHNSON. That is most usually the case. Buenos Aires, for instance, has a municipal theater that is supported by the state. Rio does the same thing. In all the European capital theaters that happens. I happen to have spent nearly 40 years of my life being a singer and I have been in most of the great theaters of Europe and South America and know the conditions in regard to them. The government, the state, and city are behind them financially.

We have depended on our box office to date because, as you well know, the Metropolitan started out as a private enterprise, but it now belongs to the public. It is public support we must have.

It is not just an opera house or theater, it is really a museum. We have the obligation to present the classics just as your museums have the primitives and paintings of the great masters. Yet we are not able to do so, because we are not commercial, and yet it is exactly in this form that we would like to have it considered, not in the sense of a commercial theater, not as a theater at all, but as an art, to differentiate between what is entertainment in music and what is art in music.

Naturally it is egotistical and selfish, perhaps, to plead our particular case, but we feel we are unique in theater fields. In the symphony fields we have 250 or more orchestras throughout the country, but there is only one opera company, and everything that comes periodically into the United States stems from us. If it were not for the United States Metropolitan Opera Association there would be no opera in San Francisco or Chicago, or the other cities where there is an opera.

We feel the future is more or less in the hands. If we are penalized with the heavy tax that will mean again our public will fall off, and we will be forced, as we probably will be anyway, to appeal again to the public.

Senator VANDENBERG. You mean the argument you are making does not apply to symphonies?

Mr. JOHNSON. I feel our position is so unique, to quote Governor Dewey again,

> The Metropolitan is unique in the life of the Nation—and almost the sole trustee of opera in the world.

The day will come, probably, when we will have a different attitude toward our arts, but music got into the picture 300 years later than the others, therefore it is designated always as a fine art and music. We feel it is also an art and should be considered in such terms.

The radio has done something that is quite extraordinary. From having an audience of 3,000 people in a single theater, we have from 10,000,000 to 15,000,000 people who listen to us every Saturday afternoon. If you could read some of the letters that come to us, you would be amazed at what it does for the country at large.

It also has a future in what should be thought of as in the educational sense.

I would like to make a similar appeal for music as a whole. I would like to take it away from our own selfish thoughts and put it in the whole field of music. So far as the educational program is concerned, we expect in the post-war period, if music could be applied, it would be, I think, as great a factor as even mathematics, for there is no greater channel for mental processes than the study of music itself, in its development of memory, concentration, its development of the sense of hearing, which makes us good linguists eventually, and in singing it is teaching people how to speak, it gives people the diction, inflection, and all the various qualities that come in singing, that could be utilized in business life, whether they make a profession of it or not. As a matter of fact, what is wrong with music today is that there are too many professionals. If it were treated more in the development of the individual and less in the way of a career it would be more seriously thought of.

The question of music in schools, I think, will eventually be an academic one, but I feel confident it will be in the curriculum, and when that day comes we will have a flood of young artists who have now no outlet. It is for that very reason I plead for the Metropolitan, in that it is today perhaps the only outlet and goal of all the singers who strive for publicity and a career.

In the olden days all the Americans went to Europe. I happen to be one of those who spent 10 years of his life learning singing, the traditions, and the languages, in the various theaters of the European capitals. We have today no opportunity to do that, for Europe is closed to our artists They depend absolutely on us and the people of my generation to give them back the traditions that we have acquired.

We feel we have good reason to be more or less set apart as a unique institution and to be classified in the sense of an educational rather than commercial enterprise.

I have a short article here which I would like very much to read to you, from one of our papers, which puts the thing perhaps a little more concisely and clearly than I could do it in my own words The article says:

> We repeat that music must not be confused, as it may be in the minds of some, with the various forms of popular entertainment. The mere fact that music is theatrical in its manner of presentation does not make that presenta-

tion a theatrical performance. Most music lovers go to music as they would to an exhibition of painting or sculpture; some go as they would to a religious service.

On every Good Friday our performance attracts people that come really in a devotional sense. Our Good Friday performance is as devotional as if we were in a church.

These are only a few of the things we are trying to accomplish. We have also, through our guild, of which Mrs. August Belmont is the head, been able to give performances for over 10,000 school children each season for the past 8 years. We have had matinees just for school children at a very minimum cost. The cost price of the performance really is put to the children at lower than even the cost, and the difference being paid by the Metropolitan Opera Guild. The performances in themselves combine orchestra performance, chorists, soloists, and also drama, painting, design of costume, and scenery. These are all combined efforts in arts where everything is represented.

We are hampered today in making experiments because we cannot afford to invest capital in an enterprise that we are not confident there will be a sufficient return on, therefore we resort continuously to our old repertoire, taking out each year a half dozen operas and replacing them with others, and therefore making a turn-over with the 40 and 50 operas that are there in the storehouse.

We have, as I have already stated, no subsidy whatsoever, and from time to time we have to make general appeals to the public. We have had the good fortune to have the foundations come to our aid, foundations such as the Julliard Musical Foundation, Carnegie Corporation of New York, the Kress Foundation, the Holmes Foundation, and the Frank Phillips Foundation. They all contributed in the drive for funds in 1940, and even since then we have had assistance from the Julliard Musical Foundation, the Carnegie Corporation of New York, the New York Community Trust, and the James Foundation. These have all assisted us from time to time with contributions

As I have said, there is no profit involved, and if there were it would certainly be turned back into the organization for the production of the newer material which is available.

Now, we have great competition, naturally, in the movies and in the radio itself, and in a city like New York in the theater itself. Nevertheless, our theater, though it sells consistently well, it can never have enough income to pay the extraordinary overhead, and from a business sense, if you will look at the picture in this way, that the overhead must be carried for 52 weeks whereas our season has been in the past only 10, 12, or 16 weeks, and this year in order to satisfy our unions, because we are a completely unionized theater, we extended the season for 20 weeks, this will only entail a greater cost because, if we lose $200,000 in 16 weeks, we are certainly going to lose a little more by adding 4 weeks more. It was in order not to change our contract and give the organization the opportunity to earn a little more money, that the board agreed to take a chance in adding 4 more weeks to the season. These 4 weeks will help us in the sense that it carries our season over to the Easter period, which is so important, as I stated before, for the production of our Good Friday performance.

We have had in the past a spring tour which has been helpful to us, which has helped us earn some money and has kept our organization employed for another 4, 5, or 6 weeks. Unfortunately, in these recent

years, with the war and the transportation condition as it is, we have not been able to make our trips as usual to the South, where we have always gone for a great many years. We appeared in Atlanta, Richmond, and Dallas, but these have been eliminated because of transportation difficulties. We still hope this year we will be able to arrange to come as far as Baltimore, perhaps Boston and Cleveland, where we have been a good many years and where we have had a very enthusiastic and very large public, and probably we are even going to add Chicago. Even in the event our overhead figures will be considerable, and we have little hope of them being otherwise, we will try to make those tours. Our great fear is we will lose again through the additional money that the public will have to pay, that we will lose this audience that we have worked so strenuously to build up.

Through love for music we have educated the people. We see it in the younger generations as they come up. After all, as I say, education in cultural things is very important, and I think it will be more so in the future, and this group who are coming out of the schools today, by means of the mechanical devices, records and radio, are much better informed than were the people in my generation. They are getting it on a silver platter, where those in my time had to get it the hard way. No income was coming to me as a young man from radio or from films. The artists we produce are going out with the prestige of the Metropolitan and are therefore having a better market value, and I think in that case many of them earn sufficient money so that they have been, if I may say modestly, good taxpayers. The opera singers as a whole earn a great deal of money, but they do not earn it at the Metropolitan. That is a sad condition, but it happens to be the truth.

So we ask your consideration for the Metropolitan, not as a commercial theater but as an education institution that has striven and is striving to hold the torch and to pass it on eventually so our success is undiminished.

The CHAIRMAN. Thank you for your prese.. ation.

Mr. JOHNSON. Thank you, sir, for listening to me.

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

BRIEF ON BEHALF OF METROPOLITAN OPERA ASSOCIATION, INC., IN SUPPORT OF REQUEST FOR EXEMPTION FROM FEDERAL ADMISSIONS TAX

Metropolitan Opera Association, Inc., is a nonprofit membership corporation incorporated under the membership corporations law of the State of New York with the consent of the Commissioner of Education of the State of New York and is conducted for the purpose of sustaining, encouraging, and promoting operatic art.

It has no power to issue stock nor to pay any dividends; and it has never done so. No part of its earnings, income, or funds inures to the benefit of any person whatsoever, excepting that Metropolitan pays reasonable compensation for services rendered and for materials furnished to it in effecting its purposes. None of the members or directors of Metropolitan receives any remuneration for his services.

It presents operatic performances at the Metropolitan Opera House in New York City and also in other cities and towns in the United States, including Boston, Philadelphia, Baltimore, Cleveland, Chicago, Dallas, New Orleans, Birmingham, Atlanta, Richmond, and Rochester.

During its operatic season, Metropolitan also presents at the Metropolitan Opera House on Sunday evening operatic concerts, including scenes and ballets from various operas and operatic solos.

The operas presented at the Metropolitan Opera House on Saturday afternoons are broadcast by radio over the Blue Network throughout the United States and in Canada, and by short wave to South America. By this means the Saturday afternoon operas are brought by radio into the homes of 12,000,000 listeners weekly.

The Metropolitan conducts at the Metropolitan Opera House a ballet school where instruction is given in operatic ballet dancing, and also a school for operatic choral singing. Students from these schools, when sufficiently qualified, are employed to perform in the chorus and ballet in Metropolitan operas.

Many singers, hitherto unrecognized and inexperienced in the field of opera, have been discovered by means of public auditions. Each year a series of competitive auditions, known as Metropolitan Auditions of the Air, is broadcast over the radio on Sundays under the auspices of Metropolitan. At the end of each series of these auditions a certain number (usually four each year) of the competing artists is selected by a committee of eminently qualified judges, of which Mr. Edward Johnson, general manager of Metropolitan, is chairman. The artists thus selected are awarded with regular contracts to perform in operas at the Metropolitan Opera House. Metropolitan then gives these artists individual coaching and instruction in operatic parts.

In this way many young and unknown singers, whose talents might otherwise remain unrecognized, are discovered and developed and the operatic art fostered.

These auditions also bring the educational values and benefits of the opera to millions of persons in their homes over the radio.

The Metropolitan roster now includes 24 artists who were originally selected by these Metropolitan Auditions of the Air.

In furtherance of its program of education and development of the operatic art, Metropolitan also gives special performances of opera to which school children and their teachers only are admitted for a nominal admission; students of music are admitted to rehearsals without charge; and thousands of complimentary tickets are distributed annually to students and members of the armed forces.

The Metropolitan Opera House in New York City was purchased by Metropolitan Opera Association, Inc., in 1940 out of a fund of over $1,000,000 raised, on appeal by Metropolitan to the public, from voluntary contributions from over 165,000 individuals from every State in this country and from foreign countries, and also from 14 musical and educational foundations, 64 school groups, and over 300 groups chiefly local music clubs in various communities throughout the United States and Canada.

In connection with that appeal, United States Commissioner of Education John W. Studebaker stated publicly:

"The opera—at one time looked upon as a strange form of entertainment imported from abroad for the special enjoyment of those who could afford it—is fast becoming one of our most democratic institutions. Through the miracle of radio, the grandeur of operatic music is now brought into a million homes each week. Its cultural and educational effect on an estimated 4,000,000 listeners is immeasurable. Added to the thrill of listening to voices and music is the human reaction to the emotions, actions, and characters of drama as expressed in music. Next to food, clothing, and shelter, music is said to be the fourth great material want of our natures. As such, the Metropolitan Opera deserves the support of every music lover in preserving the opera for the people."

Since the time of Commissioner Studebaker's statement, the number of radio listeners has increased from 4,000,000 to 12,000,000.

Governor Dewey has said recently, "The Metropolitan is unique in the life of the Nation * * * and almost sole trustee of opera in the world."

Just as our art museums preserve and display the primitives and other great classics of painting, so the Metropolitan preserves the traditions of opera and presents the historic landmarks of operatic art for all to see and hear. Both types of institution have a public following, both lead the public to appreciate tomorrow what it may not today. These institutions differ only in this: the one admits the public free, the other (having no endowment) charges an admission. To tax such admissions is a tax on education.

The underlying function of the Metropolitan is to educate both listeners and performers—to instill in the people a true love of opera, to train and develop opera singers. Music departments in universities and colleges have courses in opera. Music schools and private studios prepare singers. But all such work is preliminary. Only in the opera house itself, where the performances are prepared and presented, can the traditions of opera be maintained and developed. The

Metropolitan is in this respect unique. Taxation of admissions by which alone the Metropolitan can exist is tantamount to taxation of tuition fees.

In our American cultural life we respect our universities and their special schools of architecture, of art. They recognize opera as a sister art. Is not the art of Metropolitan Opera presentation entitled to the same respect as accorded to architecture? The Metropolitan is in reality America's National University of Opera. The difference between it and other special schools lies in the nature of the training: the one best way to prepare people for the operatic stage is to put them on it where they may work in conjunction with the famous veterans of the art. The Metropolitan is the goal of every operatic aspirant because it is the only place where American operatic artists can get the experience they need. Until recently it was necessary to go to Europe to get it. Today the Metropolitan chooses artists from public auditions, conducted on a Nation-wide basis, and all ambitious singers have confidence that they receive full consideration without fear or favor no matter where they come from. So far as is known, there is no parallel to this plan in any other organization.

As a nonprofit educational institution, Metropolitan is exempt from Federal income tax, Federal social-security tax, Federal capital-stock tax, New York State franchise tax, unemployment-insurance tax, New York real-estate tax, and New York City gross-receipts tax and occupancy tax. Admissions to performances of Metropolitan Opera were also exempt from the Federal tax on admissions until the exemption was repealed in 1941.

Opera is an art which is traditionally not self-supporting. In Europe opera not only enjoys tax exemption, but is supported by governmental subsidy. We do not ask for governmental subsidy of opera in this country, but merely that admissions to the opera, its fundamental source of revenue, be not taxed.

The imposition of the 10-percent tax on admissions to Metropolitan Opera in 1941 resulted in a sharp drop in paid attendance. During the period from 1938–41 when our prices ranged from a minimum of $1 to a top of $7 and the admissions tax was not in effect, the average paid attendance per regular performance increased from 2,921 for the season 1938–39 to 2,945 for the season 1939–40 and 3,206 for season 1940–41, with corresponding increase in our box-office revenue. The following season, 1941–42, with the same scale of prices but with the 10-percent admissions tax in effect, the average attendance per performance dropped to 2,974, although that was a period of increasing national prosperity.

In an endeavor to recoup some of this lost paid attendance, Metropolitan for the 1942–43 season reduced its entire scale of prices above the $1 minimum and adopted a new scale ranging from $1 minimum to $5.50 top, and at the same time made available a larger number of seats at $1. With the lower scale of prices in effect, the average attendance per performance increased during that season to 3,138. However, the increased attendance was not sufficient to offset the reduction in our price scale and our box-office revenue declined to $808,110 for the 1942–43 season as against $913,470 for the 1941–42 season and $982,661 for the 1940–41 season. These figures are shown in graphic form in the attached chart.

The foregoing demonstrates the additional burden which has been placed upon the opera since 1941 as a result of the admissions tax. That tax discouraged attendance and thus impaired the function of Metropolitan in promoting the operatic art. The reduction in our scale of prices aided in the accomplishment of our purpose in bringing the opera to a greater number of people, but at serious financial sacrifice.

Metropolitan could ill afford that sacrifice in revenue because, even without that loss, Metropolitan has been operating at a deficit for many years.

In June 1941 after Metropolitan had paid the cash portion of the purchase price of the Opera House and the costs of the much-needed repairs and improvements, it had a cash balance of $633,006. By June 1943 that balance was reduced to $216,116 as the result of operating deficits of $214,373 for the 1941–42 season, and $202,607 for the 1942–43 season. The reduction in the annual operating deficit from $214,373 for the 1941–42 season to $202,607 for the 1942–43 season, despite the drop of $15,334 in the box-office revenue for the latter season, was made possible principally because of the fact that artists, management, and staff alike all accepted salary reductions during the 1942–43 season, as part of a program of rigid economy, in order to help make possible the continuance of Metropolitan Opera.

Thus we entered our present fiscal year on June 1, 1943, in preparation for the season 1943–44 with a cash balance of only $216,000—a balance insufficient to guarantee the completion of the 1943–44 season.

The foregoing shows that the future of Metropolitan Opera is in jeopardy and that it is not self-supporting despite its efforts to increase paid attendance and to reduce operating expenses by salary reductions and other economies. As we have shown, the imposition of the admissions tax of 1941 resulted in a sharp decline in paid attendance and a corresponding decline in box-office revenue which has not been offset by the increased paid attendance at our lower scale of prices. We sincerely believe that if the public in this country is to continue to enjoy the educational and cultural benefits of the operatic art it is essential that nonprofit institutions, such as Metropolitan, which are devoted to the encouragement and promotion thereof, should be exempt from the admissions tax.

We respectfully request serious consideration by your committee of an amendment to the tax law to provide that:

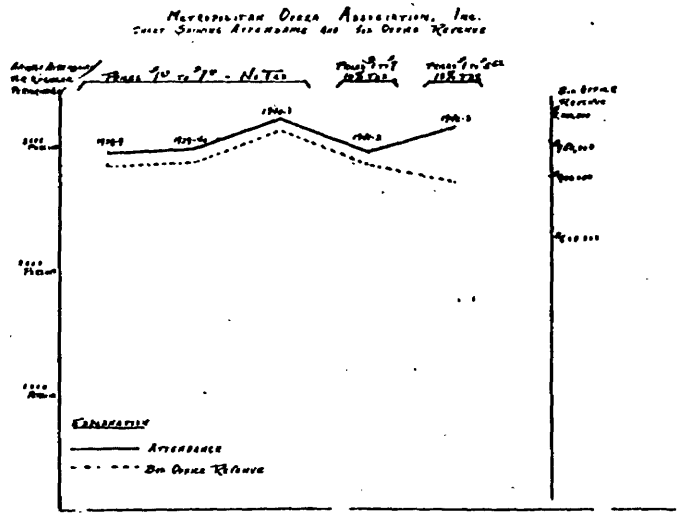
"No tax shall be levied under section 1700 of the Internal Revenue Code in respect of any admissions all of the proceeds of which inure exclusively to the benefit of any corporation, institution, society, or organization conducted for the purpose of sustaining, encouraging, and promoting operatic art and educating the general public therein and owning real property for the acquisition of which there shall have been used money obtained from voluntary contributions by the public and which real property shall be maintained for the production of opera and to otherwise obtain revenue for furthering such purpose, if no part of the net earnings of such corporation, institution, society, or organization inures to the benefit of any private stockholder or individual."

We further suggest for consideration by your Committee that the amount of revenue which the Government would sacrifice by such exemption would be relatively little and comparatively trifling as against the important benefits to the public resulting from continuance of the operatic art, particularly in times such as the present, when it is more essential than ever that we in this country, who are still fortunate enough to have it in our power so to do, continue to encourage and develop public interest in the arts.

Respectfully submitted.

EDWARD JOHNSON,
General Manager, Metropolitan Opera Association, Inc.

NOVEMBER 30, 1943.



The CHAIRMAN. Mr. Fletcher.

STATEMENT OF R. V. FLETCHER, VICE PRESIDENT, ASSOCIATION OF AMERICAN RAILROADS

Mr. FLETCHER. Mr. Chairman and Senators, my name is R. V. Fletcher. I live in Washington. I am a member of the bar and vice president of the Association of American Railroads.

Mr. Chairman, I am mindful of the demands upon your time and I will try to condense what I have to say in the smallest possible compass, out of deference to the other interests that will have to be heard here this week. I have the impression that the committee would like to conclude its hearings this week, and for that reason I will be just as brief as I possibly can.

The House bill, H. R. 3687, now under consideration by this committee, is estimated by the Ways and Means Committee to increase Federal revenue by $2,139,300,000. Of this amount, through changes in the excess-profits tax, corporations will contribute $616,000,000. This increased burden comes about by an increase in the rate of taxation from 90 percent of adjusted excess profits net income to a figure of 95 percent and a decrease in the credit rate when the invested capital basis of calculation is selected. When the invested capital of a corporation exceeds $200,000,000, as it does in the case of a large number of railroads, the credit is only 4 percent. In a recent address, Mr. Emil Schram is reported as saying that a $500,000,000 corporation, under the proposed law, after paying the 40 percent normal and surtax, would not be allowed to earn more than 2.81 percent.

Most of the railroads, though not all, are driven to adopt the invested capital base for the calculation of excess-profits tax. This choice is made necessary by the fact that, generally speaking, the investment of railroad companies is large and the earnings in the test period are relatively low. The test period is the 4 years 1936 to 1939, inclusive. Taking the class I railroads as a whole, the rate of return on property investment for 1936 was 1⅔ percent; for 1937, 2¼ percent; for 1938, 1⅓ percent; and for 1939, 2¼ percent. This calculation is made on the basis of net railway operating income, so-called, before deducting interest on indebtedness or rentals for leased property. Looking at the figure of net income, which is the amount left after payment of operating expenses, taxes, interest, and rentals, Class I railroads for 1936 had left $164,630,000; in 1937, $98,000,000; in 1939, $93,180,000; while in the bad year of 1938, there was an actual deficit of $123,400,000. These poor earnings were those of an industry with a property investment of approximately $26,000,000,000.

It can be readily seen, therefore, that with few exceptions the average earnings basis cannot be adopted by the railroad industry. Generally speaking, corporations with a large capital investment, and with relatively modest earnings are driven to the use of the invested capital basis, if their property is not to be confiscated entirely. In a special sense this is true of public service corporations, the rates of which are determined by public authority, charged as the regulating authorities are with the obligation to see no more money is collected than represents a fair return upon the value of property devoted to

public service. In the case of railroads, this rate of return, in the past 14 years, has been abnormally low, ranging from 1.24 percent in 1932 to 5½ percent in 1942. The last-mentioned year, 1942, was a war year and is admittedly abnormal. The average rate was only a little more than 2½ percent.

The effect of the change proposed by the House will be to impose a severe penalty on those public-service corporations, already bearing their full share of the tax burdens. In the year 1942, class I railroads paid about a billion dollars in Federal taxes and about $1,200,000,000 in taxes of all sorts. In this year of 1943, they are paying more than $1,000,000,000 in Federal taxes for the first 9 months of the year. It would seem probable that their Federal tax bill for this year will run up to somewhere in the neighborhood of one and a third billion dollars.

The tax bill of the railroads in 1943 is greater than in 1942 because of the operation of the excess-profits tax, because most of the credits of the railroads were exhausted in 1942 and very little is left in the way of credits for application to the tax bill in 1943.

The lowering of the credit rate proposed in the House bill from 5 to 4 percent when corporations are involved having more than $200,000,000 of invested capital seems to be wholly illogical and unjustified. I say this for the reason that the railroad industry is one with a large volume of borrowed capital, and the average rate of interest is 4½ percent. The fact that the ratio of bonds to stock is large in no way reflects upon the integrity or good judgment of railroad management. The fact is that a large part of the railroad mileage of the country was built with borrowed money, the loans being negotiated when railroad credit was good, and the interest rate relatively low. By far the greater part of this bonded indebtedness represents capital actually invested in the business and now represented by property used in railroad operation.

The law, however, provides that in determining the amount of invested capital for excess-profits-tax purposes, there can be included only one-half of the amount of borrowed capital. Since the excess-profits credits were to be applied to this one-half of borrowed capital, the law does not permit corporations to deduct from taxable income more than one-half the interest on this debt. I mean now it does not permit the deduction of more than half the interest on borrowed money, when you are considering the excess-profits net income. The theory is, manifestly, that the credit will wipe out the interest.

But mark what follows when the credit rate is reduced to a figure below the current rate of interest, as is done in the present case. The rate of credit is 4 percent—the average interest on railroad loans is 4½ percent, so that the credit does not wipe out the interest. We have, therefore, the obviously unfair result of a railroad being taxed upon a portion of its interest, in effect a tax not upon moneys received, but upon sums paid out in expenses, or what is the equivalent of expenses. This cannot be fair taxation. Probably such a result was never contemplated.

If it be conceded for the purpose of the argument that excess profits of corporations should be taxed heavily, it can hardly be said with propriety that taxes on necessary and unavoidable expenditures can be justified on the theory of excess profits. Sums so paid out are not excess profits—they are not profits at all. Profits, I respectfully

submit, cannot be classed as excessive unless they exceed a fair return upon the investment, or, in the case of public-service corporations, a fair return upon property devoted to public use. Generally speaking, the invested capital base authorized in our tax law represents a figure far below the actual value of the property, however that value may be determined.

The railroads of this country made some money in 1942; they will make a good deal less in 1943, due to a reduction in freight rates by the Interstate Commerce Commission and a large increase in taxes, wages, and the price of materials. In 1942 the railroads, after paying all expenses, taxes, interest, and rentals, had about 900 million dollars left in their treasuries. Of this amount, they disbursed only about 200 million dollars in dividends. The other 700 million they used for debt reduction and to maintain reserves for meeting the expense of deferred maintenance and to absorb, in part, the cost of the rehabilitation which will be necessary in the post-war era. They reduced their interest-bearing debt in 1942 by 325 million dollars. They are seeking to continue that process and at the same time accumulate enough cash to repair and improve their property, badly worn and debilitated by constant use, coupled with a shortage of men and materials necessary for repairs.

It is absolutely essential to the welfare of industry generally that the country should have a sound, healthy transportation system. Of the various forms of transport, the railroads are now handling something like 70 percent of the freight traffic. They have demonstrated, beyond cavil, their importance in time of war; they are almost equally essential to a sound peacetime economy. They need cash and they need credit to meet their obligations now and those that are to come. Their place in a fair and well-planned economy does not call for treatment which is discriminatory, as this excess-profits-tax plan demonstrably is. It is discriminatory because it penalizes regulated corporations with low earnings in the test period, with a large investment consisting of a large amount of borrowed capital, moving now a huge volume of traffic at rates which are the lowest in the world, and lower now than they have been in 20 years, acquiring, unfortunately, a huge volume of deferred maintenance, and struggling to build up reserves for the wholesome purpose of reducing debt and rehabilitating and improving their property, to the end that in the post-war era they may give better service at lower rates.

I have laid some emphasis upon the injustice of lowering the rate of credit from 5 to 4 percent in the case of railroad companies in the class where invested capital exceeds $200,000,000. The same considerations I have dwelt upon apply with equal force to the reduction from 6 to 5 percent of the rate of credit of those corporations that have an invested capital of $200,000,000 or less. Many railroads fall in this category. Many of them pay a rate of interest in excess of 4½ percent. There is no justification for cutting down the rate below 6 percent.

Nor should the excess-profit rate, I respectfully submit, be raised from 90 to 95 percent.

Senator WALSH. How much of your money that comes into the Treasury comes from cutting down the rate and how much from increasing the excess-profits tax?

Mr. FLETCHER. I should think about half and half, Senator. I had some figures on that but they are rather partial and do not cover all

the railroads in the country. I have an idea that half and half would be about right. Although I may be somewhat in error in that, possibly the reduction of the credit rate is a little more serious than the increase in the tax rate.

This increase hits not only railroads using the invested capital basis, but as well those few carriers that find it to their interest to use the average earnings method. Any tax rate as high as 95 percent is the foe of thrift and economy and puts a premium upon extravagance and waste. I sincerely believe that an increase in the present rate will clash headlong with the law of diminishing returns.

There seems to be a tendency in certain quarters to establish tax rates that will be punitive with respect to large corporations and tender of the interests of small companies. This philosophy, however, overlooks the fact that some of the largest corporations simply represent the combined savings of a large number of investors, each modest in amount, owned by people of moderate means, many dependent for their living upon these small investments. The railroads of the country have a million stockholders. The average stock holding is small. Should these small investors be punished because they saw proper to invest in the stock of a corporation the aggregate of which is large, rather than in a corporation where the total investment is small? It does not seem fair or reasonable. A corporation, after all, is no more than an aggregation of shareholders and their welfare should not be ignored. You cannot predicate tax policies on size alone. The test must be earnings in comparison with investment.

That is all I wanted to say upon this question, the excess-profits tax, and the other subjects that I shall discuss, Mr. Chairman, are suggestions for changes in the present law. I suppose there is no impropriety in my mentioning them.

These suggestions that I should like to make now and which I should like to submit to the committee, have to do with questions of great interest and importance to the railroad industry, but which are not mentioned in the House bill nor covered by the report of the Ways and Means Committee.

The first of these is the matter of capital losses. When I had the privilege of making a statement to this committee on August 5, 1942, when the Revenue Act of 1942 was under consideration, I made a brief statement on this subject, laying some emphasis upon losses resulting from abandonment of branch lines. In the light of a year's further experience and consideration, I should like to elaborate the proposition from a somewhat different point of view.

In recent years, Congress has enacted legislation that prohibits the deduction from taxable income of capital losses, except to the extent of capital gains. Since in recent years there are practically no offsetting capital gains, this legislation has prevented railroads and other industries, as well, from securing any tax relief, where there have been sales or exchanges of capital assets resulting in loss. I should like to approach the subject by asking your consideration of the provisions of section 117 (a) (1) of the Internal Revenue Code.

That section undertakes to define capital assets, losses in connection with which cannot be deducted. However, the statute excludes from the definition of capital assets certain classes of property ordinarily included in the category of capital assets. This means that losses on

the excepted classes of property can be deducted in arriving at taxable income. The property thus excepted is defined as "stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business"—and now comes the significant language—"or property used in the trade or business of a character which is subject to the allowance for depreciation provided in section 23 (l), etc.

It will be seen that this provision allows deductions for losses where depreciable property is owned directly by a corporation, but does not permit deductions where property is owned through the medium of capital stock. That is to say, if a railroad abandons a branch line title to which is in the taxpayer, the loss may be deducted. However, if the property abandoned is owned by a subsidiary, as in many States it must be under State law, and the effect of the abandonment is to render valueless the capital stock of the subsidiary line owned by the principal taxpayer, the loss resulting from the wiping out of the capital stock cannot be deducted. This result, I submit, is indeed to ignore the substance and give controlling effect to the form. But I would not have the committee gain the impression that this matter is of importance only in the case of abandonments. The proposition I am attempting to discuss goes much further.

All over this country, we find railroads which have made substantial investments in the stocks or other securities of other railroads. Those investments have been made with the approval of the Interstate Commerce Commission, pursuant to a public policy adopted by Congress. I refer here to those provisions of the Transportation Act of 1920 having to do with railroad acquisitions and consolidations. Without going into great detail as to the provisions of that important act, it is sufficient to say that the Interstate Commerce Commission was directed to encourage consolidations and provisions were written into the law which would allow railroads to acquire, with the consent of the Interstate Commerce Commission, control over other railroads by the acquisition of capital stock and by processes involving technical consolidations and mergers. As a practical matter, the law was so written and so administered as to make it much easier for a railroad to secure control of another by the purchase of capital stock, thereby maintaining the corporate identity of the railroad so acquired, but bringing about control and common operation in the manner favored in the Transportation Act of 1920.

In the decade of the twenties, there was much activity along this line. The railroads realized that it was the declared policy of Congress to consolidate railroads into a comparatively small number of systems and that the most convenient way to bring this about was to acquire the capital stock, always with the approval of the Interstate Commerce Commission. As time passed, however, the urge toward consolidation was sensibly diminished, by reason of a change in public thinking on the matter, so that by the time 1933 rolled around, the tendency toward consolidations had largely abated. In that year, the so-called recapture clause of the Interstate Commerce Act was repealed. Later on, in 1940, the Interstate Commerce Commission was relieved of the obligation to group the railroads of the

country into a limited number of systems and the law was revised so as to encourage voluntary consolidations, rather than to bring those about through pressure from the Interstate Commerce Commission. However, during the time when the 1920 act was in effect, many railroads had acquired securities of other railroads, the investment being made in good faith, for a substantial consideration and in accordance with what was believed to be sound policy. The effect of the law as it stands now is to prohibit the taking of losses where these securities are sold or exchanged, although losses would be permitted if the sale or exchange was of actual physical property owned directly by the taxpayer. We submit that there is no sound reason for the distinction, which rests upon a legal fiction, rather than upon any substantial reality.

In the case of other somewhat similar transactions, Congress has recognized the right to relief. Reference may be made here to deductions accorded banks and trust companies for losses sustained on the sale or exchange of bonds, debentures, and other evidences of indebtedness (sec. 117 (1)), and insurance companies for losses for capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses or to provide for the payment of dividends and similar distributions to policy holders. (See secs. 204 (c) (5) and 207 (b) (4) (F).) I may mention also credits extended to public-utility companies against the corporate surtax for dividends paid on preferred stock issued prior to October 1, 1942, the dividends on which are cumulative, limited to the same amount and payable in preference to the payment of dividends on other stock.

The utility companies, it will be remembered, appeared before this committee when it was considering the 1942 tax bill, referring to the unusual hardship of high tax rates on an industry having a large capital investment, with its rates regulated by public authority. Reference was also made in that statement to the important contribution which the utilities were making to the war effort. Those observations certainly apply to railroads, as well as to utilities.

I may refer also to special treatment given by Congress in the case of domestic corporations engaged in mining of strategic materials, where an exemption from excess-profits tax has been allowed of the portion of the adjusted excess profits net income attributable to such mining (see sec. 731). Reference may be made also to depletion provisions in respect of oil and gas wells, of coal and metal mines and sulfur and the like.

We are proposing, therefore, an amendment to section 117 (a) (1), which would exclude from the definition of capital assets not only the property there excluded but also, in the case of a common carrier by railroad or a company at least 95 percent of the stock of which is owned directly or indirectly by one or more common carriers, the stocks or securities of any other corporations subject to the Interstate Commerce Act, where the acquisition of such stock has been authorized by the Interstate Commerce Commisison, or where the securities were acquired by the taxpayer as a dividend upon other stocks lawfully owned, or in the case of a corporation controlled by or under common control with or conducting a business ancillary or auxiliary to that of the taxpayer. I should like to have the privilege of putting in the record the amendment which we suggest as being necessary to do simple justice to an industry in need of encouragement.

(1) CAPITAL ASSETS.—The term "capital assets" means property held or acquired for use by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer, *or, in the case of a common carrier by railroad, or of a company at least 95 per centum of the stock of which is owned directly or indirectly by one or more such common carriers by railroad, stocks or securities (1) of any other corporation subject to the Interstate Commerce Act, provided that the same are held by the taxpayer pursuant to due authorization by public authority if and so far as such authorization is required by law, or (2) acquired by the taxpayer as a dividend upon, or in the exercise of rights pertaining to, any stocks of the character described in the foregoing clause (1), or (3) of any corporation controlled by, or under common control with, or conducting a business ancillary or auxiliary to that of, the taxpayer or any corporation described in the foregoing clause (1):*

The committee understands, I am sure, that these investments were not made for speculative purposes. No railroad, so far as I am advised, purchased the stock of another in order that it might be resold at a profit. These transactions were not commercial, in the sense that a merchant carries on a commercial transaction. The stock was bought to effect consolidations for strategic reasons, or to improve the traffic position of a railroad, or for some other purpose which contemplated the acquisition of the securities for perfectly legitimate railroad purposes.

With the lapse of time, some of the controlling considerations have ceased to exist and others have undergone changes in emphasis which now make it desirable that the ownership of the stock should be shifted to other hands.

The CHAIRMAN. Judge Fletcher, could you indicate about how much capital stock is owned by regulated utilities such as the railroads?

Mr. FLETCHER. I could not give you that figure, Mr. Chairman.

The CHAIRMAN. Is it large?

Mr. FLETCHER. It is relatively large. During the period which I attempted to describe, just to make some references, there was a considerable purchase of the stock of railroads by other railroads where the Interstate Commerce Commission had indicated its purpose to put those particular systems together.

The CHAIRMAN. Yes.

Mr. FLETCHER. You remember, they would have about 21 railroad systems, according to the Commission's tentative plan. Usually there was one important railroad which might be considered as the core or nucleus of that system. Now, it was obviously to the interest of that railroad to purchase the stock and get control of the other railroads in that same system, so to speak. That led, to a very considerable extent, to the purchase of the securities of one railroad by another.

The CHAIRMAN. Were the securities all purchased with the approval of the Interstate Commerce Commission?

Mr. FLETCHER. Oh, yes, always, Mr. Chairman.

The CHAIRMAN. It could not otherwise purchase them?

Mr. FLETCHER. That is true.

Many railroads have had their capital structures radically affected by the necessity for reorganization through the bankruptcy courts; others have altered their allegiance, due to changes in traffic and commercial conditions. There should be, obviously, a certain amount of flexibility in the matter of railroad alliances, subject, of course, at all times to the approval of the Interstate Commerce Commission.

The amendment which we seek cannot be classed as one which would encourage purely speculative investments, if it is considered that such investments are not to be favored.

I would also like to have the privilege of having printed in the record at this point a statement on the subject issued by the Association of American Railroads, in which the views I have thus hastily stated are emphasized and elaborated. This is not too long, Mr. Chairman, and I do not think it would burden the record too much if I put it in there.

The CHAIRMAN. You may put it in.

(The matter referred to is as follows:)

THE SUBSTANCE AND NOT THE FORM

WHY RAILROAD INVESTMENTS IN THE SECURITIES OF OTHER ROADS SHOULD BE TREATED AS WHAT THEY ARE—INVESTMENTS IN "PROPERTY USED IN TRADE OR BUSINESS"—AND NOT AS "OUTSIDE" INVESTMENTS

Federal tax laws recognize a clear distinction between business investments in "property used in the trade or business of the taxpayer," and those made in outside enterprises.

Profits and losses arising from business investments are treated, for tax purposes, as ordinary income, and taxes are paid on the net earnings remaining after losses have been offset against profits.

Profits and losses arising from outside investments, on the other hand, are classed as "capital gains" or "capital losses." In arriving at the income on which taxes are to be paid, capital losses may not be offset against the general profits of the business, but only against capital gains—if there are any.

Real property used in trade or business, or other property so used of a character which is subject to allowance for depreciation—such as machinery or equipment—is not treated by the Internal Revenue Code as "capital assets." Gains or losses resulting from the sale or other disposition of such property are not treated as capital gains or capital losses, which may be offset only against one another, but as gains or losses sustained in the ordinary operations of business.

WHAT RAILROADS INVEST IN

The overwhelming bulk of all railroad investment is in that sort of property—tracks, yards, engines, shops, and all the rest of the physical plant and equipment used to carry on the business of transportation.

If such property is disposed of, either because it is worn out or no longer serves a useful purpose, or if it becomes worthless for any reason, any loss which may be sustained by the railroad is charged against its ordinary income, and is deductible in determining the earnings on which the company pays its income taxes.

But part of the investment of railroads is in the stock of other railroad companies. These investments, in almost every case, have been made in connection with and as part of the trade or business of the acquiring road, rather than as "outside" investments. In the great majority of cases, they are part of the permanent investments which constitute the corporate structure of our principal railroad systems. They are, in the truest sense, assets used in carrying on the business of the railroad systems, though the title is not to the physical properties themselves but to securities which represent them.

FURTHERING NATIONAL POLICY

After the passage of the Transportation Act of 1920, and in furtherance of the national policy then adopted of consolidating railroads into a limited number of systems, railroads made substantial investment in the stock of other lines. Such acquisitions were approved by the Interstate Commerce Commission as initial steps in the direction of the desired efficiencies and economies expected to result from ultimate consolidation of the railroads into a small number of large systems. When so approved—and all those which went into effect were approved by the I. C. C.—such acquisitions of the securities of other roads were declared by Congress to be free from the operation of the antitrust laws, State or Federal. The national policy, in short, was to encourage such investments by railroads, not from the point of view of "outside" investment, but as an integral part of the desired policy of railroad unification.

Since the depression of 1930 many of the conditions which encouraged investment by railroads in the securities of other lines have changed or disappeared. The Emergency Transportation Act of 1933 provided that the coordination of railroad facilities should not operate to reduce employment. This provision was expanded and made even stronger by the Harrington amendment to the Transportation Act of 1940. As a result of all these changes in conditions, many of the consolidations which were in prospect will probably never be made, or at least will not be made at this time.

LOSS PILED UPON LOSS

Many railroads, therefore, find themselves left with investments in other roads which are now held under very different circumstances from those under which they were acquired. In some of these cases the usual business course would be to dispose of the securities so held, even at a loss—but if this should be done, as the law now stands, the law would not permit the deduction from ordinary income of losses sustained. They can be offset only against gains—an empty privilege when there are no gains, as is usually the case.

The present tax law, in effect, operates to pile loss upon loss, to confiscate capital. This capital is represented, in some instances, by bonds issued with the approval of the Interstate Commerce Commission, and sold to the public in furtherance of the national policy looking toward consolidation of railroads. If, in addition to the losses suffered by the railroads in the sale of these investments in other roads, they are not permitted to offset them against general income for tax purposes, the difficulty of paying off these bonds in the hands of the public will be greatly increased.

A REMEDY SIMPLE AND JUST

The remedy is as simple as it is just.

Revise the law so that investments by the railroads in the securities of other railroads are defined as what they in reality are—not outside investments but investments connected with the conduct of the taxpayer's business. As such they are entitled to, and should receive, the same treatment for tax purposes as investments in track or cars or engines, or any other of the physical things which railroads use in the production and sale of transportation. The fact that the ownership is indirect, through the holding of securities, rather than direct does not alter the essential fact of the case—that these investments, in the case of railroad companies, are investments directly connected with the carrying on of the taxpayer's business.

Similar changes in the law have been made to meet the conditions arising in other lines of business. For example, banks are allowed to take into account in their ordinary tax returns losses from the sale of bonds, etc. (sec. 177 (1) of the Internal Revenue Code), and insurance companies are allowed to deduct losses from the sale of capital assets sold or exchanged to meet certain of their obligations (sec. 204 (c) (5) and 207 (b) (4) (f) of the code).

In other cases, Congress has made special provision for situations which would create unusual hardship, or to prevent such an application of the tax laws as would weaken or impair the strength of industries essential in the prosecution of the war. For example, utility companies are allowed relief in the nature of a credit against corporate surtax for dividends paid on preferred stock (section 26 (h)). This revision is of special interest in this connection because it was included in the law in recognition of the position of the utility industry as one

with large capital investment in proportion to its total income, with its rates regulated by public authority, and with an exceptionally close and direct relation to the prosecution of the war.

MEETING OBLIGATIONS OF WARTIME AND AFTERWARD

All these considerations apply with as much force to the railroads. They necessarily have a heavy investment in fixed facilities. Their rates, regulated by public authority, are today no higher than they were when the war began. Certainly no industry has contributed more directly or more powerfully to the prosecution of the war than the American railroads. And equally certain, there should be no tax policy which bears unevenly or unjustly upon such an industry, or which would tend to weaken its ability to meet its obligations now and in the future.

Because of increased wartime revenues, there may be some disposition to feel that railroads need not receive the treatment which otherwise should be accorded them. The fallacy of any such feeling, if it exists, was recently pointed out by Commissioner Claude R. Porter, of the I. C. C., as follows:

"Under the impact of the large volume of traffic generated by the war effort rail equipment is being utilized more intensively and is wearing out much more rapidly than would otherwise be true. The longer the war lasts the more rapidly and closely will approach the end of the service life of both plant and equipment. Depreciation rates on equipment have not been increased, and few railroads have made any provision for more than a modicum of plant depreciation. * * * Under the circumstances, the true earnings are considerably less than they appear to be."

Under the conditions so accurately outlined by Commissioner Porter, it is more essential than ever that railroads shall have a chance to get themselves in position to carry out the rehabilitation work which should come after the war, with consequent large-scale employment opportunities for returning servicemen, and that in doing so they should not be hindered by unequal bearing of the tax laws.

CLARIFICATION OF THE LAW PROPOSED

For these reasons, it is proposed that the section of the Internal Revenue Code which defines capital assets should be amended to make it clear that gains or losses from investments by railroads in the securities of other railroads are to be treated as what they actually are—gains or losses arising from investments in "property used in the business or trade of the taxpayer."

The section as so amended would read as follows (the amendatory language being in italics):

"Section 117 (a) (1) CAPITAL ASSETS.—The term 'capital assets' means property held or acquired for use by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer, *or, in the case of a common carrier by railroad, or of a company at least 95 percentum of the stock of which is owned directly or indirectly by one or more such common carriers by railroad, stocks or securities (1) of any other corporation subject to the Interstate Commerce Act, provided that the same are held by the taxpayer pursuant to due authorization by public authority if and so far as such authorization is required by law, or (2) acquired by the taxpayer as a dividend upon, or in the exercise of rights pertaining to, any stocks of the character described in the foregoing clause (1), or (3) of any corporation controlled by, or under common control with, or conducting a business ancillary or auxiliary to that of, the taxpayer or any corporation described in the foregoing clause (1).*"

Senator WALSH. What would be the loss to the Public Treasury?

Mr. FLETCHER. That is difficult to say, because these transactions have not occurred. Just to what extent the railroads will sell these stocks, no one can say. I have a very strong opinion that a good many railroads that have acquired these stocks would not care to sell them because they would prefer to continue the control which the Interstate Commerce Commission has said would be in the public interest. Here and there, there are instances where, due to the changes in conditions, it would no longer be apparently desirable for railroad A to own railroad B, although at one time that seemed the best thing to do. So it is almost impossible, Senator Walsh, to say what the loss to the Treasury, if any, would be.

Senator WALSH. I suppose there are some railroads that have been abandoned.

Mr. FLETCHER. There are some railroads that have been abandoned.

Senator WALSH. That will always be abandoned.

Mr. FLETCHER. Oh, yes. That means small railroads, generally speaking, that were built to serve a particular industry, to go into a forest to move out the timber, or go to the coal mine to move out the coal, and the natural resources of that part of the country have been exhausted and there is no use to continue the railroad.

Senator WALSH. Or it is no longer necessary for the railroad to go into communities where bus lines have taken over the traffic.

Mr. FLETCHER. That is true. That sometimes happens.

Senator GERRY. Is it your opinion, if they are sold at this time, the market is better for securities?

Mr. FLETCHER. That is right.

Senator GERRY. That would be one reason why you would want this legislation now.

Mr. FLETCHER. That is true. It would be good merchandising, good business judgment, to dispose of them at a time when they are a little better off. I would not say there are so much better, Senator, as far as stocks are concerned, but, generally speaking, they are an improvement now over what they have been in the past.

The CHAIRMAN. You are suggesting, Judge, that these losses be allowed as ordinary losses against ordinary gains?

Mr. FLETCHER. As ordinary losses, not being limited simply to capital gains, just ordinary business losses. That is really what, in effect, it amounts to.

The CHAIRMAN. Yes.

Mr. FLETCHER. In connection with my discussion of the excess-profits tax problem, I have referred to the large amount of deferred maintenance now accumulating on the railroads of the United States. Recently, the Association of American Railroads has undertaken to compile some figures showing to what extent this deferred maintenance has accumulated. Our best judgment is that on roadway property alone the amount exceeds $200,000,000 annually. This figure was obtained by asking the railroads to inform us as to what amount of money they expected to expend for maintenance in a given year and how much they were able to expend, in the light of the scarcity of men and materials. The difference between those sums represented the amount of deferred maintenance that we used. The $200,000,000 figure does not take into account deferred maintenance on equipment.

Senator LUCAS. That is the unexpended amount?

Mr. FLETCHER. That is the unexpended amount, that is right, which in their budget they felt like they should have expended and had the money to expend and would have spent if they had gotten the men and materials.

The CHAIRMAN. To what extent, Judge, would the loss carry-forward provision affect it?

Mr. FLETCHER. The loss carry-back and loss carry-forward provisions in the post-war period?

The CHAIRMAN. Yes.

Mr. FLETCHER. That would be helpful, Senator. I am not here to say that provision written into the act in 1942 would not be helpful, but it does not meet the situation.

The CHAIRMAN. It is not adequate?

Mr. FLETCHER. It helps that much, but it does not go far enough.

Senator CLARK. That was put in as a substitute to allow for deferred maintenance. I could not see where it was in any way adequate. That was the theory on which it was put in.

Mr. FLETCHER. I quite remember that to be the fact, at least that is my information. I am referring here now only to a lack of proper repair on the roadway and structures.

The scarcity of materials has been particularly noticeable in the case of rail. Unquestionably, if rail could have been obtained and the services of men to place it in position, very considerable amounts would have been expended by the railroads in these war years, and those amounts, chargeable to operating expenses, would have been a proper and lawful deduction from taxable income.

Senator CLARK. Judge, it is a fact, is it not, that if the railroads had stopped to make the replacements and to keep up the maintenance which was desirable and necessary really, and which would have been allowed, they would not possibly have been able to perform the tremendous task that they have performed?

Mr. FLETCHER. That is quite true.

Senator CLARK. It has been absolutely necessary for the railroads to defer the maintenance in order to perform their functions?

Mr. FLETCHER. That is quite true.

Senators, I know a little railroad in the South, in the State of Tennessee, while they have some men working on the track, the men cannot get a chance to do the work on the track because the trains go over it so frequently. By the time the section crew comes to the track and works on it for 3 or 4 minutes, they have to allow the freight train to go by, and by the time they get a drink of water and stretch themselves a little, another train is going by. So it is absolutely impossible to delay the essential rail traffic in order to keep up this maintenance.

The Interstate Commerce Commission, as I have heretofore explained to this committee, in an order entered more than a year ago, permits railroads to set up in their accounts reserves for deferred maintenance, which, for accounting purposes, are chargeable to operating expenses. Those amounts, however, are not recognized by the Bureau of Internal Revenue in calculating the tax bill of the railroads. Our proposition here is that the amounts authorized by the Interstate Commerce Commission should be declared by law to be

items deductible from income, since those amounts should have been spent and would have been spent if materials and labor had been available.

I think no one questions the propriety of such deductions. I have seen statements made by experts of the Treasury, endorsing frankly the soundness of the general proposition that where it can be demonstrated that property is in need of repair and cannot be repaired by reason of conditions over which the taxpayer has no control, justice requires the allowance of the amounts which should have been spent for this purpose. It is said, however, that it is impossible to police the matter and for that reason, officers of the Treasury have not been favorable to a change in the law on the subject.

It is well enough established, however, as an elementary proposition of law that where a wrong or injury has been sustained, redress should not be denied by reason of the difficulty of finding a remedy. In this particular case, the Bureau of Internal Revenue would have a finding of the Interstate Commerce Commission, a body informed by experience and mindful of its obligations, as to the amount of deferred maintenance, measured by the simple rule of what should have been spent and would have been spent had men and materials been available. Language could be written into the law which would put the obligation squarely upon the Interstate Commerce Commission to investigate the facts and make the necessary finding. I know of no reason why the Bureau of Internal Revenue should not accept this finding as an established fact, to which credence should be given. Congress could lay down a standard to govern the action of the Commission and the Commission, in its administrative capacity, could ascertain the facts with as much certainty as governs the deliberations of a jury, when it is called upon to award damages in an action of tort.

I have the impression that the need for setting up these reserves is not peculiar to the railroad industry. Other lines of endeavor, as well, should probably be allowed to accumulate reserves to take care not only of deferred maintenance but of the expense of changing from a war to a peace economy. However, in the case of the railroads, where the Interstate Commerce Commission supervises their accounting, there exists a policing agency which can be depended upon to protect the Treasury against excessive claims and charges.

It is certain that the railroads will need large sums of money when they face the post-war period. It will be necessary to replace much of the present equipment with lighter weight and modern equipment. Not only must there be many changes in the types of locomotives and cars in order for the railroads to hold their own in a competitive world, there will be the necessity also for expending large sums of money to improve track conditions, such as the elimination of grades and curves, the construction of additional tracks, and the improvement of terminals.

Under the law as it stands now, the railroads will be greatly handicapped in accumulating reserves to take care of deferred maintenance and to rehabilitate their properties. It would seem to be in the interest of sound economics that such reserves should not be depleted by heavy tax demands, so that the railroads will emerge from the war period so emaciated that they will not be able to meet the demands for

transportation, when the energies of the Nation are directed to civilian rather than military ends.

I would like to submit at this time for the record an amendment which would take care of this matter of deferred maintenance by requiring the Bureau of Internal Revenue to recognize the findings of the Interstate Commerce Commission. I call attention to the fact that amounts set up in the reserves must be invested in Government securities, held until the end of the war and then expended in the manner directed by the statute within 5 years from the conclusion of hostilities.

SEC. 23. (y) DEFERRED MAINTENANCE DEDUCTION—RAILROADS.—The deduction for deferred maintenance provided in Section 129.

SEC. 129. (a) DEFERRED MAINTENANCE DEDUCTION—RAILROADS.—In computing the net income of any common carrier by railroad subject to the Interstate Commerce Act, there shall be allowed as a deduction, in addition to deductions otherwise provided for in this chapter, the amount which such common carrier shall, pursuant to authorization of the Interstate Commerce Commission, accrue in its maintenance reserve account to provide for the cost of maintenance and repairs which it is unable to undertake or complete in any taxable year beginning after December 31, 1942: *Provided*, That United States Treasury securities shall be set aside and held by the taxpayer in a face amount at all times not less than the balance in said maintenance reserve account: *And provided further*, That expenditures subsequently made on account of any maintenance or repairs for which accruals have been made in said reserve account shall be charged against said account and shall not be deductible in the determination of net income, except to the extent provided in subsection (b) hereof.

(b) The deduction provided in subsection (a) of this section may be taken in any taxable year beginning after December 31, 1942, but may not be taken in any taxable year beginning after December 31 in the year in which the President shall issue his proclamation declaring the war ended by ratification of a treaty of peace or otherwise. Any amount remaining in the maintenance reserve account on December 31 of the fifth year following the year in which the President shall issue his proclamation as aforesaid shall be included in the gross income of the taxpayer in the fifth year following the issuance of such proclamation and shall be taxed at the rate or rates applicable to the latest year or years in which an equivalent amount of deduction was allowed, with interest at the rate or rates borne by the Treasury securities remaining in the taxpayer's treasury. Upon inclusion of such remaining amount in its gross income, any expenditures subsequently made on account of deferred maintenance and repairs shall be deductible under section 23 (a), and the taxpayer shall be relieved of any further obligation to hold Treasury securities under the provisions of paragraph (a) of this section.

I must mention another matter of very great importance. Up until the 1st of January 1942, under the accounting rules of the Interstate Commerce Commission, railroads were required to set up in their accounts charges for depreciation on equipment, but there was no such requirement with respect to roadway and structures. With some exceptions, so far as roadway and structures were concerned, the accounting took the form of retirement, as it is called, rather than regular rates of depreciation. In calculating the tax bill of the railroads, the Bureau of Internal Revenue did not allow deductions based on the depreciation system, except as to equipment. The allowances were on the retirement basis and the retirement basis alone. Effective January 1, 1943, the Interstate Commerce Commission established a mandatory system of depreciation accounting, not only as to equipment but as to roadway accounts as well, except what is known as the track accounts. Naturally, the railroads took up with the Bureau of Internal Revenue the question of allowing deductions on the depre-

ciation basis, rather than on the retirement basis. The purpose was to have the Bureau of Internal Revenue conform its practice to the accounting rules of the Interstate Commerce Commission.

The Bureau of Internal Revenue, however, hesitated to allow railroads to deduct depreciation on the roadway accounts and, after a considerable amount of negotiation, railroads were permitted to take this depreciation only upon condition that they would agree to set up in their accounts a large amount of theoretical accrued depreciation, amounting to 30 percent of the invested capital. The railroads were informed also that they would be required to consent to have this 30 percent deducted from the amount of their invested capital when excess profits calculations came to be made. The railroads insisted that they should have the right to contest this conclusion of the Bureau of Internal Revenue in the courts, if they were so advised by counsel. The Bureau, however, has in some cases insisted upon the execution of an agreement which would preclude the railroads from going into court on a proposition of this kind, the alternative being that they would be denied the right to deduct depreciation, although they are required by the Interstate Commerce Commission to keep their accounts in this way.

Such action on the part of the Bureau of Internal Revenue is entirely arbitrary. The effect of this action is to say to the railroads, "You must admit finally that your property has been depreciated 30 percent, although you have never been allowed in the past to deduct that depreciation from taxable income."

Senator LUCAS. Upon what basis did they arrive at that conclusion?

Mr. FLETCHER. Just the exercise, Senator, of arbitrary power, that is all I can say. In my statement we asked for an amendment of the law which would require them to allow the deduction of those amounts of depreciation required by the Interstate Commerce Commission without imposing that heavy penalty upon the railroads, which we think is unprecedented and unjust. You see, by doing that you are requiring the railroads now to take a lot of depreciation, to admit that their property has been thus depreciated and the invested capital reduced, although in the past years they got no credit for that.

Senator CLARK. Judge, as a matter of fact, in the case of a large system like a railroad, made up of a multitude of units, if it has been well maintained, properly maintained over a period of years, it is in better condition than it was some 25 years ago; is it not?

Mr. FLETCHER. That is correct. That reminds me—if I may take a moment's time—that the Bureau of Internal Revenue, for a long time at least, and I think that practice still persists, will not allow a railroad to take depreciation on a well-maintained piece of track for the very reason you have stated. A new railroad is not worth nearly as much as a railroad that is 20 years old, when the roadbed would become settled, when the embankments have become as hard as concrete almost. That is what we call appreciation of a railroad.

The limits upon my time will not permit me to elaborate the contention which I was privileged to state at somewhat greater length before the House committee. I am asking this committee, however, to consider the injustice of such action and to give consideration to an

amendment to section 718 (a) (4) of the Internal Revenue Code which would read as follows:

(4) EARNINGS AND PROFITS AT BEGINNING OF YEAR.—The accumulated earnings and profits as of the beginning of such taxable year; *provided, in the case of a common carrier by railroad subject to the Interstate Commerce Act, such accumulated earnings and profits shall not be reduced by the amount which has been or may be required by the Commissioner of Internal Revenue to be set up as a reserve for depreciation in respect of existing units of property as a condition to granting permission to change from the retirement method of accounting to the depreciation method of accounting.*

Or if the committee does not approve such an amendment, relief may be granted by amending subsection (b) of section 734 as follows:

(A) At the beginning of paragraph (2) there shall be inserted the following:

"Except in cases governed by paragraph (3)," after which a comma shall be inserted, immediately preceding the remainder of said paragraph.

(B) The numeral "(3)" at the commencement of paragraph (3) shall be changed to read "(4)."

(C) There shall be inserted, immediately after paragraph (2) of said subsection a new paragraph, to be numbered (3) and reading as follows:

(3) In the case of any common carrier by railroad subject to the Interstate Commerce Act which may have been or may hereafter be permitted to change its method of accounting in respect of any property, from the retirement method to the depreciation method, and as a condition for making such change in method of accounting has been or may be required to set up a reserve for depreciation on existing units of property and to reduce accumulated earnings and profits in the determination of invested capital for excess profits tax purposes by the amount of such reserve; the adjustment under this section shall be made to the extent of the amount of such reserve for depreciation notwithstanding the provisions of any agreement made with the Commissioner as a condition to the making of such change in accounting method, and nothwithstanding the provisions of paragraphs (b) (1) (C) and (b) (2) of this section. In computing the amount of an adjustment under this section there shall be ascertained the amount of depreciation of the units of property in respect of which the change in accounting method is made properly attributable to each prior year during which such property was in existence, the total of which annual amounts shall equal the amount by which the accumulated earnings are required to be reduced, and such annual amounts shall severally be subtracted from the taxable net income of each year to which they are respectively attributable. The difference between the amount of income taxes and excess profits taxes actually paid in each such year and the amount of the tax liability determined after making such subtraction shall constitute an overpayment allowable with interest as provided in subparagraphs (d) and (e) under this section.

One other matter must be stated and I shall endeavor to state it briefly.

Senator LUCAS. Before you leave that subject, Judge——

Mr. FLETCHER. Yes.

Senator LUCAS. Have you prepared an amendment?

Mr. FLETCHER. It is in my statement, and it will be in the record, which I think we would like to have to take care of this situation, this I think purely arbitrary action of the Bureau of Internal Revenue. I do not want to be called a scold, because those gentlemen are usually very cooperative.

Senator LUCAS. Would you place the responsibility for that upon the Interstate Commerce Commission after the Congress has laid down the general principle?

Mr. FLETCHER. That was my idea on deferred maintenance, yes, sir, and on this other matter as well.

Senator WALSH. I thought you said you favored court action.

Mr. FLETCHER. I said we would like to have the privilege, at least, of being able to take that kind of ruling to a court.

Senator WALSH. Would not that delay the decision?

Mr. FLETCHER. I think we would have to have some decision as to status quo pending the litigation while we were getting the thing cleared up if the tax court and the other court generally agreed with our position.

Senator CLARK. As a matter of fact, accrued depreciation is a matter of a guess.

Mr. FLETCHER. Absolutely.

Senator CLARK. With one property depreciated more than 30 percent and another property not at all, where the railroad was new.

Mr. FLETCHER. In order to be candid and fair, I want to say, if you take the Interstate Commerce Commission's straight-line method of depreciation it would amount, on the average, to 30 percent. I am not quarreling about the 30 percent figure, if you use any figure at all.

Senator CLARK. That is right.

Mr. FLETCHER. Quite a number of railroads are what is known as land-grant roads. They received many years ago grants of land from the Government and as a condition for receiving this land and as a result of much legislation and litigation, they are now required to transport military and naval property at half the regular rate. Many railroads that are not land-grant lines have entered into what is known as equalization agreements, under which they meet the rates of the land-grant lines. Under an act passed by Congress in 1940, these half rates apply only to such property of the Government as is classified as military and naval property moving for military and naval and not for civilian use. In other words, property, although owned by the Government, which cannot be classed as military and naval property and which is not being transported for military and naval purposes pays the regular full tariff rate.

It has come about, however, that many disputes exist as between the railroads on the one hand and the Government on the other as to what property is actually military and naval and moving for military and naval uses. The Army, the Navy, and the Maritime Commission have entertained one point of view and the railroads, honestly and consistently, maintain a different point of view as to much of this property. Of course, there could be no dispute if the Army was moving ammunition or guns, but we have many cases where material is being transported to construct ships, not regular naval vessels but ships to be used as a part of the merchant marine. We have instances where material has been moved to repair the locks on the Panama Canal. Of course, these locks, when improved, will facilitate the transport of military property, but they will also be of great use. when the war is over, in the transportation of ordinary commerce. I mention these as simple illustrations of disputes which have arisen as to the proper interpretation of the law.

The 1940 act provides that bills rendered by a railroad company against the Government shall be paid, in the first instance, as rendered,

subject to review later by the General Accounting Office and by the interested departments. The earnings of the railroads are based upon the amounts actually collected from the Government. Taxes are paid by the railroads on this basis. It may well happen 4, 5, or 6 years from now, when these bills are made the subject of a further and more careful audit, that the railroads will be required to refund to the Government large sums of money. Those sums may run into the hundreds of millions.

Of course, the amounts so refunded could be deducted from the taxable income of the railroad in the year when the refund is made. It may well happen, however, that certain railroads will then have little or no taxable income from which the deductions may be made. Simple justice, therefore, requires that if the railroads in the future are called upon to refund these sums of money to the Government, the tax bill for the year when the amounts were collected and taxes paid thereon should be restated in the light of the amounts refunded, and if it is found that the railroads have made overpayments of taxes, the Government should refund the amounts so overpaid. Simple justice requires that there be written into the law a provision of this character.

I take it there can be no question as to the justice of such a provision. Congress, as you will recall, adopted provisions of a similar character where contracts have been renegotiated, resulting in the repayment of sums of money to the Treasury. In these cases, the law now provides that the account for the year when the money was originally collected and taxes paid thereon should be reopened and the tax bill restated to reflect the actual earnings of the company. We are asking the same privilege in the case of the railroads. I submit a form of amendment which would take care of the point.

Chapter 38 of the Internal Revenue Code is amended by inserting at the end thereof the following new section:

SEC. 3807. MITIGATION OF EFFECT OF REVISION OF TRANSPORTATION CHARGES OF A COMMON CARRIER IN RESPECT OF TRANSPORTATION FOR OR ON BEHALF OF THE UNITED STATES.—

(a) Any repayment to the United States by deduction under section 322 of Part II, Title III, of the Transportation Act of 1940, or otherwise, of charges by any common carrier subject to Part I of the Interstate Commerce Act for transportation of persons or property for the United States or on its behalf, whether such repayment is made directly to the United States or indirectly through settlement by such carrier with another such carrier, if such repayment is based upon the applicability of the exception contained in section 321 of Part II, Title III, of the Transportation Act of 1940 respecting the determination of charges for the transportation of military or naval property of the United States moving for military or naval and not for civil use and the transportation of the members of the military or naval forces of the United States (or of property of such members) when such members are traveling on official duty, shall be deducted from the gross income of such common carrier for the taxable year in which the revenue for such services was included in gross income. Any additional payment to such carrier made by the United States for such transportation, whether made directly or indirectly, as aforesaid, if based upon the inapplicability of said exception, shall be added to the gross income of such carrier for such taxable year. Such repayment or additional payment shall not be reflected in the gross income of such carrier for any other taxable year. Common carrier for the purposes of this section includes its predecessor in interest and its successor in interest.

(b) The Commissioner of Internal Revenue shall determine any overpayment of or deficiency in tax under chapter 1, chapter 2-B, and chapter 2-E resulting from an adjustment of gross income for a prior taxable year under subsection (a) of this section and notwithstanding any other pro-

vision of law, any such overpayment shall be refunded or credited, and any such deficiency shall be assessed and collected, as if, on December 31 of the year in which said revision of charges is made, 3 years remained before the expiration of the periods of limitation for filing claim for refund or making assessment. If the making of such refund or assessment would be prevented except for the provisions of this subsection, the amount of the overpayment or deficiency in tax shall be computed as hereinafter in this subsection provided. There shall first be ascertained the tax previously determined for such prior taxable year. The amount of the tax previously determined shall be (A) the tax shown by the taxpayer upon its return for such taxable year, increased by the amounts previously assessed (or collected without assessment) as deficiencies and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; or (B) if no amount was shown as the tax by such taxpayer upon its return, or if no return was made by such taxpayer, then the amounts previously assessed (or collected without assessment) as deficiencies, but such amounts previously assessed, or collected without assessment, shall be decreased by the amount previously abated, credited, refunded, or otherwise repaid in respect of such tax. There shall then be ascertained the decrease in tax previously determined or the increase in tax previously determined which is attributable solely to an adjustment under subsection (a) of this section. The amount so ascertained shall be the amount of the overpayment of tax to be credited or refunded under this subsection or the amount of the deficiency in tax to be assessed under this subsection, and the amount so ascertained shall not be diminished by any set-off or credit based upon any item other than an adjustment under subsection (a).

(c) The provisions of this section shall be applicable to any taxable year beginning after December 31, 1939.

The House bill retains the 3 percent tax on freight transportation. We are making no complaint about this action, but I would like to say that there should be excluded taxes on services incidental to transportation, such as charges for demurrage and for loading and unloading freight. This becomes a matter of some importance by reason of the fact that the loading and unloading of freight, particularly of iron ore at Lake Erie ports, is sometimes performed by the railroads and sometimes by independent contractors. Under a ruling of the Bureal of Internal Revenue, if the service is performed by the railroad, the tax is applied; if the service is performed by an independent contractor, it is not classed as transportation and the tax does not apply. As a result, charges at the Lake Erie ports are not uniform. The effect is to disturb the parity which formerly existed and prefer one port over another. This is a highly undesirable situation, obnoxious to shippers and carriers alike.

I am asking that section 3475 (A) of the Internal Revenue Code, relating to the tax on the transportation of property, be amended by inserting at the end of the subsection the following:

For the purposes of this section the term "transportation" shall include all services incidental to transportation that are covered by the transportation rate or charge, but shall not include any such incidental service for which a separate charge, in addition to the transportation charge, is imposed.

In conclusion, permit me again to recommend that Congress repeal the capital stock tax and the related excess profits tax and that it give consideration to removing the 2-percent penalty for making consolidated returns.

Mr. Chairman, certain railroads now undergoing reorganization hope to make an appearance here this week to argue a proposition that I am neither inclined nor competent to argue, namely, that they should be permitted to deduct dividends on preferred stock the same as they

deduct interest on bonds in cases where stock has taken the place of bonds in the reorganization process. I have been requested by those particularly interested in that to ask you to put in the record here at the close of my remarks this short statement which elaborates that point.

The CHAIRMAN. You may enter it in the record.

Mr. FLETCHER. I am very thankful to the committee. I would be glad to answer any questions.

The CHAIRMAN. Are there any questions that any member of the committee wishes to ask?

We thank you very much, Judge.

(The statement referred to and submitted by the witness is as follows:)

MEMORANDUM ON BEHALF OF REORGANIZATION RAILROADS—IN THE MATTER OF H. R. 3687

To the Honorable the Finance Committee of the United States Senate:

At a recent meeting of the American Bar Association a report was submitted by one of the standing committees in which attention is called to the necessity of remedial legislation to mitigate tax injustices resulting from reorganization. We quote the following from this report:

"The committee calls attention to the gross inequities which result from the heavily increased taxes imposed upon corporations as a result of changes in capital effected by reorganization.

"Interest on creditor obligations may be deducted in determining the net income of a corporation which is subject to tax. Dividends on preferred and common stock may not be so deducted. The result is that when, through reorganization, creditor obligations are converted into stock equities, the amount of income subject to tax is greatly increased. In many of the railroad situations, because of the impact of this difference in deductibility, it is necessary for the reorganized corporation to earn more than twice as much gross income after reorganization to pay the same aggregate amount of interest or dividends to its security holders.

"In railroad reorganizations, particularly, the Interstate Commerce Commission, because of the public interest involved, refuses to approve plans unless a majority of the capitalization of the railroad, after reorganization, consists of stock rather than creditor obligations. The old creditors and stockholders have very little control over the matter.

"Assuming that the view of the Interstate Commerce Commission is correct, that the public interest demands this type of capitalization, it nevertheless is grossly inequitable to the security holders to compel them, as a result of such recapitalization, to donate millions of dollars of income, otherwise available for payment to them, to the payment of taxes.

"Resistance on the part of security holders to this gross inequity has greatly impeded the completion of railroad reorganizations. Because of this tax loss, the old security holders are naturally loath to accept stock in place of bonds or other creditor securities."

The undersigned are a committee of counsel representing 27 class I railroads already reorganized or in process of reorganization appointed to present this proposal to Congress in connection with the forthcoming tax bill. To this end, the Ways and Means Committee of the House of Representatives was asked to include in the tax bill as originated by it an amendment of the present revenue code permitting railroads reorganized under section 77 of the Bankruptcy Act, or in receivership proceedings, to deduct from corporate gross income a sum equal to the interest on indebtedness replaced by stock issued in reorganization to the extent that dividends are paid on such stock during the taxable year; such deduction to be allowed in the case of the normal and surtax, but not to be applicable to the excess-profits tax.

Since H. R. 3687 does not grant this relief the committee now respectfully asks the aid of the Senate.

A tentative draft of the amendments which would accomplish the purpose described above is hereto attached for the consideration of your committee.

This committee stands ready to give you such aid or assistance in connection with this matter as you may desire. Any communication should be addressed to Mr. Frank C. Nicodemus, Jr., chairman of the committee, 33 Pine Street, New York 5, N. Y.

FRANK C. NICODEMUS, Jr., *Chairman.*
W. R. C. COCKE,
MARCUS L. BELL,
H. A. TAYLOR,
W. C. MULLIGAN,
Committee for Reorganization Railroads.

NOVEMBER 29, 1943.

PROPOSED AMENDMENTS TO THE INTERNAL REVENUE CODE AS AMENDED

(1) Section 23 (b) is amended by designating the present subsection as paragraph "(1)" and by adding a new paragraph to read as follows:

"(2) In the case of a reorganized railroad corporation, the deduction provided in section 129."

(2) Insert after section 128 the following new section:

"SECTION 129. DEDUCTION BY A REORGANIZED RAILROAD CORPORATION.—

"(a) AMOUNT OF DEDUCTION.—A reorganized railroad corporation shall be entitled to a deduction equal to the interest on indebtedness replaced by stock issued in reorganization to the extent that dividends are paid on such stock during the taxable year.

"(b) DEFINITIONS.—As used in this section and section 23 (b) (2)—

"(1) REORGANIZED RAILROAD CORPORATION.—The term 'reorganized railroad corporation' means a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended, organized or made use of to effectuate a plan of reorganization approved on or after August 27, 1935, by the court having jurisdiction of a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended—

"(A) in a receivership proceeding, or

"(B) in a proceeding under section 77 of the National Bankruptcy Act, as amended.

The term 'reorganization' as used in this section, shall not be limited by the definition of such term in section 112 (g).

"(2) STOCK ISSUED IN REORGANIZATION.—The term 'stock issued in reorganization' means stock which was issued after August 27, 1935, in discharge of claims of holders of bonds, debentures, notes, certificates, or other interest-bearing evidences of indebtedness in order to effectuate the plan of reorganization approved by the court in the proceeding described in the preceding paragraph."

(3) Section 711 (a) (2) (B) shall be amended by designating the present subparagraph (B) (1) and by adding a new subparagraph to read as follows:

"(2) DEDUCTION BY A REORGANIZED RAILROAD COMPANY.—The deduction provided for in section 23 (b) (2) shall not be allowed."

(4) The amendments made by this section shall be applicable to taxable years beginning after December 31, 1939.

(The following letter was submitted for the record:)

RAILWAY LABOR EXECUTIVES' ASSOCIATION,
Washington, D. C., November 30, 1943.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee, Washington, D. C.

DEAR SENATOR: The Railway Labor Executives' Association, composed of 19 national and international organizations, must, because of the quandary in which it places them, object to, and oppose, the amendment set forth on page 28 in H. R. 3687, which inserts after subsection (e) the following language:

"Every organization, except as hereinafter provided, exempt from taxation under section 101, shall file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provision of this chapter as the

Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe. No such annual return need be filed under this subsection by any organization exempt from taxation under the provisions of the section 101."

The House Ways and Means Committee reported this amendment without opportunity for representatives of any of the organizations who may be affected to state their position with respect to the amendment. Then the House adopted a rule limiting general debate to 2 days and providing that no amendment shall be in order except those offered by the committee. In other words, a very definite "gag" rule.

We do not know what the committee wants, what it is driving at. If there are hidden ulterior motives, they should be out in the open and clearly understandable. The organizations represented by this association have no secrets to hide behind. They make public to their entire membership their entire financial standing with respect to income and outgo, some monthly, some semimonthly, others annually, and this may be obtained by any parties who are interested and who may think that it is of use or value to them. The dissemination of such information has always been on a voluntary basis and no reason for compulsion has ever existed.

Why, we ask, should such an amendment be injected into a general revenue bill dealing with 50,000,000 or more taxpayers? If the purposes are germane, then why not introduce such broad legislation in a separate bill which will make clear its real purposes and afford opportunity for all interested parties to be heard? The complexities of the House revenue bill are legion and, even if confined to the collecting of revenues, will lead to all kinds of misunderstandings which the vast majority will be unable to fathom or comprehend.

The committee's report (pp. 24–25) dealing with the amendment in section 112 of the House bill, does not even match the reasons given to explain and try to justify section 112. Either section 112 should be dropped or it should read to correspond with the reason advanced in the report.

The report says it wants information from organizations which are now exempt from tax but are operating business enterprises at a profit in competition with companies which are subject to tax.

Why, then, should not section 112, if there is to be such section (and we see no need whatsoever) read so that it applies only to organizations now exempt from tax which operate any business at a profit in competition with companies which are subject to tax. In brief, either strike out section 112 entirely or limit it to the justification advanced in support of it.

Efforts along similar lines as provided for in this amendment were tried on various occasions in the House, which, however, never materialized into enacted legislation. To now inject an amendment into the general revenue bill is but an attempt to sneak it in the back way, trusting that the adoption of such a revenue bill will carry with it this absurd and wholly unnecessary provision.

We repeat that, if legislation is desirable and necessary to meet the requirements of the House amendment, then separate it from the far-reaching tax bill. Afford those affected an opportunity to be heard, instead of "gagging" them as the rule adopted "gags" even the colleagues in the House from offering amendments to strike this absurd and obnoxious language, changing the principles of section 101 of the Revenue Code.

We respectfully request that the Senate reject this amendment and strike the language of paragraph (f) on page 28 of the House bill 3687.

Yours truly,

J. G. LUHRSEN,
Executive Secretary,
Railway Labor Executives' Association.

The CHAIRMAN. Mr. Parlin.

STATEMENT OF CHARLES C. PARLIN, ATTORNEY, NEW YORK, N. Y.

The CHAIRMAN. Give your name and address to the reporter, Mr. Parlin.

Mr. PARLIN. My name is Charles C. Parlin. I am an attorney; 63 Wall Street, New York City. I am a practicing attorney in New

York City and spend the majority of my time in tax work. As a matter of friendship I have assisted a number of the members of the armed services in attempting to make out their income taxes for the calendar year. In connection with that work relating to the members of the armed forces, a situation has arisen which strikes me as unfair. This committee has been kind enough to allow me to state my views here.

The taxpayers use the current income to pay the taxes for the preceding year. A man may use his 1942 income to pay the 1941 tax, and so on, and it was found advisable to put all taxpayers on a current-payment basis, which was done by the forgiveness of 75 percent of the 1942 taxes. Auxiliary provisions were necessary, however, and those were adopted to protect the revenues and to prevent windfalls to taxpayers by adding to the 1943 tax various items.

Then it was realized that certain provisions must be made to temper and give relief from double payments, and among those was the relief given to members of the armed forces.

Take, for example, a top executive who had a salary in 1942 of $100,000, his tax, I think, would be $60,000. If he entered the armed forces and had a commission at $4,000 or $5,000, he is faced with the problem of paying a $60,000 income tax out of his commissioned pay of $4,000 or $5,000.

It was recognized there was an injustice and some remedy should be given. The relief was given in section 6 (d) which provided that in cases of the armed forces the 1942 tax could be recomputed for the purpose of this carry-over provision by excluding the earned income. The cross reference, however, picked up not the real earned income but the earned income as defined for the earned income credit, which says under any circumstances $3,000 is earned income and under no circumstances is more than $14,000 earned income, with the result that we have the following absurdity working out for a member of the armed forces: A man who had a private income but no earned income in 1942 goes into the services and goes on Uncle Sam's pay roll. This statute arbitrarily brands $3,000 of his private income as earned income and proceeds to give him the benefit of the adjustment as if that $3,000 had been earned, and he had lost that by going into the armed services. Conversely, take the case of a man who has actually earned in 1942 the salary of $25,000, which he has lost by going into the armed services, this definition allows us to recognize as earned income only $14,000 and brands as private income and subjects it to the windfall provisions the balance of $11,000, which was in fact earned but which is now branded as private income and taxed as private income.

My suggestion, therefore, is that this committee consider retaining that present adjustment in favor of members of the armed forces, but making the adjustment on the basis of actual facts, on the earned income that had been sacrificed by going into the armed services, and eliminating this arbitrary definition which contorts private income into earned income and actual earned income into private income. The adjustment can be very easily made by a proper cross-reference to the definition of "earned income" which is in the statute, instead of cross-referencing it to this peculiar earned-income-credit provision.

As a matter of fact, the House bill suggests a complete elimination of the earned-income credit beginning March 1, 1944, but the amendment will not be effective to remedy the situation which I am pointing out, because that situation is involved in the computation of the 1943 tax.

I will not bore you with the definitions and cross-references, which are purely technical, but I would like to file a memorandum that gives a background of these references to accomplish the point I am trying to make, namely, in the interest of our colleagues who have entered the armed services, to make the adjustment on the basis of actuality and not a contortion of earned income and private income.

The CHAIRMAN. You may file it.

Mr. PARLIN. Thank you, sir.

(The memorandum referred to is as follows:)

MEMORANDUM TO SENATE FINANCE COMMITTEE RE RELIEF TO ARMED FORCES FROM DOUBLE PAYMENT OF 1942 TAX

PROPOSAL FOR AMENDMENT

It is proposed that the 1943 Revenue Act, section 6 (d) (1), now reading in part:

"(as defined in section 25 (a) (4))"

should read:

"(as defined in the first sentence of section 25 (a) (4 (C))."

The present House bill does not deal with this section or the problem here presented.

PURPOSE OF AMENDMENT

The Current Tax Payment Act of 1943 was based on the established fact that many, and probably most, taxpayers were using their current earnings to pay tax on their income of a prior year. It recognized the soundness of putting taxpayers on a current-payment basis.

To put taxpayers on a current basis 75 percent of the 1942 tax was forgiven. New provisions for computing the 1943 tax were enacted designed to protect the revenues, to prevent windfalls to taxpayers, and to give certain relief from double payments.

Relief from double payments was given to members of the armed forces by section 6 (d) (1). Civilians have their 1943 tax increased by the excess of the 1942 tax over the 1943 computation. Members of the armed forces, in carrying over this excess as part of their 1943 tax, are permitted to recompute their 1943 tax. They can exclude from the 1942 computation their "earned net income (as defined in section 25 (a) (4))."

Section 25 (a) (4) defines "earned net income" and then provides that in every case it shall be a minimum of $3,000 and a maximum of $14,000. The proposed amendment would eliminate these arbitrary minimum and maximum amounts and give to a member of the armed forces relief from double payments on the basis of the actual facts.

OPERATION OF PRESENT LAW

The theory of relief to members of the armed forces is sound in principle but the arbitrary limitations of $3,000 and $14,000 prevent the accomplishment of this obvious purpose. If a man had no earned income prior to entering the armed forces he has made a financial gain by going on the Government pay roll. There would appear to be no necessity for giving him an additional tax benefit by arbitrarily classifying $3,000 of his private income as earned income. On the other hand, a man with earnings in excess of $14,000 by going into the armed forces has made a substantial financial sacrifice. It seems unfair that of his actual earnings in 1942 only $14,000 should be recognized as earned income.

REASONS FOR AMENDMENT

The relief from double payments given to members of the armed forces by section 6 (d) (1) is sound and should be retained. The relief, however, should be based on actual facts and not upon arbitrary designations.

A civilian who has less income in 1943 than in 1942 may have a hardship under the present law. This hardship, however, is due to business reverses. A member of the armed forces who had a substantial earning for 1942 and only his Army or Navy pay in 1943 has made this sacrifice in the national interest and is entitled to special relief.

A man who had $14,000 of earned income in 1942 and only Army or Navy pay in 1943 is adequately protected under the present act. But a man who has 1942 earnings in excess of $14,000 in 1942 and only his Army or Navy pay in 1943 has a real hardship. The higher the earned income in 1942 the higher the tax brackets and the more impossible the situation created under the present act.

As indicated above, the current tax payment act of 1943 is premised on the fact that taxpayers paid their 1941 tax out of 1942 income, their 1942 tax out of 1943 income, etc. A man who leaves a partnership, commission, or salaried position which enabled him in 1942 to earn, say, $100,000 will be faced with paying in 1943 approximately $60,000. With only the armed forces pay for 1943 this is obviously impossible. The higher the earnings for 1942 the greater the sacrifice in entering the armed forces and the more acute the tax hardship.

Under the present act a civilian who has a large income for 1942 can get the maximum benefits of the forgiveness provisions by bringing his 1943 earnings up to the level of his 1942 income. In civilian life most substantial taxpayers are familiar with this situation and are making an effort to bring their 1943 earnings up to at least the 1942 level. A man in the armed forces cannot accomplish this. He clearly should be entitled to relief from double tax based on actual earned income. The present statute would give satisfactory relief if it used the present definition of earned income but eliminated the arbitrary minimum of $3,000 and maximum of $14,000.

The old earned-income-credit provision which contained this minimum and maximum never had a logical basis. It came into the law as a compromise at a time when it was urged that earned income be taxed at rates different than other income. The present House bill proposes to abolish the credit and incorporates (for 1944 and subsequent years) a definition of earned income without any minimum or maximum. H. R. 3687, section 108. As the proposed amendment does not apply to the year 1943 it does not solve the problem of the members of the armed forces outlined in this memorandum.

CHARLES C. PARLIN.

NOVEMBER 29, 1943.

APPENDIX

REVENUE ACT OF 1942, SEC. 6. RELIEF FROM DOUBLE PAYMENTS IN 1943

"(d) Rules for application of subsections (a), (b), and (c).

"(1) Application of subsection (b) to members of armed forces.—If the taxpayer is in active service in the military or naval forces of the United States or any of the other United Nations at any time during the taxable year 1942 or 1943, the increase in the tax for the taxable year 1943 under subsection (b) (1) shall be reduced by an amount equal to the amount by which the tax for the taxable year 1942 (determined without regard to this section) is increased by reason of the inclusion in the net income for the taxable year 1942 of the amount of the earned net income (as defined in section 25 (a) (4))."

INTERNAL REVENUE CODE, SEC. 25. CREDITS OF INDIVIDUAL AGAINST NET INCOME

"(a) *Credits for normal tax only.*—There shall be allowed for the purpose of the normal tax, but not for the surtax, the following credits against the net income:

* * * * * * *

"(4) *Earned income definitions.*—For the purposes of this section—

"(A) 'Earned income' means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered, but does not include any amount not included in gross income, nor that part of the compensation derived by the taxpayer for personal services rendered by him to a

corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income production factors, a reasonable allowance as compensated for the personal services actually rendered by the taxpayer, not in excess of 20 per centum of his share of the net profits of such trade or business, shall be considered as earned income.

"(B) 'Earned income deductions' means such deductions as are allowed by section 25 for the purpose of computing net income, and are properly allocable to or chargeable against earned income.

"(C) 'Earned net income' means the excess of the amount of the earned income over the sum of the earned income deductions. If the taxpayer's net income is not more than $3,000, his entire net income shall be considered to be earned net income, and if his net income is more than $3,000, his earned net income shall not be considered to be less than $3,000. In no case shall the earned net income be considered to be more than $14,000."

The CHAIRMAN. Mr. Rice.

STATEMENT OF ROLAND RICE, GENERAL COUNSEL, AMERICAN TRUCKING ASSOCIATION, INC.

Mr. RICE. Mr. Chairman and members of the committee: My name is Roland Rice. I am general counsel of the American Trucking Associations, Inc. Our offices are at 1424 Sixteenth Street NW., Washington, D. C. The association is the national trade association of the trucking industry and is a federation of some 50 associations in the various States, the District of Columbia, and the Territory of Hawaii. Its membership represents every type of trucking operation.

We are not here today to complain about taxes but to point out just a few problems to which we hope the committee will give careful consideration. As a matter of fact, many of our members are in such straitened financial position that they will earn but little and have but little tax to pay. As to those which are in position to produce earnings, we respectfully request that the House proposal to increase the excess-profits tax from 90 percent to 95 percent be rejected. There is little enough left for future needs when 90 percent is taken.

As to this point I see no particular purpose in extending the discussion because what has been said by Judge Fletcher for the railroads really applies to us also.

The trucking industry employs more personnel than any other form of transportation, the total employment being estimated as something over 3½ million. From the point of view of providing work, this industry from the beginning has been one of the most beneficial in the Nation, its units being relatively small, thus necessitating large numbers of men for the total volume of freight carried.

The burden of taxes on highway carriers is enormous and in 1942 the total special taxes, such as registration fees, gasoline tax, and excise taxes, were over $539,000,000—well on toward $1,500,000 per day. This figure does not include personal property taxes, income taxes, and real property taxes on terminals, shops, and so forth. We urge, therefore, that since our taxes and labor costs are high and employment stable, this committee give favorable consideration to the suggestion that the present social-security taxes be not increased as originally contemplated. According to many of those who have made a study of the subject, the reserves are entirely adequate for any needs that we may anticipate.

I hope it will not be amiss here to state—and I do it with considerable pride—that our industry is making an enormous contribution to the war effort in spite of the greatest handicaps. As you know, we have had practically no new equipment since the war but are forced to depend almost entirely upon what we had when the attack was made on Pearl Harbor. Manpower shortages are alarming, gasoline and rubber shortages are causing the deepest concern, and in many cases the lack of necessary parts lays up vehicles for weeks and sometimes the parts cannot be found at all. Added to this, the cost of these items has risen tremendously, and especially in the case of rubber—an indispensable commodity—the service life of the product does not compare with what was available at the outbreak of the war. This gives some idea of why our financial condition is so bad at present.

And yet with all these handicaps the trucking industry is performing an unbelievably great service. It is the opinion of many authorities that the great development of the motor vehicle is largely responsible for our success in avoiding a transportation break-down in the present war with an all-time high in freight and passengers transported. Mr. Joseph B. Eastman, Director of the Office of Defense Transportation, has stated publicly on many occasions that the contribution of the motor vehicle to our war program is outstanding and that without the highway carrier the rails could not possibly carry the load. Today the load of many of our carriers consists of 75 percent of war goods and some carriers have devoted 100 percent of their facilities to the Government, these war loads moving swiftly over short distances and long, and frequently at the urgent request of Army and Navy personnel for service to and from camps, installations, war factories, and ports of embarkation. It is our hope that we can continue this service in war and that we shall be provided an opportunity to resume a normal role when peace returns, and make an even better record than in the past.

I should like to comment briefly upon the proposal to repeal the 3-percent transportation tax. May I say that in spite of the fact that our industry does not pay the tax direct, it has nevertheless been a great burden in the use of manpower, and its application particularly with reference to accessorial charges has not always been clear.

At this point there is one angle that I should like especially to stress before the committee at this time. You will recall that under the Motor Carrier Act, now called part II, Congress established classes of carriers such as common, contract, and private carriers. The contract carrier is frequently considered a species of private carrier, especially because of his confining his services to individual shippers and because of his close relationship to the shipper's business. The 3-percent transportation tax has made it difficult for the contract carrier to retain his business in the face of private carrier competition because the latter is exempt from the payment of the tax both with regard to traffic carried on his own vehicles and on vehicles which he may lease. You may know there are a great many socalled rental firms, vehicle rental firms, from which the private carrier may lease trucks. That 3 percent may very well spell the difference between having the goods moved by a contract carrier and having the private carrier perform his own service. In other words, the 3 percent may mean the difference between staying in business and being put out

of business, and it has been the cause of very grave concern to our contract carriers. When the committee considers this phase of the tax problem, we hope it will give careful thought to this particular issue.

I come now to what is considered by our members a very important matter and that is the question of deferred maintenance. Judge Fletcher, in speaking for the railroads just a few minutes ago, gave attention to a similar subject obtaining in his industry. That subject has received much public discussion and I am sure the committee is aware of the fact that in some instances, at least, management is not able to carry on the necessary maintenance work for the very simple but compelling reason that the materials, parts, time, and manpower are not available.

In our case, we cannot give you specific figures as to the total amount of maintenance already deferred, but it is obvious to even a casual observer that we are not now doing the mechanical work on our equipment that we would normally have done. The problem is aggravated by the fact that it has been necessary for us to keep in operation hundreds of thousands of vehicles that might have been replaced had new ones been available. Even after the war is over, we must continue to operate these vehicles and the newer ones for a long time. As to our equipment, it is being run harder and longer and subjected to much greater abuse than ever before, and we are not able to provide the necessary maintenance. The money that is made through this type of operation is really not a profit but an expense and some day it ought to be applied to restore the Nation's transportation plant to real operating efficiency.

I am sure this committee and the Congress are interested in having an adequate peacetime highway transportation agency. We are doing our best in war but we want to continue to live and to serve when peace returns. In order to do it we need to have exempted from tax an amount equivalent to what would be used if we had the time, the manpower, the material, and parts with which to do it. We are willing, as are the railroads, to have the Interstate Commerce Commission set up an account for this deferred maintenance and a fair figure might be established through the use of a normal period—perhaps from 1936 to 1939. We could then measure our present needs against our experience in that period and I think a fair figure could be arrived at. In our industry, it would be difficult to go back much farther than 1936 because adequate records would not be available. You see, regulation by the Interstate Commerce Commission began in full in that year.

If the committee should decide that the suggestion for the purchase of Government securities is desirable, such a plan would be entirely acceptable to us.

I might depart from my prepared statement here to comment briefly on the suggestion made by Judge Fletcher with regard to the consideration for carriers who are offering to the Government land-grant rates. He made a suggestion, I believe, that there might be established such a thing as a tax-exempt fund. While the motor-truck industry of course does not carry anything like the volume of freight that the railroad industry carries, and while the land-grant rates do not generate such large sums of money in our industry as

they do in the railroad industry, nevertheless this is a very considerable problem to our people, and when this committee considers the suggestion made by Judge Fletcher, and perhaps by others on the same subject, we sincerely urge that you give consideration to the fact that the same problem applies, though in a smaller amount, to the highway carrier industry.

There is just one final matter I should like to bring to the attention of the committee: Within our industry we have had a relatively large number of automobile transporters, men who have carried thousands of automobiles from the manufacturing points to the various distributing areas around the country. Before the war, half the Nation's automobiles were moved by the highway companies. When Pearl Harbor came there were no more new automobiles to carry and these men found themselves utterly at a standstill, but there was need for the transportation of small guns, airplane wings, fuselages, and other parts, the famous jeeps, and similar small vehicles. The Government also needed workers carried to its newly established war plants.

Consequently, with most of these carriers, and with some others, there was the immediate problem of conversion to a new type of vehicle for a war purpose only, since it was only through this conversion that they were able to serve the Government and also keep in operation at all. Today these vehicles are devoted to a service different from that for which they were built and one which will not be in existence when the war is over. Consequently, we have in our industry a reconversion problem which will be pressing immediately upon the cessation of hostilities. The subject of reconversion may have been presented to this committee by other witnesses for consideration. When the committee comes to that point, we respectfully ask that if any provision whatever is made, consideration be given to the fact that in the highway transport industry reconversion will be very important to many carriers and that they should be included in any legislation drafted to recognize and alleviate this condition.

That concludes my statement, Mr. Chairman.

The CHAIRMAN. Are there any questions? There are no questions. Thank you very much, Mr. Rice.

Mr. RICE. Thank you, Senator.

The CHAIRMAN. Mr. Sutherland is not present this morning. That leaves Mr. Satterlee. I believe Mr. Satterlee requested that he be carried to the foot of the calendar, if it is agreeable, and I suppose it is.

(The following statement was submitted for the record:)

STATEMENT OF RAILROAD SECURITY OWNERS ASSOCIATION, INC., RESPECTING CERTAIN PROPOSED AMENDMENTS AFFECTING TAXABLE INCOME OF RAILROADS

This statement is submitted in behalf of Railroad Security Owners Association, Inc., 110 East Forty-second Street, New York, N. Y., by its authorized executive committee.

Railroad Security Owners Association represents 48 life-insurance companies and 350 mutual-savings banks owning about 28 percent of the total funded debt of the railroads of the United States. Investments of the association's members are fiduciary in character. The association seeks to contribute to the protection and promotion of the investment interests in the American railroads of many million of life-insurance policyholders and savings-banks depositors.

The association's executive committee urges the adoption of amendments to the pending bill so as to provide for the deduction in the computation of taxable railroad income of—

1. Amounts set aside in a reserve fund and invested in Government securities to provide for the overtaking in the future of current undermaintenance attributable to present shortage of labor and material; and

2. Losses, not limited to offsets against capital gains, incurred in the disposition of other railroad corporations' securities acquired for the enlargement of the taxpayer's transportation service.

At hearings before the House committee on October 11, 1943, in testimony beginning at page 523 of the print, and before the Senate committee on November 30, 1943, the Association of American Railroads, appearing by its vice president, Judge R. V. Fletcher, proposed amendments that would accomplish the purposes above indicated. That presentation in behalf of the railroad managements is commended to the Finance Committee for most careful consideration.

1. Reserve against current undermaintenance.

By reason of the tremendous and imperative demands of the war on railroad transportation, wear and tear of railroad plant and equipment is abnormally great. Shortages of labor and material have made it difficult for the railroads to keep the maintenance of their property up to the standard required for proper safety and highest efficiency of present operations. The railroads have been compelled to defer a great volume of maintenance work that ordinarily would be in progress, that must eventually be performed to restore the property, but that can be postponed without impairment of present service. This postponement of demand for labor and materials serves vital national interest. The accumulation of large funds to be spent upon the cessation of war activity will assist greatly in the sustaining of the national economy after the war passes.

A sharp reduction in railroad revenues will come with the end of the war. At the same time the railroads will be confronted by exceptional demands for capital expenditures required for the modernization of plant and equipment to meet the greatly magnified competition of other forms of transportation. The possession of reserve funds for the necessary overtaking of accumulated undermaintenance will ease the approaching financial strain.

The existing tax laws practically forbid the setting aside of any funds for such future use. If not currently spent, income that is available for and ordinarily would be employed in maintenance work is treated as profit, and subjected to a tax that for railroads ranges up to 81 percent. This would increase the cost of postponed maintenance provided for currently to an amount in excess of five times the amount subsequently expended therefor. As a consequence, present provision of funds to be used later for the payment of present cost of service is negligible.

The Interstate Commerce Commission has recognized that maintenance work which ordinarily would be in progress under a normal program, but which under present circumstances must be postponed for performance as soon as conditions permit, should be treated as current operating expense. By regulations issued June 29, 1942, the Interstate Commerce Commission permits the railroads to set aside funds to be used in such work, subject to restrictions and upon conditions for supervision insuring proper application of the funds. There is thus at hand an agency and a plan to simplify the drafting of the proposed legislation, facilitate its administration, and insure the accomplishment of its purpose.

2. Losses from railroad investments in other railroad corporations.

The typical railroad corporate structure is highly complex in that there is an integration of separate corporations, frequently considerable in number.

This is so for diverse reasons. One is that the system, usually a single operating unit, has been built up progressively over the course of many years, in numerous instances exceeding or approaching a century. From time to time a railroad corporation strong and enterprising among its neighbors has acquired the stock, and sometimes also the bonds, of an existing corporation owning connecting or otherwise auxiliary lines of railroad. In other instances, the railroad corporation seeking to enlarge its transportation service has set about the construction of branches and extensions from its existing lines, and frequently the most practical course was to form a subsidiary corporation, ownership of the newly constructed property thus becoming indirect through ownership of capital stock. State laws often made the creation of a separate corporation desirable or necessary upon the crossing of a State line. Occasionally railroad corpora-

tions approaching equality in strength and importance have effected a degree of union through the acquisition by the one of the capital shares of the other.

Acquisitions by one railroad organization of the securities of another were encouraged and accelerated by the adoption of the provisions in the Transportation Act of 1920 expressly designed to bring about consolidations of railroads into a limited number of systems. An indirect impetus in the same direction was furnished by the provisions in the 1920 act for the recapture of excess earnings. What were then the prosperous railroad corporations, of which the list later changed greatly, were thereby as a matter of policy encouraged to take over the stock of the less prosperous ones and combine the operations into one system.

The drift toward unifications appears to have been sharply arrested, if indeed in certain respects it has not been reversed. This is largely due to a change in public opinion and in Federal legislative policy. The result has been a proper desire on the part of many railroad corporations to divest themselves of railroad securities originally acquired in pursuance of a national policy. Moreover, abandonment of many unneeded and burdensome branch lines has been accomplished, is now going forward, and will continue. This is particularly true as to railroad corporations now undergoing reorganization under section 77 of the Bankruptcy Act, or recently emerged therefrom. Frequently, ownership of these branch lines was represented by ownership of the securities of a subsidiary corporation. There have been great changes in traffic conditions, and in the channels of traffic, affecting the desirability of the retention of ownership by one railroad of the securities of another.

In railroad set-ups of which representative examples have been outlined, the distinction between indirect ownership of physical property through ownership of securities of the corporation possessing legal title, on the one hand, and direct ownership, on the other hand, is highly technical and artificial. The essential situation is widely different from that which exists in the case of investment by an individual or the ordinary run of profit-seeking commercial corporations in the securities of a dissociated enterprise, prompted by expectation of profit from increase in the market value of the securities or from dividends. In the one case the securities truly represent property used in the business of the owner. In the other case they do not. The two diverse classes of investments should not be treated in the same way for income tax purposes. The injustice of the failure to differentiate is strikingly apparent in the case of investments of railroad corporations of a character which design to serve the public has prompted and public policy has encouraged.

Where the railroad ownership of the physical property has been direct the property is treated as "used in the trade or business of the taxpayer" and loss incurred by reason of its depreciation or disposition is deductible from ordinary income. Where the loss is incurred in the disposition of securities, it may now be deducted only as an offset against capital gains. Railroads seldom have such investment gains to account for.

We submit that the tax laws should be amended so as to provide for the exclusion of railroad investments of the type above described from the definition of "capital assets," to the end that for income tax purposes the legal fiction of separate corporate identity will not serve to visit an undue hardship upon the railroads.

Respectfully submitted.

PHILIP A. BENSON,
President, Dime Savings Bank of Brooklyn, Brooklyn, N. Y.
HENRY BRUERE,
President, The Bowery Savings Bank, New York, N. Y.
J. HAMILTON CHESTON,
Vice President, The Philadelphia Saving Fund Society, Philadelphia, Pa.
H. C. HAGERTY,
Treasurer, Metropolitan Life Insurance Co., New York, N. Y.
AUGUST IHLEFELD,
President, Savings Banks Trust Co., New York, N. Y.
ALFRED H. MEYERS,
Vice President, New York Life Insurance Co., New York, N. Y.
F. W. WALKER,
Vice President, The Northwestern Mutual Life Insurance Co., Milwaukee, Wis.
By F. N. O.,
Executive Committee, Railroad Security Owners Association, Inc.

STATEMENT OF MAURICE H. STANS, ALEXANDER GRANT & CO., CERTIFIED PUBLIC ACCOUNTANTS, NEW YORK AND CHICAGO

Mr. STANS. Mr. Chairman and members of the committee, my name is Maurice H. Stans; I reside in Kenilworth, Ill. I am senior partner of Alexander Grant & Co., certified public accountants, with offices in New York and Chicago. I hold certificates as a certified public accountant in the States of New York, Ohio, Illinois, and Wisconsin and have been engaged in the practice of public accounting for approximately 15 years.

The purpose of my appearance before your committee is to suggest the substantial modification or complete elimination of section 6 (c) of the "current tax payment act of 1943," commonly known as the "second windfall provision." Such legislation could feasibly and properly be accomplished as part of the technical refinements in the revenue bill of 1943 (H. R. 3687). The premise on which I make this suggestion is the fact that the operation of section 6 (c) works substantial inequities on certain classes of taxpayers, as I propose to demonstrate by illustrations based upon actual experiences known to me.

HISTORY AND DESCRIPTION OF SECTION 6 (C)

Section 6 (c) of the current tax payment act of 1943 was not in the original bill as reported by the House Committee on Ways and Means or as passed by the House. It first appeared in the bill as reported by the Senate Finance Committee and was retained when the bill was passed by the Senate. In the conference report which followed, the provisions of the Senate bill relating to section 6 (c) were adopted with some slight modification and became a part of the act as finally enacted.

The current tax payment act of 1943 was enacted for the purpose of placing the collection of income taxes from individual taxpayers on a current basis. It adopted, with some modifications, the idea of the so-called Ruml plan of forgiveness of 1942 taxes in order to accomplish that purpose. Section 6 (c), or the "second windfall provision" of the act, was designed to limit this forgiveness of tax in the case of individual taxpayers whose 1942 and 1943 incomes were substantially greater than those of the pre-war period. It imposed this forgiveness limitation by providing, in effect, that the maximum limit of forgiveness of tax liability would be an amount of tax determined by applying 1942 tax rates to the taxpayer's highest surtax net income in any of the certain pre-war years (1937, 1938, 1939, and 1940) increased by $20,000.

This "second windfall provision" was presumably designed to prevent an apparent advantage to taxpayers whose incomes in 1942 or 1943, by reason of the war, were substantially greater than in any of the pre-war years. The conference report cites an illustration of an individual whose surtax net income was $5,000 in his highest pre-war base year but whose surtax net income for 1942 was $30,000, composed entirely of dividends and interest.

EXPERIENCES WITH SECTION 6 (C)

The actual experiences of some taxpayers under section 6 (c) disclose that it frequently will bring about an inequitable and unfair result. This is due to the fact that, in many cases, the taxpayers who

are subject to it are not holders of securities and through them the recipients of dividends and interest in extraordinarily large amounts, but are the owners of businesses under the proprietorship or partnership form.

The inference of section 6 (c), which limits the extent of forgiveness in cases in which incomes have increased substantially, is that any such substantial increase in income is abnormal and is a windfall, and that the taxpayer who has thus increased his income should be penalized under the forgiveness provisions in comparison with other taxpayers. This inference overlooks two vital circumstances affecting individuals in business as proprietors or partners:

(*a*) Business income of individuals, where resulting from participation in the war effort through Government contracts or subcontracts, is subject to renegotiation by the Government to enable it to recapture any excessive profits. In the renegotiation proceedings there is developed a standard of measurement of reasonable profits, depending on such factors as the extent of risk assumed by the contractor, his developmental and engineering accomplishments, the nature of his performance, and in general, his over-all contribution to the war effort. As a result of this individually determined standard, the contractor-taxpayer is permitted to retain a reasonable net income for his services performed or products delivered.

(*b*) Business income is subject to many factors of fluctuation apart from any connection with the war effort. It is subject to many possible changes of character from one year to another. An inventor may spend many years in working out a development on which his ultimate returns in 1 or more years may seem to be relatively large. An individual may change from the status of an employee working for a salary to that of an entrepreneur, risking capital and assuming much greater responsibility, under which he is normally entitled to a larger return. The owner of a business may spend years in the long, expensive process of developing a product, or a market for a product, or in expanding a field of service, in the expectation of more substantial returns ultimately.

In the cases under (*a*), to regard such renegotiated "reasonable" profits as a windfall is manifestly contradictory. In the cases under (*b*), to ignore the logical evolution of business effort, especially for the smaller business, is to put a supertax on ability, invention, and ambition. It is clearly unfair to segregate such taxpayers for special discriminatory treatment, as against others patently less worthy of consideration. Equity would be served by the elimination of section 6 (c) in all such cases. This is true no less here in the case of individual business incomes than in the case of corporate incomes, for which special relief is granted under section 722 of the Internal Revenue Code in corresponding circumstances (though for a different purpose).

ILLUSTRATIONS OF INEQUITY

In contradistinction to the illustration in the conference report of an individual whose surtax net income increased from $5,000 in the base year to $30,000 in 1942, composed entirely of dividends and interest, there are cited three actual cases of the application of section 6 (c):

Case I: Taxpayer A is an inventor. In 1936, with extremely limited resources, he acquired the assets of a defunct airplane company

and endeavored to apply his inventive knowledge to the development of various improvements in airplane construction. One of such products was a tail wheel for light planes which he began to market about 1940. All his time was devoted to this and to other engineering research in connection with aircraft, operating as a solo proprietorship. His business profits, prior to 1940, were extremely negligible. In 1940, as a result of the success of the tail wheel and other of his items, his sales level increased to the point where his profit was over $15,000. In 1941, the Army Air Forces, in recognition of his special abilities, gave him a number of Government contracts which ultimately increased his sales volume manyfold. Some of these were contracts in which it was necessary for him to solve intricate engineering problems and to devise ways of performing difficult functions, such as the perfection of certain types of pontoons and the adaptation of plastics to cockpit enclosures. His success in accomplishing these objectives made possible the attainment of a profit level of over $100,000 in each of the years 1942 and 1943. Naturally, this result was not accomplished without a tremendous mental and physical exertion and the devotion of practically all his waking hours to the solution of the problems involved. A large contributing factor was his ability to build and train, in a very short time, an organization of persons qualified to meet the requirements of the Army Air Forces on these specialized problems.

Senator WALSH. Was it not the result of the war effort?

Mr. STANS. The income was the result of the war effort.

Senator WALSH. If it had not been for the war he would not have gotten that income.

Mr. STANS. I am not certain what his income would be. No one could know, Senator.

The extent, if any, to which his 1942 or 1943 profits will be reduced by renegotiation is not now known. However, if the renegotiation authorities determine the amount which constitutes a reasonable return for the effort, skill, and inventive genius which has been applied, it would certainly seem to be unfair that the results accomplished should be penalized in comparison with other taxpayers by the application of the "second windfall provision."

Case II: Taxpayer B was, prior to 1941, an employee of secondary rank in a retail merchandising business, working on a salary. In 1941 his employer died. By committing himself for substantial amounts on loans, selling securities, and mortgaging his farm, taxpayer B was able to accumulate funds to purchase the business from the estate of his former employer at the beginning of 1942. As a result of his provision of capital and his assumption of risks and responsibilities, his income increased substantially in 1942 and 1943. Very clearly the comparison of these years with the pre-war years under section 6 (c) is not a proper one because of the very material change in the conditions which produced the income.

Case III: This case involves a story of four French patriot brothers, two of whom were in the United States at the time of the fall of France and two of whom came from France shortly thereafter. They were the principal stockholders of a French corporation manufacturing electrical resistance welding machines under a process

which was invented by one of the brothers. These machines were in great demand by American aircraft factories because they employed principles in welding of aluminum and light alloys different from those of any other machine. The two brothers who were in the United States at the time of the fall of France were here to assist in the placing and operation of such machines for aircraft production.

When the four brothers were reunited in the United States, they attempted for a brief time to carry on the business of the French corporation under an operating arrangement with an American manufacturer. Shortly thereafter, upon advice of counsel, they divorced themselves from the French corporation and formed a partnership to manufacture their welding machines to make them available to manufacturers of aircraft in this country. The business made an outstanding contribution to the war effort, as evidenced by the fact that it is estimated that approximately 80 percent of the welding on airplanes is done by these machines. Various agencies of the United States Government have interested themselves in this case from time to time and have assisted the brothers in various ways because of the remarkable results which their machines, and no others, are able to produce.

In order to fulfill the demand for their equipment for vital war production, the brothers have committed themselves for the purchase of a large manufacturing plant and the necessary equipment. This was done without any Government financial aid, although assisted by bank financing under a Regulation "V" loan. They have invested $500,000 in plant and equipment, of which about $200,000 is represented by a purchase mortgage, and are carrying $600,000 in inventories for current production.

Under the tax laws in effect at the time of the making of these commitments, they were logical and practicable; admittedly, the delay of a year in paying income taxes afforded a means of financing without which the project could not have been carried out on the required scale.

The subsequent enactment of the Current Tax Payment Act of 1943, requiring current payment of taxes, imposed a serious squeeze on this position, particularly because of the impact of section 6 (c). Inasmuch as the first two brothers who were in the United States were here on a visitor's visa, they received only nominal compensation from the French corporation for their services here. The other two brothers arrived in the United States in October 1940. The result was that the income to the four brothers in 1940 was very small in relation to their normal incomes and such portions as are recognized under the tax law as being earned in the United States represented only a portion of their actual 1940 earnings. There is no provision in section 6 (c) for annualizing this pre-war earnings credit in computing the "windfall" adjustment, or for considering the earnings from services out of the United States.

It happens, incidentally, that the contract renegotiation law has now tightened this squeeze, particularly in view of the Income Tax Unit's ruling known as I. T. 3619. In 1942, due to the remarkable character of, and great demand for, their welding machine, the sales were large

and the business realized a profit of about $585,000 which was allocated equally between the four brothers as partners. The renegotiation proceedings resulted in an agreement to refund $125,000 of such profits. According to I. T. 3619, this amount must be paid by the end of 1944 in order to permit a recalculation of the tax liability for 1942 and a credit against the "windfall" taxes thereunder. This results in a situation in which the partners will be required to pay in 1944, in taxes and in renegotiation, an amount equal to and possibly greater than the total net income of the business. The renegotiation authorities are sympathetic to the partnership's position, and conceivably an arrangement might be worked out with them which would extend the renegotiation payments for several years. If that were done, the income tax credit would be lost entirely under I. T. 3619, and the partners would then probably pay as much in income taxes and renegotiation payments over the next three or four years as they could earn. If the 1944 rates proposed by the Secretary of the Treasury were enacted, the situation would become even more impossible.

For the purpose of presenting this case, detailed figures are not considered necessary here but basic data is presented in accompanying schedules. It is clear that unless some amelioration of the present statute is found to be possible, these four brothers who have made such an outstanding contribution to the war effort will be deprived of all reward for that effort and will face bankruptcy after the war. Incidentally, they have all applied for naturalization and have received their first papers.

SUGGESTED AMENDMENTS

The latter and somewhat more dramatic case of the four French brothers would initially suggest that equity might be provided by an amendment to Section 6 (c) providing, for example, recognition of pre-war income earned outside the United States, in determining the limitation upon the forgiveness of tax. It might also suggest, without providing any particularly effective solution, that income earned in a base year by a taxpayer employed or occupied or in business during only a portion of such year might be annualized.

However, it seems to be a fair and logical conclusion that Section 6 (c) may not be serving the purpose for which it was originally intended and that it should be substantially amended or eliminated. If it is not to be eliminated, then certainly it should be proper that it be amended to exclude its application to cases in which the income is realized from business profits through a proprietorship or partnership, especially when such business profits result from war production which is subject to renegotiation. Other relief provisions possibly should be devised to recognize modifying facts in cases of inventive profits, changes in circumstances, et cetera.

It is probable that the amount of income taxes which could be realized through Section 6 (c) as it now stands is extremely small in the aggregate. If these illustrations are found to be representative, its repeal seems desirable in order to avoid inequitable and discriminatory effects upon the few taxpayers to whom it does apply.

(Mr. Stans submitted the following tables:)

COMPUTATIONS ILLUSTRATING CASE III

This is a partnership consisting of four brothers, each having an equal interest in ownership and profits. The following computations of tax position of one of the brothers is representative of that of each of the other three:

I

Surtax net income for highest pre-war year 1940 (three months in United States) $9,400
1939-8-7 ..... None

II. Computation of unforgiven portion of 1942 tax under "Current tax payment act of 1943" (partnership net income $585,000 before renegotiation; renegotiation refund $125,000)

	Before renegotiation	After renegotiation
Surtax net income (distributable share from partnership)	$146,000	$114,750
Total 1942 tax (less than tax for 1943)	104,400	77,900
Less 25 percent thereof not forgiven	26,100	19,475
75 percent forgiven	78,300	58,425
Less tentative base period tax (based on surtax net income of $9,400)	12,600	12,600
Windfall tax	65,700	45,825
Plus 25 percent of 1942 tax not forgiven	26,100	19,475
Total unforgiven tax for 1942	91,800	65,300
Payable at following dates, under options:		
Mar. 15, 1944	13,100	9,800
Mar. 15, 1945	29,500	21,300
Mar. 15, 1946	16,400	11,400
Mar. 15, 1947	16,400	11,400
Mar. 15, 1948	16,400	11,400
Total	91,800	65,300

III. *Computation of amounts payable in future years, before 1942 renegotiation settlement*

	1943	1944	1945	1946
Estimated partnership net income	$800,000	$800,000	$400,000	$400,000
Distributable share, one-fourth	200,000	200,000	100,000	100,000
Current year's tax	158,600	158,600	67,600	67,600
Balance of 1942 tax under sec 6 (a)		13,100	13,100	
Additional tax under sec. 6 (c)			16,400	16,400
Total	158,600	171,700	97,100	84,000

IV. *Computation of amounts payable in future years, after 1942 renegotiation settlement, payable in 1944*

	1943	1944	1945	1946
Estimated partnership net income	$800,000	$800,000	$400,000	$400,000
Distributable share, one-fourth	200,000	200,000	100,000	100,000
Current year's tax	158,600	158,600	67,600	67,600
Balance of 1942 tax under sec. 6 (a)		9,800	9,800	
Additional tax under sec. 6 (c)			11,400	11,400
Renegotiation payments, 1942		31,250		
Total	158,600	199,650	88,800	79,000

Senator WALSH. In the case you cited, did these partners receive a substantial income when they were in foreign countries?

Mr. STANS. Yes.

Senator WALSH. It seems some allowance ought to be made to them.

Mr. STANS. The figures are not available because the books are in the hands of the enemy, but we have information that they are very responsible people; they had four manufacturing plants in France and one in England before the war.

The CHAIRMAN. When is the second windfall-tax liability due?

Mr. STANS. It is to be paid at the request and option of the taxpayer in four payments beginning in 1945, 1946, 1947, and 1948.

The CHAIRMAN. So it is not an immediate problem to the taxpayer. He has got to take it up in 1944.

Mr. STANS. It becomes an immediate problem in this case because of the renegotiation payment, which must be paid in 1944 in order to get the tax benefits.

I have a letter that illustrates the nature of their work from the Office of Production Management to the Honorable Cordell Hull, Secretary of State, which I will submit for the record.

(The letter referred to is as follows:)

OFFICE OF PRODUCTION MANAGEMENT,
Washington, D. C., January 29, 1941.

The Honorable CORDELL HULL,
Secretary of State.

SIR: My friends, David Crawford, president of the Pullman Co., and C. A. Liddle, president of the Pullman Standard Car Manufacturing Co., have informed me that they are manufacturing for Sciaky brothers the Sciaky electric resistance welding machine, which the aircraft builders of the country are now using and for which there is a great demand. I have seen some of these welding machines operating in the Glenn L. Martin plant, and I am somewhat familiar with what they can do.

I am informed that these machines greatly speed up the building of aircraft parts to a remarkable extent, and that the product is even superior to parts which are built with other standard practices, as, for example, by riveting.

The Pullman Co. is anxious to go ahead and invest very substantial sums of money in factory, plant, and equipment, so that they can produce more of these machines to satisfy the actual demand of the aircraft industry, but they feel that they should not do this until they can be assured that the four Sciaky brothers, David, Sam, Mario, and Maurice, are permitted to remain in this country on a permanent basis. They are here now on visitor visas, and, therefore, they may be forced to leave the country almost any time. The Pullman officials themselves—and they advise us that the aircraft producers are of the same opinion—say that the engineering knowledge and scientific experience of the Sciaky brothers is absolutely essential to the prosecution of the building of these welding machines and their servicing in the hands of the aircraft builders. They know of no other engineers in the United States whose knowledge and experience in this field are at all comparable to these men. It happens that all of them are in this country as Greek nationals, by reason of the fact that at the time of their birth their father and mother were living in Salonika, Greece, where the father was an office official of a French corporation. The family for many generations has lived in France, and these brothers have for many years been residents of France.

In addition to the Sciaky brothers, there is Jaimes Caraaso, who is also an important official with the Sciaky Co. He is in the country as a Spanish national and should also be included.

I understand that the Army and the Navy are making a request to you, and I wish to join them in urging that in the interest of the national defense program these men be permitted to have immigration visas so that they may become citizens of the United States, which I understand is their intention.

Respectfully,

MERRILL C. MEIGS,
Director, Aeronautical Section.

The CHAIRMAN. Thank you very much, Mr. Stans. The committee notices a number of witnesses here on the luggage tax and the handbag tax. If those who desire to appear can consolidate their statements in the afternoon it would be of help to the committee. We will reconvene at 2:30.

(Whereupon at 12:06 p. m. the committee recessed until 2:30 p. m. of the same day.)

AFTERNOON SESSION

(The committee reconvened at 2:30 p. m., upon the expiration of the recess.)

The CHAIRMAN. The committee will be in order. The other members will be here as soon as they have finished voting, unless they are called right back on another vote.

Mr. Withers.

STATEMENT OF DR. WILLIAM WITHERS, REPRESENTING UNION FOR DEMOCRATIC ACTION

The CHAIRMAN. What is the point you wish to speak to, Mr. Withers?

Dr. WITHERS. I want to speak to the general character of the House bill as passed.

The CHAIRMAN. All right, sir. Will you please indicate your name, your address, and connections?

Dr. WITHERS. My name is William Withers; I am an associate professor of economics at Queens College. My address is 399 East Fifty-second Street, New York City. I am representing the Union for Democratic Action, which is located in New York City.

The CHAIRMAN. I am sorry I will have to ask you to proceed, although the other members of the committee are not here, but they will be here during the course of your statement.

Dr. WITHERS. I am appearing to present the recommendations on the revenue bill which have been formulated by the Union for Democratic Action. The Union for Democratic Action is a liberal organization with membership throughout the country. I have reason to believe that the position taken by it upon tax questions is the position of many thousands of progressive-minded citizens throughout the United States.

On November 11, 1943, eight groups submitted a similar tax program to the House of Representatives. These were the C. I. O., the National Farmers Union, the Brotherhood of Railroad Trainmen, the National Association for the Advancement of Colored People, the National Women's Trade Union League, the League of Women Shoppers, the Consumers Union, and the National Lawyers Guild. The American Federation of Teachers, of which I am a member, advocates a similar program. I am inclined to believe that the proposals which I shall submit on behalf of the Union for Democratic Action are the most representative of progressive opinion that can be found. I would even venture to say that millions of taxpayers would share these views.

The unique feature of the Union for Democratic Action is that it typifies progressive opinion of both labor and middle-class origins. It is a group free from political party control or influence, which centers its activities on matters of critical concern to progressive Americans of all party affiliations.

Liberal policies concerning the collection of tax revenue in 1944 are concerned with the total amount of tax revenue and the methods of taxation. Although these two aspects of tax policy are interrelated, they are separated in this statement for purposes of analysis.

Secretary Morgenthau suggests that Federal tax laws be revised upward to provide for an addition of $10,500,000,000. This proposal is based primarily upon the assumption of an inflationary gap of 42 billions. This amount is obtained by subtracting the anticipated value of consumption goods in 1944 of eighty-nine billions, and the anticipated tax revenue from personal taxes of twenty-one billions, from the estimated national income payments to individuals of one hundred fifty-two billions. Whatever the size of the inflationary gap, we believe that it will be large enough to require additional taxes to absorb part of the excess purchasing medium in order to reduce inflation. The size of the gap could be diminished either by an increase in the quantity of taxation or by reduction in the size of the budget.

It is recommended that instead of a tax addition of $10,500,000,000, an attempt be made to obtain an additional $8,000,000,000. It is assumed that the budget of 106 billions can be cut considerably. Some Congressmen believe that the reductions in expenditures can be as high as 8 billions without reducing the efficiency of the war effort. Whatever the size of these budget reductions, however, they must not be made by cutting necessary welfare expenditures. The renegotiation of war contracts, reduction of personnel in some of the emergency agencies, reduction of Army and Navy construction projects, and the release of admittedly excessive Army and Navy supplies can provide sizable budget reductions from the 106 billions proposed in 1944.

Although the recommended 8 billions of additional taxes may cover only a relatively small part of the inflationary gap, it will assist the efforts of the Federal administration in "holding the line" against inflation. It is our belief that main reliance for the prevention of inflation must still be placed upon adequate price control. If the Roosevelt administration could strengthen price control enforcement much more would be accomplished than through an increase in taxes.

It is apparent that we have now reached a point where further tax increases may not prevent inflation. In the first place, an attempt to add to the burdens of taxpayers in the lower income brackets is already leading to corresponding increases in wages, whether the taxes take the form of income or excise taxes. Persistent demands for higher wages will be stimulated by higher taxes at these levels; in the second place, in view of the opposition to further taxation, there cannot be an increase sufficient to eliminate a large inflationary gap. These considerations lead us to believe all the more strongly that chief reliance must be placed upon price control mechanisms.

The development of strong antitax attitudes, particularly among those who have fixed incomes and are in the lower income brackets, may

lead to the same tendency toward the fascism which inflation is supposed to cause. The point has now been reached where further increases in taxation on lower incomes may prove more dangerous in this respect than inflation.

The Union for Democratic Action continues its opposition to the use of the sales tax. We do not believe that the sales tax can collect enough money to close up the inflationary gap. A 10-percent tax will probably yield less than seven billions. It will also set in motion tendencies which are essentially inflationary. Sales taxes are added to costs of production and thus increase prices. They tend to cause the inflation which they are supposed to prevent. Apart from inadequacy as means of inflation control, sales taxes are extremely unfair taxes, especially when the rates are as high as 10 percent. We support the contention of Randolph Paul that the burden of sales tax of 10 percent may be three times higher on the incomes below $2,000 than on incomes above $10,000.

Chief reliance should be placed upon the personal income tax in the collection of the eight billions proposed. In the main, we support the recommendation of Secretary Morgenthau concerning the increase in income tax rates, particularly upon gross incomes above $5,000. We do not, however, favor the reduction in the personal exemptions proposed, preferring to retain those now in effect ($1,200 married; $500 single.) We believe also that the rates of the income tax should be increased in the levels of gross income from $3,000 to $5,000. Certainly the rates below $3,000 should not be increased. It is our belief that if the rates between $3,000 and $5,000 are increased by about 20 percent and the rates below $3,000 are maintained at their present levels, at least $5,000,000,000 additional revenue could be obtained through the revised rates proposed by Secretary Morgenthau.

These recommendations concerning income tax rates make us vigorously oppose the addition of 4 percent of the normal tax rate which has been passed by the House of Representatives to compensate for the repeal of the Victory tax. Such an addition to the normal tax rate is grossly unfair to the lowest income groups.

We favor the changes recommended by the Treasury Department in corporate income taxes, which involve an increase in the rates from 40 percent to 50 percent. We do not believe that the present level of corporate taxation is too high, or threatens the ability of corporations to build up adequate reserves for post-war reconstruction. Corporate earnings after payment of taxes have increased in spite of the large increase in corporate taxation since 1941. The Treasury estimates that at least 11,000,000,000 of reserves have been accumulated by corporations since 1941, over and above taxation.

We support the increase in rates in estate taxes proposed by the Treasury Department. It would seem that one of the best methods of coping with war profits is to prevent their inheritance.

We also support the Treasury Department in its proposals concerning the increase in the rates of the excess-profits tax and recommend that every effort be made to reduce the tax loopholes which have been developed in connection with this tax. Maximum rates of 95 percent recently proposed by the House Ways and Means Committee should be supported.

We do not think the increases in rates in most luxury excise taxes proposed by the Treasury are excessive. It is probable, however, that some study should be given to the effects of these increases upon tax evasion. This is particularly pertinent in the case of liquor taxation. Experts in these fields have warned us that if the rates are so high as to reduce the yield because of tax evasion, they should be reduced. We do not believe, however, that any of the rates are so high as to prove unfair to the industries and products involved. It is possible that rates for admissions, transportation, jewelry, and furs should be even greater than the 30 percent proposed by the Treasury. In view of the large attendance at theaters and the excessive growth of transportation, even higher rates might prove effective as a means of restricting the use of these facilities during wartime.

Additional tax revenue can be obtained by removing exemptions now allowed to holders of Government securities. It would be desirable to use the war emergency as a means of emphasizing the unfairness of this type of tax exemption. The tax losses from this source should not be tolerated in view of the heavy tax burdens which the lower income groups must now bear.

As I stated at the outset, we believe that the above proposals represent progressive, modern labor and middle-class desires. It is dangerous to ignore continually the wishes of this large group of voters in the United States. Failure to pay attention to these groups in Germany in the period after World War I was, in my opinion, the major cause of fascism. Blind tax legislation puts class against class and creates a revolutionary atmosphere. I do not think that Congress can continue to ignore the wishes of the liberal middle class.

The tax bill as it was recently passed by the House of Representatives requires wholesale revision. It needs to be altered from foundation to roof—and this structural alteration has a first priority. Apparently the House of Representatives, guided by the Ways and Means Committee, had a guilty conscience, since they passed the bill under gag rule. Would our Congressmen have found themselves embarrassed either by a discussion on the specific features of the bill or by a roll call? If so, this is all the more shameful in view of the fact that the liberal groups that I mentioned at the outset pleaded for a discussion on the floor of the House of the specific tax proposals involved.

It will not be long now before progressive voters will be told that their Congress has unduly increased the tax burdens upon the low-income groups and particularly upon those with fixed incomes. For 2 years now, Congress has put up a magnificent bluff in which it has posed as the poor man's friend by defeating the National Association of Manufacturers' proposal for a general sales tax. At the same time, it has so broadened the income tax base and increased the lower tax rates that the burdens have been increased on these low income groups in a degree exceeding the wildest dreams of the National Association of Manufacturers. Net taxable incomes from zero to $500 are now taxed at 19 percent. In the beginning only a 5 percent general sales tax would have hit these taxpayers and certain exemptions for food

and necessities were being proposed. It will be an unqualified outrage if this Congress, after defeating one of the most unfair taxes ever placed upon the statute books of the United States, the Victory tax, reenacts it through a shameful camouflage by increasing the normal tax rate from 6 to 10 percent. But the House of Representatives has done this very thing through its voice vote, with no discussion.

Reputable tax authorities pointed out some years ago that even in 1937 individuals with incomes of $1,000 or less were paying out 25 percent of their total incomes in taxes: Federal, State, and local. The middle income brackets were paying two-thirds to one-half of this percentage. In spite of these extreme burdens upon the low income groups, we have gone merrily ahead, increasing the burden on the poor, though in 1937, these income receivers of $1,000 or less were not paying a cent of income tax.

Misinterpretations of statistics supplied by the Treasury Department are considerably to blame for this situation. The Treasury has rightfully pointed out that four-fifths of the national income is received by individuals who have $5,000 or less annual income. What has not been pointed out, however, is that most of the increases in personal income which have occurred since we began to prepare for the war are to be found between the brackets of $2,000 and $5,000. In fact, incomes below $2,000 have in some cases actually declined in absolute amount since 1941. To say that four-fifths of the income is received by those with $5,000 or less does not justify increasing the burden upon those with incomes below $2,000 by two or three hundred percent.

The root of all inflation is government evil. I am inclined to ask whether we must wait 100 years for the achievement of four important objectives which have been the subject of almost frantic clamor by progressives since 1941. First, how long are we going to have to wait for an adequately planned and economical war budget, the major features of which can be revealed to the general public without exposing military secrets? The excuse of military secrecy blankets a lot of sins in our Government today. There is no doubt, in my opinion, that we do not need a war Budget of a hundred billion dollars. There is no doubt that it is the inflation of this Budget which causes the inflation of prices. After 2 years of war we still have in this country scandalous hoarding of material and manpower. It seems sometimes that the war Budget is stretched primarily for the purpose of allowing excessive accumulation of inventories of raw materials and new machinery by war plants, which may come in handy after the war is over. To bring the matter closer to home, there is no doubt in my mind that there is excessive hoarding of manpower by some of the largest war agencies of the Federal Government. At the same time that these agencies are keeping large numbers of people on their staffs without "full employment," they are being hampered by the Bureau of the Budget in the collection of data on consumer expenditures or in devoting their energies to price enforcement, both of which are critically needed at the present time.

Second. How long are we going to have to wait for a national emergency that will be sufficiently critical to extirpate that age-old evil of

American public finance, tax exemption of State and local securities? Even a struggle that threatens the very life of our political institutions seems not important enough to prompt Congress to face this issue.

Third, how long are we going to have to wait for an honest attack upon the many loopholes through which thousands of dollars of Federal taxes are still lost? These loopholes are so well known that elementary school students are now finding them in their curriculum for discussion. How absurd to think that every schoolboy will soon know and be drilled in "tax loopholes" in his country's tax system. There are the invested capital method of estimating excess-profits tax liabilities, separate returns of husband and wife, the use of the trustee device, and many other methods. And at the same time that we talk about raising the pay-roll tax rates for purposes of restricting income, we allow certain States, under the Social Security Act, to reduce the tax rates for their unemployment funds—our sole concrete preparation for post-war unemployment. Truly there are some skeletons in the tax closet that we might be able to cash in on. How many machineguns and jeeps would our tax loopholes buy?

Fourth, how long do we have to wait for the complete, final, and deep burial of the sales tax as the major device to prevent inflation? In 1942, I challenged the House Ways and Means Committee to submit a questionnaire to 100 recognized tax experts in the United States on the advisability of adopting a general sales tax as the means of preventing inflation. I predicted that if this were done, it would be found that 95 out of the 100 tax experts would oppose the use of this device. So far as I know, no such questionnaire was ever sent. I think the reason is obvious.

Most Congressmen know that tax experts who have devoted long years of study to this question are completely skeptical as to the usefulness of a sales tax as an inflation preventer. The arguments against it have been repeated a hundred times. The sales tax taps inflation-producing incomes unfairly; it is unfair to persons, localities, and industries. The sales tax taps these incomes inefficiently. Since the cause of inflation is an increase in net incomes, the only efficient way to siphon off this income is through a net income tax. The sales tax, particularly if it provides for exemptions, is difficult to administer and would add unduly to the administrative burdens of a much overburdened Treasury Department. The sales tax directly causes inflation by causing prices to rise. It is added to the cost of production and it is shifted to the consumer through higher prices. The sales tax is not, as many suppose, the only device through which all people may be made to support the war effort. All people were paying taxes long before the sales tax was proposed as a war measure, whether they knew it or not.

In summary, I think that the Senate could perform a notable public service by revising completely the tax bill as it has come from the House of Representatives. Above all, I would urge that the Senate not pass the increase in the normal income-tax rate from 6 to 10 percent. Let's stop putting a guilt complex about the war on the low-income groups by insisting that they pay for it.

The CHAIRMAN. All right; we thank you.

Mr. Underwood.

STATEMENT OF I. J. UNDERWOOD, REPRESENTING THE OKLAHOMA NATURAL GAS CO.

Mr. UNDERWOOD. Mr. Chairman and members of the committee, my name is I. J. Underwood; I am a practicing attorney, residing at Tulsa, Okla. I appear here for a client of mine, the Oklahoma Natural Gas Co., a typical natural gas company, relatively small as compared to many others, engaged in all phases of the natural gas business in the State of Oklahoma. It has no interstate lines and no interstate business. It is engaged in the production of natural gas, in the transmission of that gas through pipe lines belonging to it to markets, and in the distribution and sale of natural gas. It likewise purchases large volumes of the natural gas itself.

I appear also on behalf of the entire natural gas industry.

I am in a position today, in appearing before this committee, of contentment. The Ways and Means Committee of the House recognized the plight that natural gas companies were in on account of the burdensome effect of excess-profits taxes as applied to the income that arises from abnormal and excess output of gas in order to support war activities and war industries. That is a component part now of the Revenue Act, beginning on page 57, section 208.

In other words, gentlemen, recognition was accorded natural gas companies and the need for relief from the burdensome effect of excess-profits taxes on this type of income, similar and comparable in principle to the relief afforded in the 1942 Revenue Act under section 209 to the hard-rock mining industry and to the timber industry.

Natural gas occurs only in nature. It cannot be manufactured, and it cannot be reproduced. There is a finite supply of it in this country. It is an exhaustible and nonreplaceable product. When the natural gas reserves of a going company are dissipated or used up, that company has to go out of business unless it has the capital or can procure the capital to do new exploratory work for new reserves and build lines to them.

The substance of the provision that has been inserted in the 1942 Revenue Act is that one-half of the unit net profit, and the unit in the case of natural gas is 1,000 cubic feet—one-half of the unit net profit, multiplied by the excess send-out, or output, shall be relieved from the burden of excess-profits taxes. Not from straight income taxes or surtaxes, but from the excess-profits taxes.

The natural gas industry, of which my company is a part, was a very substantial and major source of fuel in this country prior to this war. About 36,000,000 people were served either directly or indirectly, wholly or in part, with natural gas for their fuel. These people were located in about 40 different States. It is not an industry that is confined strictly to the oil and gas-producing States.

Since the advent of this war its importance has been increased, because the war activities, the war camps, Army and Navy installations, and manufacturing plants called upon this industry to furnish additional supplies of fuel, and to the extent of its ability the industry has responded. There are literally thousands of factories, large and small, located throughout this country, that are using natural gas for fuel, engaged in war worrk. There are literally hundreds of Army

and Navy installations and related activities that are dependent upon natural gas for fuel.

There has been an increase, gentlemen, in the consumption of natural gas in the year of 1943, as compared to the base period defined in this act, of something like 40 percent. In other words, in the base period, which is from 1936 to 1939, the total consumption of natural gas in this country was two and one-third trillion cubic feet—astronomical figures in themselves; in the present year, which is almost ended, the consumption is three and one-quarter trillion cubic feet, and in all probability, in 1944, it will be three and one-half or three and three-quarters trillion cubic feet.

That means about this, that the natural gas companies in responding to this call are dissipating their known and existing reserves to which they have extended lines, and are shortening the useful life of these lines, converting their stock in trade into cash and having it confiscated by a 100 percent application of the excess-profits taxes.

I do not discount to any extent the dire need of the mining and timber industries for the relief which has been given to them, but I say to you, gentlemen, the natural gas industry has peculiar characteristics inherent in its business that makes it more entitled to the relief than these other companies.

The natural gas industry is the only industry that must construct the transportation lines by which its product is conveyed to market. Natural gas is something which cannot be sent by tank car, by railroad, by truck, or by ship, or by any other medium of transportation than the huge pipe lines that these companies must finance and build, in most instances with the support of the public, to the market.

Very strangely, and perhaps unfortunately, the big reserves of natural gas in this country are far removed from the markets where the big demand for the use of natural gas exists. The big reserves of natural gas as now known and as recognized by experts, are located principally in the Gulf Coastal Plain of Louisiana and Texas, in what is generally known as the Panhandle of Texas, in certain areas in the State of Oklahoma, and in the southwestern part of Kansas.

That natural gas is now being tapped and taken through these company-owned transportation facilities as far as twelve and fourteen hundred miles.

I want to show the committee, just to illustrate that point, if I may, a map of the United States, which has thereon the main natural gas trunk lines extending to the markets where the principal consumption exists. As I said, the main reserves of natural gas are in the Gulf Coastal Plain here in Louisiana and Texas, in what is known as the Panhandle of Texas, the extreme western part of Oklahoma and the southwestern part of Kansas.

Each one of these lines on here represents a major transmission line which has been extended to these reserves by the natural gas companies from the markets where natural gas is consumed. There are lines from twelve to fourteen hundred miles long carrying gas into the Detroit area, into the Chicago area, into the Minneapolis and St. Paul area, and interconnections into the Detroit area bring this gas also into what is known as the Appalachian area. Natural gas

is also conveyed from these fields to Atlanta and Birmingham; it is conveyed from West Texas fields as far as Phoenix, Ariz.

Millions upon millions of dollars are invested in these lines and the useful life of these lines is being shortened very appreciably by this excess send-out of natural gas. In other words, gentlemen, in the main, the natural gas industry has been financed, the building of these lines has been financed, upon a 15-year basis, where public financing was resorted to. Let us take as illustrative, a company that builds a line costing $45,000,000 to a big gas reserve. On a 15-year basis it must amortize the cost of that line through the sinking-fund method in 15 years. That is $3,000,000 a year. Now, then, if twice the amount of production is taken through as was contemplated at the time of the original financing, the life of that line necessarily is cut in two. That company will have a conversion of its extra stock in trade into cash which will be confiscated by the Government through the excess-profits taxes, and will never be able to pay off and discharge the indebtedness unless lightning strikes in some fortunate way.

The natural gas industry, too, gentlemen, is a regulated industry.

Senator MILLIKIN. May I interrupt, Mr. Chairman?

The CHAIRMAN. Very well.

Senator MILLIKIN. I don't see how lightning could strike in a fortunate way. You are dealing with a wasting resource, and once that gas is gone, it is gone.

Mr. UNDERWOOD. The only way lightning could strike in a fortunate way would be in the case of a discovery of a reserve a short distance beyond the existing line, of another large reserve of gas, and that is purely speculative.

Senator MILLIKIN. That rests on its own bottom.

Mr. UNDERWOOD. That rests on its own bottom.

Senator MILLIKIN. It requires separate exploration, separate financing, separate feeder lines to tap the existing lines, and it is not an act of God. I would say it is an act of business enterprise.

Mr. UNDERWOOD. That is right. I did not mean to convey the thought that natural gas companies and those who loaned their money to build these lines could depend upon that. If the life of a field is cut in two the natural gas company has but a line of pipe in the ground which it can put to no use.

Senator MILLIKIN. I would like to suggest that even if you found another field, in the way you are speaking of today, that also would be subject to this same premature dissipation and depletion to which you are referring.

Mr. UNDERWOOD. Exactly. We call that accelerated depletion on account of the war effort.

I want to make this point to the committee, too; this extra conversion of your capital and stock in trade into cash does not represent true excess profits.

The natural gas industry is a regulated industry, either through the action of State commissions or Federal commissions. It has been

given no bonuses for increased production. I know of no case where its rates have been raised. I know of many cases where the rates have been actually lowered since the commencement of the war. That has been the tendency in the case of natural gas companies since the war began, and of course no increase, no matter how well merited, could be put into effect without the approval of the Office of Price Administration.

If this amendment is kept in the bill, as it now exists, and that is all I am interested in, and I appear for these natural gas companies, they can face the future with some feeling of confidence. They will be permitted to retain some of this cash so that they can build up a cash reserve for the purpose of extending lines, making new discoveries, looping existing lines, building additional compressor stations and getting their gas to market in the interests of the general public and the war needs.

If this relief is not kept in the bill, then the natural gas companies will face, in my judgment, disaster after this war ends. They will have used up their gas and paid it all out in excess-profits taxes; they will have these idle lines or lines that are practically idle, and lines that can be put to no use without the expenditure of large amounts of capital, and all we ask, gentlemen, is favorable consideration of the amendment as has been written in the act by the lower house of Congress, after extended and controversial study.

I have, Mr. Chairman, a printed memorandum that I would like to put in the record for the purpose of making the record here more complete. It contains many additional reasons supporting the justice of this amendment that I have not enumerated here.

The CHAIRMAN. That may be done.

(The document referred to is as follows:)

MEMORANDUM OF THE NATURAL GAS INDUSTRY IN SUPPORT OF REQUEST FOR LEGISLATIVE RELIEF FROM DISCRIMINATORY AND UNFAIR APPLICATION OF PRESENT EXCESS PROFIT TAX LAWS

Submitted on behalf of the Natural Gas Industry by the persons named below constituting a special committee thereof: Norman Hirschfield, Chairman, Consolidated Gas Utilities Corporation; James Comerford, Gas Companies, Incorporated; Edward J. Farrell, National Gas & Electric Co.; W. E. Hix, Lone Star Gas Co.; F. W. Peters, Oklahoma Natural Gas Co.; F. B. Plank, Cities Service Gas Co.

I. STATEMENT OF RELIEF REQUESTED

The natural-gas industry requests that it be granted substantially the same relief from the discriminatory and unfair application of the excess-profits-tax law that was granted to the mining and timber industries by section 209 of the Revenue Act of 1942 (sec. 735 of the Internal Revenue Code). Under the provisions of section 200 producers of minerals and timber were granted complete exemption from excess-profits taxes on the net income attributable to the payment of bonus income by the Federal Government for increased production of "output" over a specified quota, and also were granted a partial exemption from excess-profits taxes on the net income, attributable to the excess output during the current taxable year as compared to the normal output. Normal output is defined as the average output during the taxable years beginning after December 31, 1935, and not beginning after December 31, 1939. The partial exemption is limited to varying specified percentages depending upon the relation of the excess or increased output to the recoverable reserves, and may at the option of

the taxpayer, be applied to (a) the average net income put unit during the 1936 to 1939 period multiplied by the number of units of increase output, or (b) one-half the net income attributable to the increased output during the taxable years as compared to the base period.

The relief requested by the natural-gas industry necessarily differs in some respects from that granted to the mineral and timber industries because of differences in modes of operation and circumstances affecting only the natural-gas industry. The principal differences are as follows:

(1) The natural-gas industry receives no bonus payments, for increased output, and therefore no relief comparable to that granted the mining and timber industries with respect to bonus income is requested.

(2) The natural-gas industry requests that the exempt excess output, and therefore the relief granted, be based directly on the increased output, without relation to recoverable reserves.

(3) The natural-gas industry requests that its optional relief provision comparable to that granted to the mining industry under section 735 (b) (2) be based on the increased net income per unit of excess output for the taxable year as compared to the base period rather than one-half of the net income per unit of excess output.

The natural-gas industry requests that the relief provisions applicable to it be made retroactive to taxable years beginning on or after January 1, 1942.

The natural-gas industry does not presume to advise the Congress as to the exact form and language of relief legislation, but is including herewith, beginning on page 4 of the appendix, a draft of suggested amendments, which is offered as a suggestion of the kind of relief needed.

II. Statement of Facts

1. THE NATURAL-GAS INDUSTRY IS A MAJOR ESSENTIAL WAR INDUSTRY

The natural-gas industry is one of the major fuel industries of the Nation. It is serving a population of more than 36,000,000 people in 34 States and the District of Columbia. The total marketed production of natural gas for the year 1942 was 3,014,000,000,000 cubic feet, and for 1943 is estimated to be 3,182,500,000,000 cubic feet (table 1, p. 1 of appendix). The present annual production has a fuel value equivalent to approximately 100,000,000 tons of coal or 425,000,000 barrels of fuel oil. The natural-gas industry now furnishes the fuel and heating requirements of many thousands of plants manufacturing war materials and of hundreds of military camps, reception centers, air bases, and other military establishments, the effect of which has been to strain to the limit the facilities of the industry to meet this abnormally heavy demand for the war effort, and the industry, without being permitted to make even normal expenditures for critical materials, is doing everything within its power to comply with the wishes, as well as requirements, of all war agencies.

The natural-gas industry is very definitely an essential war industry and is recognized as such by all war agencies. So important to the war effort is the natural-gas industry that on February 16, 1942, the War Production Board issued its Limitation Order No. L-31 (thereafter on November 12, 1942, amended) by the terms of which order each natural-gas company is required to "as far as practicable so operate its * * * facilities as to achieve maximum deliverability of natural gas in the area or areas in which a shortage exists or is imminent * * *" and authorizing the Director General for Operations to issue specific directions to natural-gas companies requiring them to pool their facilities and gas reserves so as to achieve maximum deliveries to war and other essential industries. Pursuant to the terms of Limitation Order L-31 the Director General for Operations has issued numerous directives requiring designated natural-gas companies to make deliveries of natural gas to other natural-gas companies without regard to the price which they are to receive for the same or the effect which such deliveries will have on their gas reserves. Directives of varying nature have been issued by the War Production Board, and, in some instances, companies have been required to deliver to competing natural-gas companies all of the gas which they can make available. In order to save natural gas for more critical industries and for industries which must, because of their fuel-burning requirements, use natural gas exclusively, Limitation Order L-31 also restricts,

and in many instances prohibits, the delivery of natural gas to new customers and increased deliveries to old customers, and, during periods of shortage, requires natural-gas companies to discontinue or curtail gas service to industrial and other consumers not considered essential to the war effort and to consumers who are equipped to use other fuels.

2. THE NATURE OF THE NATURAL-GAS INDUSTRY AND BASIC FACTS RELATING THERETO

The natural-gas industry is one of four major classes of industry engaged in the business of producing and selling an exhaustible natural resource. There are many problems and conditions peculiar to these industries, and each of them has its own difficulties not common to the others.

The natural-gas industry is certainly one of the most unusual and hazardous of all classes of business. It is probably the only industry that must constantly increase its facilities and investment to furnish the same amount of the same commodity to the same market. It is the only industry limited to one mode of transportation which must be furnished exclusively by that industry.

The natural-gas business differs materially from other classes of business. The merchant or manufacturer who increases his output will do so by increasing his purchases of merchandise or raw materials, but this does not affect his ability to purchase merchandise or raw materials in subsequent years. When natural-gas companies increase their output they must do so by using up a capital asset, their only stock in trade, an irreplaceable and exhaustible natural resource.

Natural gas is produced in 26 States from some 54,000 gas wells and additional thousands of oil wells in hundreds of separate and distinct fields. For the past few years an average of approximately 5 percent of the total number of gas wells have been abandoned each year, which indicates that the average life of gas wells is approximately 20 years. But the lives of many wells and many fields are much less than 20 years, and the lives of others are substantially greater. Different fields vary greatly in their size, volumes of gas and rock pressures, and different wells, even in the same field, vary widely in both their current and ultimate capacities to produce.

Gas supply problems differ greatly in different sections of the country, and even in different parts of the same State. But an adequate supply of gas is vital to the continued existence of every natural gas company, and conditions must be such as to make it economically feasible to build the necessary pipe-line facilities from field to market. The market cannot be moved; the product cannot be transported by rail or truck, but each company must build or depend upon transportation facilities constructed at great cost as gas can only be transported by pipe line.

Every gas well, when connected to a pipe-line outlet, declines in rock pressure and deliverability day by day and year by year until its ultimate exhaustion and abandonment. Therefore, to maintain adequate gas supplies even in normal times when the demand is fairly constant, many hundreds of wells must be drilled every year to replace the gas being currently utilized, and many compressor stations must be built to increase the deliverability from low-pressure wells. New fields must be and are being discovered each year, but many of them are found in areas where known reserves are now plentiful rather than areas of scarcity. The new fields may be close to existing markets or existing transportation systems, but many are far enough distant from both to require large expenditures in the construction of new pipe-line facilities. The size of the total proven reserves of the Nation offers little consolation to the company which is connected to a failing gas supply and unable to finance an expensive drilling campaign or the construction of pipe lines to a field having adequate reserves.

Every time a well is drilled, every time a new well is connected to a pipe-line system, and every time a well is abandoned, the expenditure of substantial sums of money is required. When new fields are connected the required expenditures are substantially greater, especially since the pipe in the old lines usually cannot be removed until the new lines are constructed, and old lines are never removed until the wells to which they are connected have declined in pressure to the point of abandonment. Thus, even in normal times the average gas company must constantly and continually make substantial expenditures in searching for new supplies of gas, rearranging its existing pipe-line systems, building additional compressing-station capacity, and constructing additional pipe lines to new sources of supply.

3. REGULATION AND CONTROL OF THE INDUSTRY

Practically all natural-gas companies are to some extent subject to regulation and control by the Federal Power Commission or State regulatory commissions, or both. Even during peacetimes regulated gas companies are limited to (but not assured) the earnings of a reasonable profit. Consequently their average earnings over a period of years tend to be below the reasonable-profit level. Now that war has come, the Office of Price Administration, through its power of intervention in regulatory proceedings, is seeking to limit or reduce regulated natural-gas rates; in addition, nonregulated gas prices (for example, for gas sold in the field or for gas sold to industrial customers in interstate commerce), are limited by the Office of Price Administration pursuant to the Emergency Price Control Act. Gas companies, therefore, are not likely to have increased profits through the medium of increased rates. Through the medium of increased sales volume, however, there is a resulting increase in their total earnings. Gas companies face the prospect of having such increased earnings wrongly designated "excess profits" under the present law, even where there is no increase in the profit per unit, and in spite of the fact that such increased sales directly reflect the exhaustion of their stock in trade, proportionately shorten the useful life of their facilities, and irrecoverably exhaust a substantial part of the total available supply of natural gas.

Where the peacetime sales prices of natural gas were fixed by regulatory commissions certain depreciation rates were presumably reflected in the determination, such rates being fixed on the basis of amortizing the facilities over the life of the natural-gas supply to which such facilities were connected, the life being computed at the peacetime rate of consumption. In view of the tremendous increase in the rate at which such gas supplies are being used up to promote the war effort, gas utilities will not be able to amortize their properties at peacetime depreciation rates without being called upon to pay wartime excess-profits taxes. Even if the natural-gas companies are partially relieved of wartime excess-profits taxes, they will still be in jeopardy of being unable to recover the cost of their properties out of earnings. Since the regulated price of gas does not contemplate any change in depreciation rates, and sales prices of gas are limited, it is impossible for gas companies to recover such accelerated depreciation.

4. INCREASED CONSUMPTION DUE TO WAR EFFORT

The total marketed production of natural gas, the amount consumed and the amount sold by natural-gas utilities have all increased very materially since the war started and the increases are continuing in 1943 at an accelerated rate.

The average marketed production per year from 1936 to 1939, inclusive, was 2,336,935,000,000 cubic feet, as compared to 3,014,000,000,000 cubic feet in 1942 and an estimated 3,182,500,000,000 for 1943. This represents an increase of 28.97 percent in 1942 and 36.18 percent for 1943. The average annual consumption for the years 1936 to 1939 was 2,332,855,000,000 cubic feet as compared to 3,006,100,000,000 in 1942 and an estimated 3,174,370,000,000 for 1943. This represents an increase of 28.86 percent in 1942 and 36.07 percent for 1943 (table 1, p. 1 of appendix).

Approximately 60 percent of the total natural gas consumed is sold by natural-gas utilities, with the remaining 40 percent handled exclusively by nonutilities. Utility natural gas sales have increased more rapidly than total marketed production and total consumption. The average annual utility sales for the years 1936 to 1939 was 1,269,686,000,000 cubic feet, as compared to 1,768,895,000,000 cubic feet in 1942 and an estimated 2,008,414,000,000 cubic feet for 1943. This represents an increase of 39.32 percent in 1942 and 58.18 percent for 1943 (table 2, p. 2 of appendix).

Increased sales of gas at the present time can only be attributable to the war effort, as the War Production Board's Limitation Order L-31, issued February 16, 1942, and amended November 12, 1942, and the difficulty in obtaining materials, effectively prevent expansion for ordinary civilian or nonwar purposes. More than 80 percent of the increased volume of natural-gas sales in 1943, as compared to the 1936 to 1939 period, is due directly and solely to the war effort.

The total estimated consumption of natural gas for 1943 is 841,521,000,000 cubic feet greater than in the base period of 1936 to 1939. This increase is divided as follows: Industrial, 75 percent; domestic, 17 percent; commercial, 8

percent. Nearly all of the increased industrial consumption is attributable to the war effort. This is due to the control exercised by the War Production Board over deliveries of natural gas, the fact that many war industries cannot use any other fuel, and the fact that industrial expansion is now confined to essential industries. In addition, by far the larger proportion of the increased domestic and commercial consumption is in cities and towns having a heavy influx of population by reason of war and essential industrial activity. Approximately 78 percent of the total natural-gas consumption is industrial consumption, including consumption by training camps and other military establishments.

5. EFFECT OF INCREASED CONSUMPTION ON THE INDUSTRY

Because natural gas is an exhaustible natural resource the increased consumption of natural gas materially shortens the productive life of existing connected gas reserves and the useful life of installed facilities used in transporting the gas to markets. It is axiomatic that when the withdrawals from any field are increased the productive life of the field is shortened at least proportionately to such increase. Also, too rapid production tends to flood sands by causing water encroachment, thereby losing otherwise recoverable reserves. The natural-gas industry is composed principally of many small companies who obtain all or a substantial part of their gas from one or perhaps several local or nearby small fields. The present abnormally heavy withdrawals are prematurely exhausting many hundreds of these small fields, and will also prematurely exhaust the larger fields. The natural-gas industry has been very fortunate in the past in that the oil industry has discovered practically all known gas reserves. This has saved the gas companies many millions of dollars and has enabled them to sell natural gas at comparatively low rates. But natural-gas reserves are now being exhausted at an alarming rate—much faster than under normal conditions, much faster than had been anticipated, and in many areas much faster than new reserves are being discovered.

The transportation systems of the industry must be expanded and enlarged to handle the constantly increasing volumes of gas required by the war effort. The industry must be in a position to adjust itself to wide variations in demand by having always at hand a production and delivery capacity equal to or in excess of the anticipated maximum demand, and, in addition, have this capacity so disposed that it may be instantly responsive to its consumers' requirements.

As a result of these facts the industry is faced with a very serious supply problem which can be solved only by a combination of (a) the drilling of many new wells; (b) the constant relocation of existing pipe lines; (c) the continual construction of new lines to new sources of supply; (d) the installation of more and more compressing station equipment, and (e) the replacement with larger sizes or looping of existing pipe lines to increase their capacity. Natural gas companies cannot continue to furnish gas at the greatly accelerated volume required by the war effort without very sharply increasing their expenditures for leaseholds, exploration, development, compressor stations and pipe lines.

6. DIMINISHING RETURN PER M. C. F.

Operating revenues of natural gas utilities increased from an average of $438,401,000 during the years 1936 to 1939, inclusive, to $583,025,000 in 1942, and are estimated to be $623,638,000 for 1943. This represents an increase of 32.99 percent in 1942 and 42.25 percent for 1943. On the other hand, the net profit per thousand cubic feet, after taxes, declined from 5.52 cents in the 1936 to 1939 period to 4.13 cents in 1942 and an estimated 3.86 cents for 1943. This represents a decline of 25.18 percent in 1942 and 30.07 percent for 1943 in the net profit per thousand cubic feet, after taxes, which will not permit the industry to make normal additions and extensions, much less abnormal and premature ones occasioned by its contribution to the war effort (table 3, p. 3 of appendix). The practical effect of the industry's contribution to the war effort is a certain piecemeal taking, without any compensation therefor, of its capital assets.

A part of this decline is due to a reduction in the average selling price of gas, but most of it is attributable to the increase in Federal taxes and the unfair application of the excess-profits tax. The net income after taxes will be about 10 percent greater in 1943 than during the 1936 to 1939 period, but this is due to tremendous reductions in interest requirements and certainly is not commensurate with the accelerated diminution of reserves caused by a 58 percent increase in withdrawals.

7. EFFECT OF EXCESS PROFITS TAX LAW ON THE INDUSTRY

If natural-gas companies are to continue in business, the next few years must see the expenditure of many millions of dollars for additional reserves and service facilities. The present depletion and depreciation allowances are supposed to make it possible for the natural-gas operator to retain funds to reinvest in exploration and development of additional reserves and to replace his transportation and distribution facilities when they are worn out. However, such allowances are entirely inadequate to provide funds for the discovery of the necessary additional reserves to continue the present greatly accelerated output, replace the present declining reserves, and rearrange and extend the transportation systems to take gas from new sources of supply. Exploration for natural gas is very expensive and difficult to finance because of its uncertainty. Existing natural-gas properties are nearly all heavily encumbered by bonded debt. By the terms of the bonds, retirement is required within the life of the available gas reserves, based on normal sales. When sales greatly increase, it follows that some provision should be made for accelerating payment of the debt, but excess-profits taxes would prevent this. Investors require substantially better earnings by natural-gas companies than by other classes of business when they invest in their securities and will not lend money on natural-gas properties without adequate reserves and assurance of payment within their life. The required expenditures must therefore be financed largely through earnings, and pre-war earnings were not sufficient for that purpose. Earnings cannot now be increased through the medium of increased rates. The present excess-profits tax laws effectively prevent the accumulation of sufficient earnings to finance the tremendous expenditures that lie ahead.

The natural-gas industry, including every part of it, is one of the most hazardous of all industries, and no natural-gas company can continue to live, even under normal conditions and much less during wartime, unless it can constantly build a reserve for future expenditures or regularly increase its equity in existing property and maintain a satisfactory earnings record so that it can borrow the money for the additional expenditures that are sure to come. It is impossible for the industry or any branch of it to protect itself in such manner under existing tax laws.

Under the circumstances the natural-gas industry has only two alternatives. One is to accept graciously the present discriminatory tax laws and thus passively permit the bankruptcy and extinction of many members of the industry. The other alternative is to call to the attention of the Congress the discriminatory effect of present tax laws and request that they be corrected by allowing a normal or reasonable profit per unit of output before the application of the excess-profits tax. The industry has chosen the latter course.

III. EXPLANATION AND ARGUMENT

1. PREFACE

Natural-gas companies are desirous of paying taxes on a basis comparable with other classes of industry and make this request for partial relief from discriminatory and excessively burdensome excess-profits taxes in good faith in the firm belief that they are equitably entitled to the relief sought; and in the firm belief that the war effort would be aided and the public welfare protected by the granting of their request. They do not ask to be relieved of any part of the normal income or surtax, or to be exempted from all excess-profits taxes, but request that the present excess-profits-tax law be corrected so that it will not burden them far more than it does taxpayers who do not derive all of their earnings from the recovery and marketing of exhaustible natural resources. They merely seek the right to retain a reasonable part of the earnings attributable to their increased business so that they will be able to finance the discovery and development of new sources of gas supply and to finance the construction of new pipe lines to such new sources of supply.

Natural-gas companies will continue to make their full contribution to the war effort, but they do not believe their efforts to aid in its prosecution should be the cause of their being forced out of business. They are not complaining about increased business. They appreciate such business so long as they can handle it, retain a reasonable profit therefrom, and not be doomed. In short, all that natural-gas companies ask is that they be permitted to live and to protect their own existence, and thereby continue to serve at reasonable rates the training

camps, war industries and general public that are accustomed to and dependent upon natural-gas service.

2. RELIEF HAS BEEN GRANTED TO OTHER NATURAL RESOURCE INDUSTRIES

Congress recognized the necessity of relief and wisely granted it to the mining and timber industries by section 209 of the Revenue Act of 1942 (sec. 735, Internal Revenue Code). It is not the intention of the natural-gas industry to base its aim for relief on the mere fact that relief was granted the mining and timber industries. It desires, however, to call attention to the fact that the justice of this request has been recognized and the relief granted under similar conditions in other industries.

Section 209 does not give preferential tax treatment to producers of minerals and timber, but its inclusion prevents what would have been unjust and discriminatory taxation of such producers of natural resources. The section is undoubtedly an aid to the war effort, and it most certainly will permit many small and some large corporations to continue to exist.

But why should such needed relief be granted to producers of only two kinds of exhaustible natural resources? Why should not similar relief be granted to natural-gas companies? There are many sound reasons why the Congress should have granted the relief given to mining and timber companies, but every reason is equally applicable to the natural-gas industry, and there are some additional reasons applicable to this industry that do not apply to the mining and timber industries.

3. A TYPICAL HYPOTHETICAL ILLUSTRATION

Consider a hypothetical but typical case of a natural-gas company with sufficient reserves on January 1, 1942, to deliver 1,000,000,000 cubic feet of gas per year for a period of 10 years, and which had an average output of 1,000,000,000 cubic feet a year in the base period at an average profit, before income and excess-profits taxes, of 5 cents per thousand cubic feet, with an excess-profits credit of $50,000. If during the taxable year it again had an output of 1,000,000,000 cubic feet, but at a profit of 10 cents per thousand cubic feet or $100,000, the additional $50,000, being more than the normal profit, would be treated as excess profits. To this we take no exception. If, however, in order to aid the war effort it increased its output to 2,000,000,000 cubic feet in 1942, making, however, only the normal profit of 5 cents per thousand cubic feet, or a total of $100,000, under the present law this normal profit of $50,000 on the increased output is treated as if it were excess profits and subjected to the 00 percent tax. If the company had produced the 2,0-0,000,000 cubic feet at a profit of 10 cents per thousand cubic feet, or a total of $200,000, there is no protest against treating the additional 5 cents per thousand cubic feet or $100,000, as excess profits. But the industry does protest the treatment of the normal profit per thousand cubic feet as if it were excess profits and subject to the heavy tax.

The above-mentioned typical company, with its existing reserves, would have been able in normal times to serve its market for a period of 10 years but, due to the war emergency and its effort to assist in its prosecution, the company would be doubling its output and thereby exhausting its reserves in 5 years, or one-half the time it normally would have taken, and would be permitted to retain only slightly more than half of its profit per thousand cubic feet that it normally would have retained. At the end of 5 years the company will be out of business unless it is able to discover and develop new gas reserves and construct the necessary pipe-line facilities to connect such reserves to its existing system. Under the present tax structure it is allowed only one-half the amount of credit against the excess-profits tax that it would have been allowed if its operations had continued at the normal rate of output, and it cannot retain any substantial part of its earnings for the replacement of gas reserves and extension and rearrangement of its pipe-line system. Merely because it has responded to the demand for all-out production and is exhausting its gas reserves in 5 years instead of the expected 10 years, it is said to have large excess profits even though it might make only the same 5 cents per thousand cubic feet that it was making before the emergency and must pay such a large portion of its earnings in excess-profits taxes that it may find it impossible to finance the necessary exploration, development, and construction necessary to keep it in business.

This illustrates the tremendous sacrifice that that present law requires natural-gas companies to make for giving their cooperation and assistance to the war effort. Natural-gas companies have done and will continue to do their utmost to

supply the increased demands for natural gas, but they ask that the tax law deal fairly with them and not penalize them for the cooperation and assistance they are giving.

If the relief requested by the natural-gas industry is granted, the above-mentioned typical company would not be required to pay any excess-profits taxes so long as the profit per unit, or thousand cubic feet, remained at the normal rate of 5 cents but would pay 40 percent income taxes on the normal profit of $50,000 and also on the increased profit of $50,000, or a total of $40,000 in taxes. Under present law this company would pay an excess-profits tax of 90 percent on the increased profit of $50,000 and an income tax of 40 percent on the normal profit of $50,000, or a total of $65,000 in taxes. However, increased output frequently produces an increased profit per unit. Assume, therefore, that the company given in the example has a profit of 10 cents per thousand cubic feet when its output is doubled and, in that case, the comparison of the taxes required to be paid under present law and those which would be paid under the requested relief provision would be as follows:

Under present law:	
Excess-profits tax $150,000, at 90 percent	$135,000
Income tax $50,000, at 40 percent	20,000
Total tax	155,000
Under requested relief provision:	
Excess-profits tax $100,000, at 90 percent	90,000
Income tax $100,000, at 40 percent	40,000
Total tax	130,000

The company would not receive an exemption from excess-profits taxes but would be permitted to retain an additional $25,000 of its earnings per year, which would total $125,000 during the 5 years of remaining life of the field. This additional $125,000 would in all probability mean the difference in its ability or inability to finance the necessary expenditures to enable it to stay in business. Actually, this is typical of the relief that is requested by the industry and is typical of the proportionate reduction in taxes that would be effected if the request of the industry is granted. The industry certainly feels such request to be reasonable.

4. RELIEF SHOULD APPLY TO ENTIRE INDUSTRY

The natural-gas industry urges that the relief requested herein be made applicable to the entire industry, including both utility and nonutility companies; that it apply equally to gas purchased and gas produced, and that it apply to the complete natural-gas operations of production, transportation, storage, and distribution.

The average natural-gas company produces less than half of its requirements and, therefore, purchases more than half of the gas delivered to the ultimate consumer. A majority of wells producing natural gas are owned by companies or individuals engaged primarily in other lines of business. The investment of the industry as a whole is approximately 10 percent in production property, 50 percent in transportation facilities, and approximately 40 percent in distribution equipment.

The purchaser of natural gas is in the same predicament when his source of supply is exhausted as the producer who transports his own gas to market. He must sooner or later obtain a new source of supply if he is to continue in business. The producer who sells his gas at the well head is penalized by the increased production due to the war effort but not to the same extent that the transporter or distributor is penalized. He does not have investments in other property 10 times as great as his production investment which will be lost, except for the salvage value, when his supply of gas is exhausted.

It is the owners of transportation and distribution facilities who are really hurt when gas reserves are exhausted. They have the obligation, both moral and legal, to discover or connect new reserves and deliver the gas so obtained to their customers. They must protect their heavy investment in other property by maintaining an adequate gas supply, with certain death or sacrificial sale the only alternative. Their business is probably the only one in the United

States which must constantly increase its investment and facilities in order to furnish the same amount of the same commodity to the same market. They must overbuild to a new field in order to have ample pipe-line capacity to transport the same amount of gas when the rock pressure of the field declines. They are usually required by State ratable taking laws to expend large sums of money to connect with and purchase gas from wells belonging to others in the same field under penalty of not being permitted to take any gas from wells owned by them in that field. They are the ones who are most unjustly burdened by the present inequities application of the tax laws.

The company owning only city distribution properties is also in a critical condition. Its source of supply may be a great distance from its market. It is dependent upon somebody else to furnish an ample amount of gas at the city gate, but if that supply fails the responsibility is definitely placed upon such distribution company to find a new source of supply, and perhaps build the necessary pipe-line facilities for transporting the gas to the cities served by it. Such company can, of course, convert to manufactured gas or build a manufacturing plant and serve mixed gas, but such plants are very expensive, both to build and to operate, and are not economically feasible except in large cities.

Natural gas has very little value at the well and is entirely worthless without a market. The relief given mining and timber companies permits them to include all operations necessary to market their product. Comparable relief to natural gas companies would require the inclusion of all operations, production, transportation, storage, and distribution, necessary to the marketing of gas. Any lesser relief would be discriminatory and inadequate.

5. OPTIONAL RELIEF PROVISIONS ARE NECESSARY TO AVOID DISCRIMINATIONS AS BETWEEN COMPANIES

Section 735 of the Internal Revenue Code relating to the exempt excess output of mining and timber companies contains optional relief provisions permitting them to obtain partial exemption on either the normal profit from the increased output or one-half the net income attributable to such increased output. Similar optional relief provisions are requested by the natural gas industry, and, unless they are granted, a substantial part of the industry would not obtain any relief at all. The first provision providing for the exemption of the normal profit from the increased output deals fairly with the companies which made a reasonable profit during the base period but would not grant any relief to companies—and there are many of them—which had a net loss during the base period.

The amount of excess-profits taxes payable by any company depends very largely upon its earnings during the base period. Natural gas companies, being subjected to regulation and control by regulatory commissions, were not permitted to make exorbitant profits during the base period, and the industry as a whole earned only approximately 4 percent on the total investment. The companies which had a net loss or very small profit during the base period are at a distinct disadvantage under the excess-profits tax law, as they are forced to use the invested capital credit and, because of low earnings, have not been able to build any sizable surplus upon which to base their excess-profits tax credit. Excess-profits taxes, therefore, hit such companies much harder than those with good earnings during the base period. It would certainly be an injustice not to include an optional provision which would permit such companies to obtain relief comparable with that given those who enjoyed good earnings from 1936 through 1939.

The natural gas industry therefore requests the inclusion of such an optional provision and requests that it be based upon the increased net income per unit of increased output rather than one-half of such net income per unit, as it is felt that the provision contained in section 735 relating to mining and timber companies would not give to natural gas companies which had very low or no net income during the base period equal protection with those which had reasonable earnings at that time.

6. POSSIBLE ADMINISTRATIVE RELIEF AND RELIEF UNDER EXISTING STATUTORY PROVISIONS IS NOT SUFFICIENT

It may be argued that natural gas companies do not need additional statutory relief because under existing law the Treasury Department may and will grant accelerated depreciation rates where the facts justify, and the present Internal Revenue Code contains various relief provisions designed to eliminate inequities

in the application of the tax laws. This argument is fallacious for at least four reasons:

(1) This is not a problem of accelerated depreciation.
(2) The present tendency of the Treasury Department is to reduce rather than increase depreciation rates.
(3) Administrative relief, even if granted, is unsatisfactory in that the taxpayer does not know until years after the close of the taxable year what depreciation rates will be applied, or what relief, if any, will be granted.
(4) Present code provisions for excess profits tax relief, while helpful and appreciated, are not of material benefit to the natural gas industry.

Accelerated depreciation alone cannot solve the problems of the natural gas industry. Depreciation is intended and can only be used to recover the investment in existing equipment when it reaches the end of its economic life. If the natural gas industry had only the problem of replacing existing equipment, it would not be asking for this relief. The problem is one of maintaining credit and providing funds for a greatly expanded and more costly system, including the construction of additional plant, plus the finding of new sources of natural gas supply even though the purpose may be merely to remain in the public service and to maintain the existing volume of business.

Take an actual example which is typical of the industry. A small company serving a city having a population of about 10,000 people formerly obtained all its gas through its own 8-inch line from a field approximately 30 miles south of that city. This field declined to the point where the gas that could be obtained and transported through that line was insufficient for its requirements. In the summer of 1941 the company was forced to build approximately 25 miles of new 6-inch line to another field northwest of the city to augment its gas supply. The original 8-inch line was not removed and probably will not be for several years. Accelerated depreciation on the 8-inch line would not have solved that company's problem and would probably not have been allowed, since the useful life of the 8-inch line was not ended even though its usefulness is now considerably lessened.

It is that kind of situation the industry must protect itself against. The increased demand for gas due to the war effort will hasten the day when many companies must make similar additions to their property. They must be able to retain enough of their earnings to finance such premature capital investments, since new capital funds could not be attracted into the business with no prospect of additional earning capacity. In any event, relief which is dependent solely upon the attitude of administrators is very unsatisfactory and uncertain. The Treasury Department is now reexamining depreciation rates of many gas companies and the industry as a whole is forced to the defensive position of trying to hold present rates without hope of being able to increase them.

The present Internal Revenue Code contains relief provisions which were designed to adjust inequalities in the application of income and excess-profits-tax laws in special cases. These provisions, while helpful in some instances and very much appreciated, are not of material benefit to the natural-gas industry, and none of them gives any relief to the large majority of natural gas companies.

7. RELIEF GRANTED TO NATURAL GAS COMPANIES CANNOT BE BASED ON THE RELATION OF EXCESS OUTPUT TO RECOVERABLE RESERVES

In defining exempt excess output in the case of mineral properties and timber blocks, in section 735 (a) (11), the code provides what is called, in the Senate Finance Committee's report, "a sliding scale of relief depending upon the rapidity with which the mineral property is being depleted." That is, the exempt excess output may equal the total excess output, or may be a certain part of such amount, depending on the relation of the excess output from a given property to the estimated reserves recoverable from that property.

Such a sliding scale is inappropriate in the case of a natural gas company, for three reasons: First, that the rate of exhaustion of a natural gas property does not depend merely on the rate of withdrawal from taxpayer's property alone, but on the rate of withdrawal from all properties in the field, including properties of other interests; second, that the conditions indicative of normal or excess profits in the case of a natural gas company can best be determined for the company as a whole, rather than by properties; third, that the entire increased output compared with output in normal commercial years represents

the forced using up of its nonreplaceable capital assets during an emergency period.

8. THE RELIEF REQUESTED BY THE NATURAL GAS INDUSTRY WOULD AID THE WAR EFFORT AND SERVE THE PUBLIC WELFARE

Natural gas companies are now attempting to do everything within their power to aid in the prosecution of the war. Their facilities are utilized to the limit to meet the abnormally heavy demand of the war effort and they are sincerely striving to meet the requirements of all war agencies. Many companies have gladly complied with directives of the War Production Board to make interconnections with competing companies and deliver gas to such competitors, even though they realize in some cases that such deliveries will soon place them in an unfavorable position, as compared to that particular competitor, in the matter of available gas supplies. Operators of natural-gas companies, however, are human and it is unfair to expect them to continue to exhaust their own reserves under a tax structure that does not give them equal protection with other classes of industry.

The natural gas industry feels deeply the discriminatory effect of the present tax laws, and if some relief provision is enacted that will give them reasonable assurance of continuing in business they will be better able to furnish the additional gas required by the war effort, even though a substantial part of the increase results merely in the swapping of dollars. If the war lasts a long time many of the present producing gas fields will become exhausted, or their capacity greatly curtailed. Unless companies connected to these fields are permitted to retain a sufficient amount of their earnings to explore and develop additional gas supplies and build the necessary pipe line facilities to them, many war industries and training camps may face a serious shortage of gas. Any such shortage will impede the production of war materials and the training of the armed forces, as well as necessitate expensive installations of equipment for substitute fuels, which would require the diversion of large quantities of vital war materials. Furthermore, if any substantial number of domestic and commercial consumers are forced to substitute other forms of fuel and heating for natural gas, a diversion of materials needed in the war effort will be necessary and the general public will be forced to make large expenditures of money which might otherwise be invested in war bonds. It is necessary to the proper prosecution of the war effort, as well as for the welfare of the general public, that the persons, industries, and training camps now using natural gas and not having equipment to use substitutes continue to have natural gas available for their use.

APPENDIX

TABLE 1.—*Natural gas production and consumption for the United States*

[Millions of cubic feet]

	Average 1936-39	1940	1941	1942	Estimated 1943	Increase 1942 over average 1936-39	Increase 1943 over average 1936-39
						Percent	*Percent*
Total marketed production	2,336,935	2,660,222	2,812,658	3,014,000	3,182,500	28.97	36.18
Consumption:							
Domestic	368,529	443,646	442,067	493,254	513,122	34.39	39.24
Commercial	115,411	134,644	144,844	168,951	184,327	46.39	59.71
Industrial:							
Field	652,469	711,861	686,153				
Carbon-black plants	324,181	368,802	1,532,123	2,341,901	2,476,927	33.66	33.97
Other industrial	872,265	995,706					
Total consumption	2,332,855	2,654,659	2,805,192	3,006,106	3,174,376	28.86	36.07

Source of information: Figures from 1936 to 1941, inclusive, obtained from printed bulletins and releases of Bureau of Mines. Figures for 1942 and 1943 constructed from table 2 and the relationship in 1941 of total consumption and sales by utilities. The present unofficial estimate of Bureau of Mines of 1942 marketed production is 3 trillion cubic feet.

TABLE 2.—*Natural gas industry in the United States comparative data on sales to consumers by natural gas utilities*

[Millions of cubic feet]

	Average 1936-39	1940	1941	1942	Estimated 1943	Increase 1942 over average 1936-39	Increase 1943 over average 1936-39
						Percent	*Percent*
Domestic	356,856	419,615	423,013	476,200	494,068	33.44	38.45
Commercial	102,095	122,568	130,405	154,512	169,888	50.46	65.42
Industrial	810,135	899,792	1,052,555	1,138,183	1,344,458	40.49	65.95
Total	1,269,686	1,441,975	1,605,973	1,768,895	2,008,414	39.32	58.18

Source of information: Figures from 1936 to 1941, inclusive, obtained from Statistical Bulletin No. 49, Annual Statistics of the Natural Gas Industry in 1941, of American Gas Association. Figures for 1942 obtained from monthly bulletins of American Gas Association. Figures for 1943 estimated from experience of representative portion of the industry during first 3 months of year.

TABLE 3.—*Natural gas industry in the United States comparative estimated earnings and taxes*

[Thousands of dollars]

	Average 1936-39	1940	1941	1942	Estimated 1943	Increase 1942 over average 1936-39	Increase 1943 over average 1936-39
						Percent	*Percent*
Total operating revenue	438,401	501,071	534,280	583,025	623,638	32.99	42.25
Net income before taxes and interest and other deductions	152,955	165,481	172,480	190,977	204,280	24.86	33.56
Taxes accrued	41,023	57,724	71,480	93,020	103,958	126.75	153.41
Net income before interest and other deductions	111,932	107,757	101,000	97,957	100,322	[1] 12.49	[1] 10.37
Interest and other deductions	41,873	34,073	28,303	24,872	22,714	[1] 40.60	[1] 45.76
Net income available for capital expenditures, payment of indebtedness, dividends, and surplus	70,059	73,684	72,697	73,085	77,608	4.32	10.78
M. C. F. sales (millions of cubic feet)	1,269,686	1,441,975	1,605,973	1,768,895	2,008,414	39.32	58.18
Net income per millions of cubic feet.....cents	5.52	5.11	4.53	4.13	3.86	[1] 25.18	[1] 30.07
Average sale price per millions of cubic feet....cents	34.53	34.75	33.27	32.96	31.05	[1] 4.55	[1] 10.08

[1] Decrease.

Source of information: Figures from 1936 to 1941, inclusive, obtained from Statistical Bulletin No. 49, Annual Statistics of the Natural Gas Industry in 1941, of American Gas Association. Total operating revenue for 1942 obtained from monthly bulletins of American Gas Association. Remaining figures constructed from published reports of operations of companies having approximately 86 percent of total industry revenue. Figures for 1943 estimated from available data, including experience of representative portion of industry during first 3 months of year.

DRAFT OF SUGGESTED AMENDMENTS

(Suggested new language italicized)

SEC. —. NONTAXABLE INCOME FROM EXEMPT EXCESS OUTPUT OF CERTAIN INDUSTRIES WITH DEPLETABLE RESOURCES.

(a) INCOME CREDIT.—*Section 711 (a) (1) (I) of the Internal Revenue Code (relating to excess profits credit computed under income credit) is amended to read as follows:*

(I) NONTAXABLE INCOME OF CERTAIN INDUSTRIES WITH DEPLETABLE RESOURCES.—In the case of a producer of minerals, or a producer of logs or

lumber from a timber block *or a natural gas company*, as defined in Section 735, there shall be excluded nontaxable income from exempt excess output of mines, timber blocks, *and natural gas property* and nontaxable bonus income provided in Section 735.

(b) INVESTED CAPITAL CREDIT.—*Section 711 (a) (2) (K) of the Internal Revenue Code (relating to excess profits credit computed under invested capital credit) is amended to read as follows:*

(K) NONTAXABLE INCOME OF CERTAIN INDUSTRIES WITH DEPLETABLE RESOURCES.—In the case of a producer of minerals, or a producer of logs or lumber from a timber block *or a natural gas company*, as defined in Section 735, there shall be excluded nontaxable income from exempt excess output of mines, timber blocks, *and natural gas property* and nontaxable bonus income provided in Section 735.

SEC. —. NONTAXABLE INCOME FROM CERTAIN MINING, TIMBER, AND NATURAL-GAS OPERATIONS.

Section 735 of Subchapter E of Chapter 2 is amended to read as follows:

SEC. 735. NONTAXABLE INCOME FROM CERTAIN MINING, TIMBER, AND NATURAL-GAS OPERATIONS.

(a) DEFINITIONS.—For the purpose of this section, Section 711 (a) (1) (I), and Section 711 (a) (2) (K)—

(1) PRODUCER.—The term "producer" means a corporation which extracts minerals from a mineral property, or cuts logs from a timber block, in which an economic interest is owned by such corporation.

(2) *Natural Gas Company.—The term "natural gas company" means any corporation engaged in the business of producing, transporting by pipe line, storing or selling natural gas, or any combination of such activities.*

(3) MINERAL UNIT.—The term "mineral unit" means a unit of metal, coal, or nonmetallic substance in the minerals recovered from the operation of a mineral property.

(4) TIMBER UNIT.—The term "timber unit" means a unit of timber recovered from the operation of a timber block.

(5) *Natural Gas Unit.—The term "natural gas unit" means one thousand cubic feet of natural gas.*

(6) EXCESS OUTPUT.—The term "excess output" means the excess of the mineral units, timber units, *or natural gas units* for the taxable year over the normal output.

(7) NORMAL OUTPUTS

(A) The term "normal output", *except in the case of natural gas company*, means the average annual mineral units, or the average annual timber units, as the case may be, recovered in the taxable years beginning after December 31, 1935, and not beginning after December 31, 1939 (hereinafter called "base period"), of the person owning the mineral property or the timber block (whether or not the taxpayer). The average annual mineral units or timber units shall be computed by dividing the aggregate of such mineral units or timber units for the base period by the number of months for which the mineral property or the timber block was in operation during the base period and by multiplying the amount so ascertained by twelve. In any case in which the taxpayer establishes, under regulations prescribed by the Commissioner with the approval of the Secretary, that the operation of any mineral property or any timber block is normally prevented for a specified period each year by physical events outside the control of the taxpayer, the number of months during which such mineral property or timber block is regularly in operation during a taxable year shall be used in computing the average annual mineral units, or timber units, instead of twelve. Any mineral property, or any timber block, which was in operation for less than six months during the base period shall, for the purposes of this section, be deemed not to have been in operation during the base period.

(B) In the case of natural gas companies, the term "normal output" means the average annual natural gas units sold by the taxpayer whether produced, purchased or withdrawn from storage in the taxable years beginning after December 31, 1935, and not beginning after December 31, 1939 (hereinafter called "base period"), of the person owning the natural gas property (whether or not the taxpayer). The average annual natural gas units shall be computed by dividing the aggregate of such natural gas units for the base period by the number of months for which the natural gas property was in operation during the base period and by multiplying the amount so ascertained by twelve. In any case in which the taxpayer establishes, under regulations prescribed by the Commissioner with the approval of the Secretary, that the operation of any natural gas property is normally prevented for a specified period each year by physical events outside the control of the taxpayer, the number of months during which such natural gas property is normally prevented for a specified period each year by physical events outside the control of the taxpayer, the number of months during which such natural gas property is regularly in operation during a taxable year shall be used in computing the average annual natural gas units, instead of twelve. Any natural gas property, which was in operation for less than six months during the base period shall, for the purposes of this section, be deemed not to have been in operation during the base period.

(8) MINERAL PROPERTY.—The term "mineral property" means a mineral deposit, the development and plant necessary for the extraction of the deposit, and so much of the surface of the land as is necessary for purposes of such extraction.

(9) MINERALS.—The term "minerals" means ores of the metals, coal, and such nonmetallic substances as abrasives, asbestos, asphaltum, barytes, borax, building stone, cement rock, clay, crushed stone, feldspar, fluorspar, fuller's earth, graphite, gravel, gypsum, limestone, magnesite, marl, mica, mineral pigments, peat, potash, precious stones, refractories, rock phosphate, salt, sand, silica, slate, soapstone, soda, sulphur, and talc.

(10) TIMBER BLOCK.—The term "timber block" means an operation unit existing as of December 31, 1941, which includes all the taxpayer's timber which would logically go to a single given point of manufacture, but shall not include any operation unit acquired after December 31, 1941.

(11) Natural gas property.—The term "natural gas property" means all of the property of a natural gas company used for the development, production, purchase, transportation by pipe line, storage, distribution and/or sale of natural gas.

(12) NORMAL UNIT PROFIT:

(A) *In the case of mineral units,* the term "normal unit profit" means the average profit for the base period per mineral unit for such period, determined by dividing the net income with respect to minerals recovered from the mineral property (computed with the allowance for depletion computed in accordance with the basis for depletion applicable to the current taxable year) during the base period by the number of mineral units recovered from the mineral property during the base period.

(B) In the case of natural gas units, the term "normal unit profit" means the average profit during the base period per natural gas unit, determined by dividing the net income with respect to the production, purchase, transportation by pipe line, storage, distribution, and/or sale of natural gas (computed with the allowance for depletion and depreciation computed in accordance with the basis of depletion and depreciation applicable to the current taxable year) during the base period by the number of natural gas units sold by the taxpayer during the base period whether produced, purchased, or withdrawn from storage.

(13) ESTIMATED RECOVERABLE UNITS.—*Mining and timber operations.*—The term "estimated recoverable units means the estimated number of units of metal, coal, or nonmetallic substances in the estimated recoverable minerals from the mineral property at the end of the taxable year plus the excess output for such year. All estimates shall be subject to the approval

of the Commissioner, the determination of whom, for the purposes of this section, shall be final and conclusive.

(14) EXEMPT EXCESS OUTPUT—*Mining and timber operations.—In the case of mining and timber operations:* the term "exempt excess output" for any taxable year means a number of units equal to the following percentages of the excess output for such year:

100 per centum if the excess output exceeds 50 per centum of the estimated recoverable units;

95 per centum if the excess output exceeds 33⅓ but not 50 per centum of the estimated recoverable units;

90 per centum if the excess output exceeds 25 but not 33⅓ per centum of the estimated recoverable units;

85 per centum if the excess output exceeds 20 but not 25 per centum of the estimated recoverable units;

80 per centum if the excess output exceeds 16⅔ but not 20 per centum of the estimated recoverable units;

60 per centum if the excess output exceeds 14⅔ but not 16⅔ per centum of the estimated recoverable units;

40 per centum if the excess output exceeds 12½ but not 14⅔ per centum of the estimated recoverable units;

30 per centum if the excess exceeds 10 but not 12½ per centum of the estimated recoverable units;

20 per centum if the excess output exceeds 5 but not 10 per centum of the estimated recoverable units.

(15) Exempt excess output—Natural gas companies.—In the case of natural gas companies the term "exempt excess output" for any taxable year means the excess output for such year.

(16) Unit net income:

(A) In the case of mining and timber operations, the term "unit net income" means the amount ascertained by dividing the net income (computed with the allowance for depletion) from the coal or iron ore or the timber recovered from the coal mining property, iron mining property, or timber block, as the case may be, during the taxable year by the number of units of coal or iron ore, or timber, recovered from such property in such year.

(B) In the case of natural gas operations, the term "unit net income" means the amount ascertained by dividing the net income (computed with the allowance for depletion and depreciation) with respect to the production, purchase, transportation by pipe line, storage and/or sale of natural gas during the taxable year by the number of natural gas units sold by the taxpayer during such year whether produced, purchased, and/or withdrawn from storage during each year.

(b) Nontaxable income from exempt excess output.—

(1) GENERAL RULE.—For any taxable year for which the excess output of mineral property which was in operation during the base period exceeds 5 per centum of the estimated recoverable units from such property, the nontaxable income from exempt excess output for such year shall be an amount equal to the exempt excess output for such year multiplied by the normal unit profit, but such amount shall not exceed the net income (computed with the allowance for depletion) attributable to the excess output for such year.

(2) COAL AND IRON MINES.—For any taxable year, the nontaxable income from exempt excess output of a coal mining or iron mining property which was in operation during the base period shall be an amount equal to the excess output of such property for such year multiplied by one-half of the unit net income from such property for such year, or an amount determined under paragraph (1), whichever the taxpayer elects in accordance with regulations prescribed by the Commissioner with the approval of the Secretary.

(3) TIMBER PROPERTIES.—For any taxable year, the nontaxable income from exempt output of a timber block which was in operation during the base period shall be an amount equal to the excess output of such property for such year multiplied by one-half of the unit net income from such property for such year.

(4) NATURAL GAS COMPANIES.—*For any taxable year, the nontaxable income from exempt excess output of a natural gas company shall be an amount equal to the exempt excess output for such year multiplied by (a) the normal unit profit per natural gas unit, or (b) the excess of the profit per*

unit realized during the taxable year over the normal unit profit, whichever is greater, but shall not exceed the net income (computed with the allowance for depletion and depreciation) attributable to the excess output for such year.

(c) NONTAXABLE BONUS INCOME.—The term "nontaxable bonus income" means the amount of the income derived from the bonus payments made by any agency of the United States Government on account of the production in excess of a specified quota of a mineral product or of timber the exhaustion of which gives rise to an allowance for depletion under section 23 (m), but such amount shall not exceed the net income (computed with the allowance for depletion) attributable to the output in excess of such quota.

(d) RULE IN CASE INCOME FROM EXCESS OUTPUT INCLUDES BONUS PAYMENT.—In any case in which the income attributable to the excess output includes bonus payments (as provided by subsection (c)), the taxpayer may elect, under regulations prescribed by the Commissioner with the approval of the Secretary, to receive either the benefits of subsection (b) or subsection (c) with respect to such income as is attributable to excess output above the specified quota.

(e) RETROACTIVE EXCLUSION OF NONTAXABLE BONUS INCOME.—The amendments made by this section inserting Section 711 (a) (1) (I), Section 711 (a) (2) (K), and Section 735 (c), to the extent that they relate to nontaxable bonus income, shall be applicable to taxable years beginning after December 31, 1940.

(f) RETROACTIVE PROVISION RELATING TO NATURAL-GAS COMPANIES.—The amendments made by this section and by section —, to the extent that they relate to natural-gas companies, shall be applicable to taxable years beginning after December 31, 1941. In any case where the tax has been paid for any year without benefit of such provisions, claims for refund may be filed, and shall be allowed, in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary.

Senator MILLIKIN. I have had some slight touch with the gas industry myself, and I want to say that your remarks have been very interesting to me. I think you have made a very excellent presentation.

Mr. UNDERWOOD. Thank you, Senator.

I have one additional thing I want to call to the committee's attention. I asked several different typical natural-gas companies to furnish me figures illustrating what we consider to be the discriminatory effect of the excess-profits-tax law as it now exists in the case of natural-gas companies.

One company reported in the year 1943, which, of course, is partly estimated, but is pretty well known at this time, an increase in their Federal income and excess-profits taxes of 36.08 percent; they had increases in sales of 20.1 percent; they had a decrease in net income of 32.62 percent.

Another company reported an increase in Federal income and excess-profits taxes for the year 1943, as compared to 1940 of 72.21 percent, an increase in send-out of 52.29 percent, and a decrease in net income of 15.03 percent.

Another company reported an increase in Federal income and excess-profits taxes of 205.97 percent in those 2 comparable years, an increase in send-out of over 60 percent, and a decrease in net income of 26 percent.

Another company reported an increase in Federal income and excess-profits taxes of 1,094 percent, an increase of sales—that is, volume of gas sold, of 107.09 percent, and a decrease, gentlemen, in net income of 12.5 percent.

I ask permission to also introduce in the record a recapitulation of the figures submitted to me by eight typical natural-gas companies showing the effects of the present excess-profits-tax law as applied to the year 1943 and a comparison as with the year 1940.

The CHAIRMAN. That may be done.

(The statement referred to is as follows:)

Comparative statement of income, 8 typical natural-gas companies, for years 1940 and 1943

	1940	1943 [1]	Percent of increase or decrease [2]
Company A:			
Operating revenues	$16,887,240	$17,925,000	6.15
Average cents per thousand cubic feet	24.72	20.32	*17.80*
Net income before Federal income and excess-profits taxes	$7,382,345	$6,520,000	*11.68*
Federal income and excess-profits taxes	$2,204,535	$3,000,000	*36.08*
Net income	$5,177,810	$3,520,000	*31.02*
Sales in thousand cubic feet	68,318,000	88,200,000	29.10
Total fixed capital	$76,870,000	$100,765,000	31.08
Return on investment.....percent..	6.74	3.49	*48.22*
Company B:			
Operating revenues	$8,537,322	$12,017,322	42.77
Average cents per thousand cubic feet	19.449	18.233	*6.27*
Net income before Federal income and excess-profits taxes	$2,855,922	$3,232,231	13.18
Federal income and excess-profits taxes	$854,844	$1,531,965	79.21
Net income	$2,001,078	$1,700,266	*15.08*
Sales in thousand cubic feet	45,439,286	69,198,675	52.29
Total fixed capital	$32,142,861	$42,338,411	31.72
Return on investment.....percent..	6.23	4.02	*35.47*
Company D:			
Operating revenues	$6,380,000	$8,346,000	30.82
Average cents per thousand cubic feet	19.30	18.62	*3.53*
Net income before Federal income and excess-profits taxes	$2,835,000	$3,577,000	26.62
Federal income and excess-profits taxes	$720,000	$1,389,000	92.92
Net income	$2,100,000	$2,188,000	3.94
Sales in thousand cubic feet	33,000,000	44,830,000	35.60
Total fixed capital	$25,644,000	$31,510,000	22.87
Return on investment.....percent..	8.21	6.94	*15.47*
Company E:			
Operating revenues	$20,894,000	$24,100,000	17.02
Average cents per thousand cubic feet	37.79	27.60	*26.96*
Net income before Federal income and excess-profits taxes	$5,948,000	$7,654,000	28.68
Federal income and excess-profits taxes	$1,407,000	$4,305,000	205.97
Net income	$4,541,000	$3,349,000	*26.25*
Sales in thousand cubic feet	54,493,000	87,300,000	60.20
Total fixed capital	$107,051,000	$113,880,000	6.38
Return on investment.....percent..	4.24	2.94	*30.66*
Company F:			
Operating revenues	$11,602,000	$13,130,000	13.17
Average cents per thousand cubic feet	21.59	18.65	*13.62*
Net income before Federal income and excess-profits taxes	$4,895,000	$5,383,000	9.97
Federal income and excess-profits taxes	$1,391,000	$2,594,000	86.48
Net income	$3,504,000	$2,789,000	*20.41*
Sales in thousand cubic feet	53,734,000	70,419,000	31.05
Total fixed capital	$54,306,000	$56,103,000	3.14
Return on investment.....percent..	6.44	4.97	*22.85*
Company G:			
Operating revenues	$9,422,000	$12,852,000	36.40
Average cents per thousand cubic feet	28.00	23.73	*15.25*
Net income before Federal income and excess-profits taxes	$2,854,000	$4,624,000	62.02
Federal income and excess-profits taxes	$538,000	$2,824,000	424.91
Net income	$2,316,000	$1,800,000	*22.28*
Sales in thousand cubic feet	33,656,000	54,151,000	60.90
Total fixed capital	$52,817,000	$60,000,000	13.60
Return on investment.....percent..	4.38	3.00	*31.51*
Company H:			
Operating revenues	$2,203,940	$3,803,793	72.59
Average cents per thousand cubic feet	22.06	17.15	*22.26*
Net income before Federal income and excess-profits taxes	*$16,585*	$1,203,637	.....
Federal income and excess-profits taxes	.....	$782,208	.....
Net income	*$16,585*	$421,429	.....
Sales in thousand cubic feet	9,991,948	21,429,189	114.46
Total fixed capital	$15,351,818	$16,000,000	4.22
Return on investment.....percent..	*.11*	2.63	.....
Company I:			
Operating revenues	$587,796	$986,706	67.87
Average cents per thousand cubic feet	20.46	18.58	*18.96*
Net income before Federal income and excess-profits taxes	$176,534	$418,847	137.26
Federal income and excess profits taxes	$23,892	$285,255	1,094.06
Net income	$152,642	$133,562	*12.50*
Sales in thousand cubic feet	2,873,021	5,949,778	107.09
Total fixed capital	$1,848,890	$1,940,000	4.96
Return on investment.....percent..	8.26	6.88	*16.71*

[1] Partially estimated.
[2] Italic figures denote decrease.

Senator MILLIKIN. Mr. Chairman, may I add one more observation? A small company that has its wells in a large field is in no position to protect itself. For even if it should decide it will not go into accelerated production, it would have its holdings drained off by those who did.

Mr. UNDERWOOD. Precisely. Natural gas is altogether different from a hard rock mineral or a reserve of timber. If you don't produce your own gas, it may be drained off through offset or neighboring wells, and a small company that depends upon one field in which large lines run may have its reserve depleted just as surely by the withdrawals of the large lines, as if it had taken the gas out itself.

Gentlemen, I thank you for this opportunity of appearing before the committee.

The CHAIRMAN. Very well; thank you.

Mr. Turner.

STATEMENT OF CLARENCE L. TURNER, REPRESENTING THE PENNSYLVANIA STATE CHAMBER OF COMMERCE

Mr. TURNER. Mr. Chairman and Senators, my name is Clarence L. Turner. I am a certified public accountant of Philadelphia and I am appearing in behalf of the Pennsylvania State Chamber of Commerce as vice chairman of its committee on taxation and Government expenditures.

The members of the Ways and Means Committee are to be congratulated in recognizing the already heavy tax burdens the American people are now carrying by refusing to accept the recommendations of the Treasury Department. The organization which I represent believes that the cost of this war should be paid insofar as possible with current taxes; also it believes that the revenue which will be produced under existing law is all that can be expected without permanently injuring the national economy.

I wish to speak especially concerning the burdens of corporation taxation and to urge that they not be increased at this time. Most of the members of the Pennsylvania State Chamber of Commerce are small enterprises and these concerns feel that any further increases in their tax rates would impair initiative and resources for production and would weaken their capacities for employment after the war. We are very glad to contribute our part to paying for the war and, as stated, we are mindful of the necessity for onerous taxation in wartime. However, it is our conviction that any advances in the excess profits or other corporate tax rates would damage our productive efficiency and that we should now be planning to reduce taxes as soon as the war situation will permit instead of adding to the existing tax rates.

There has been much talk about the tremendous corporate earnings, savings, and dividends. Undoubtedly a relatively few corporations may have enjoyed substantial gains from the war effort, even after their heavy taxes have been paid. No doubt some corporations may have laid aside substantial reserves for post-war requirements. Probably some corporations have paid out higher dividends. But the profitability of corporate enterprise has been greatly exaggerated and many concerns have suffered low incomes and losses in recent years.

Even the rather optimistic estimate of the Department of Commerce that corporate earnings after taxes will be in the neighborhood of $8,000,000,000 in 1943 concedes to corporations a gain of only a little over $1,000,000,000 to meet their greater needs for reserves and for cash to pay dividends. Federal taxes will take from corporations about $15,000,000,000, as compared with earnings before taxes of some $23,000,000,000.

Back in 1929, corporations enjoyed earnings before taxes of over $9,000,000,000, paid taxes of $1,200,000,000, and had about $8,000,000,000 left. During the lean years of depression in the 1930's severe losses were experienced. In the 3 years 1931–33, total losses of $10,000,000,000 were accumulated. In 1942, the best year corporations in general have had since 1929, earnings after taxes were not quite $7,000,000,000, before renegotiation. This year, 1943, if the Department of Commerce estimate proves correct, earnings after taxes and before renegotiation may slightly exceed the 1929 level. After renegotiation they will probably dwindle materially.

Other estimates have been less optimistic. The Cleveland Trust Co., in its bulletin of October 15, 1943, estimates that earnings after taxes and before renegotiation will be about $7,700,000,000 in 1943, somewhat less than in 1942 and 1929.

During the 1920's the earnings of corporations after taxes were running consistently between six and eight billion dollars. During the 1930's they ranged from a deficit of over $5,000,000,000 in 1932 to a peak of slightly over $4,000,000,000 in 1939. Recently they have tended to climb back to the level of the 1920's, but without fully compensating for the attendant risks and the contingencies that must now be assumed.

I have spoken of the trends in corporate earnings after taxes to emphasize certain facts. These earnings, after long years of depression, are just now beginning to equal 1929 earnings after taxes. But in 1929 the corporate investment and sales were much lower and a much smaller national income was being produced. Unfortunately, data are not available to indicate the total capital investment of corporations during World War I. But Treasury statistics of corporate earnings, as analyzed by the National City Bank of New York in its November bulletin, show that the ratios of net income after taxes to gross income in recent years have been much lower than similar ratios during World War I and in the prosperity of the late 1920's. The ratios of net income after taxes to gross income for selected years are listed for purposes of comparison:

	Percent		Percent
1917	8.7	1929	5.1
1918	5.4	1941	3.7
1919	6.4	1942	3.6
1927	4.1	1943	3.4
1928	5.0		

Of course neither the prosperity of the late 1920's nor of the prewar year 1939 provide adequate standards for purposes of comparison of the adequacy of corporate earnings at the present time, when corporate investments and output are far greater. Business enterprise has never been faced with the gigantic risks which must now be assumed as the result of problems of production and employment; has never needed such vast amounts of capital as will be required for the

readjustment to new conditions after the war, when employment must be found for many millions of workers.

In view of the tremendous growth in corporate enterprise, the present earnings after taxes are relatively small. Moreover, recent improved paper earnings follow depressed years of low gains and losses. If capital is to be available for the urgent needs of post-war production and if reserves are to be accumulated to weather the storms of future adverse conditions in off years, corporate tax rates must not, in our opinion, be increased.

The exaggerated notions concerning corporations have been extended to their savings and dividends, as well as to their earnings after taxes. Even if we accept recent estimates that corporations have been retaining as much as $3,000,000,000 or $4,000,000,000 out of their earnings in the last 2 or 3 years, we should recognize that such saving would not be unusual in relation to the needs of corporations for capital in facing the critical problems which they will encounter after the war.

During World War No. 1, corporations were saving at a high rate, as indicated by an analysis of Treasury income statistics by the Temporary National Economic Committee. In 1916 they retained $4.9 billion and in 1917, $4.3 billion. They plowed back $1.9 billion in 1918 and $3.7 billion in 1919. Now corporations have much greater capital requirements and risks than those during World War No. 1, but their savings have increased only moderately.

Moreover, corporations have only recently emerged from the strenuous years of depression which largely consumed their accumulated savings. For 9 straight years in the period 1930–38, corporate savings were negative, according to Treasury income statistics. Losses and low incomes were encountered but dividend payments were continued at as high a rate as possible out of reserves. Negative saving reached a low level of $8,000,000,000 in 1932, and positive savings were not enjoyed until 1939. In the 9 years 1930–38, the total negative savings, or the excess of dividends over net income after taxes, exceeded $31,000,000,000. Instead of accumulating funds for future needs, corporations were living on their savings of past years. The hardships of the prolonged depression were survived and dividends were paid out to the shareholders to provide funds for consumption, but savings were reduced by $31,000,000,000.

As we look back over the cycle of corporate profits and losses, we realize that recent earnings after taxes and recent savings have been relatively modest. Corporations entered the war stripped of their reserves and have been struggling to restore their savings. Those savings, in view of the uncertainties and the complexities which will be encountered after the war in producing for American consumers and in providing greater employment, are far from excessive and are not yet adequate for all the needs for capital, in our opinion.

Again, there has been much talk about vast corporate dividends. As a matter of fact, while the national income has been soaring, the dividends paid out in recent years have fluctuated around $4,000,000,000 and were smaller in 1942 than they were in 1941 or 1940. The total dividends for the first 10 months of 1943, according to the Department of Commerce, have been somewhat smaller than they were during a comparable period in 1942. When dividends reached a peak of

$4,400,000,000 in 1941, they were still running over $1,000,000,000 behind the dividend payments of the 1920's.

Thus, while the national income has been increasing by leaps and bounds, corporation dividends have been maintained around $4,000,000,000 after falling to a low lever of about $2,000,000,000 during the depression. The shareholders of most corporations have not been receiving increased incomes from those corporations. In fact, dividends have tended to decline because corporations have urgently needed capital and they have been trying to lay aside reserves for future needs so that they will not be forced to come to the Government for subsidies after the war.

Senator WALSH. Did you say the corporate income has not increased during 1943?

Mr. TURNER. The dividends. The dividends are less, according to the statistics of the Department of Commerce.

Senator WALSH. We had statistics presented some days ago indicating there were substantial increases in the dividends of corporations in the past year. But perhaps that was for chosen companies.

Mr. TURNER. It must have been chosen companies. This is from the Department of Commerce.

Senator WALSH. Yes.

Mr. TURNER. Corporations are now preparing to help produce a national income of more than $150,000,000,000, when our best efforts before the war, even in the prosperous days of the 1920's, hardly carried us to a national income of $90,000,000,000. Corporations are also seeking to find employment for the millions who will be turning away soon from war work and for the millions who will soon be released from military service. Under these conditions, we would be foolhardy to appraise corporation earnings after taxes, savings, and dividends in terms of outmoded pre-war standards. Larger, not smaller reserves, should be available for the greater needs for capital which will be met after the war.

In estimating the adequacy of corporate reserves for post-war requirements, we should note that the reserves which have been accumulated are not perfectly liquid and are not necessarily in the form of cash. In fact, a large part of the reserves is represented by such assets as materials and equipment which could not readily be converted into cash or could be changed into cash quickly only at a loss. Assets which appear to be liquid and available for any needs may actually be earmarked for such purposes as expected future tax payments.

The increases in cash and the more liquid assets reflect the necessity for more working capital to carry on the larger production demanded in wartime. Much of the increase is related to the great uncertainty over post-war conditions and the desire to be prepared for the risks of the unknown future. Some of the increase has resulted from the purpose to set aside funds for deferred maintenance and for other needs which cannot now be met because of wartime scarcities.

The growth of corporate reserves does not in general indicate a capacity to pay higher rates of taxation or an adequacy of funds for post-war needs.

Moreover deductions for reserves for approved purposes will be desirable in order to provide for the many complex problems of business which have been created by the uncertainties of the war and post-

war periods and the burdens of onerous war taxation. It should be emphasized that ample reserves are necessary to take care of the current accumulation of expense items as a result of the war activity and production.

The prompt settlement of terminated contracts and the carry-back of losses will no doubt aid many corporations to survive. On the other hand, many establishments have no war contracts and many concerns are suffering from low incomes rather than losses. The general situation requires deductions for additional reserves for appropriate purposes.

In considering proposals to increase the corporate-tax rates we should not overlook the fact that the tax rates now in effect are exceedingly high and are the result of several rate increases. The combined normal and surtaxes attain a maximum of 40 percent and the excess-profits tax is imposed at a rate of 90 percent, exclusive of the post-war credit. Two-thirds of total corporation earnings are now being taken by Federal taxes and some corporations are giving up as much as 80 percent of their earnings in taxation.

The present corporate tax rates are sufficiently high to dull the incentives of enterprisers to produce with greater efficiency and at lower costs. Increases in net income are very largely taken in taxes and the resistance to higher costs is weakened, while the urge to expand production is balked by the little reward left.

To the heavy burdens of the corporate taxes, however, must be added the burdens of the high-rate personal-income taxes upon dividends received by the shareholders. Double taxation of corporate earnings results from the application of (1) the corporate-income taxes and (2) the personal-income taxes to dividends.

In the application of the taxes on corporation income, all shareholders in a given corporation are hit alike, regardless of their incomes and their economic responsibilities. Furthermore, much of the income paid out as dividends is received by persons with moderate incomes.

It is reported in the Treasury income statistics that persons with incomes below $5,000 received $1,261,000,000 in dividends in 1941, or one-third of the total dividends of domestic and foreign corporations received. The high-rate corporation taxes are especially harsh on this group of shareholders, but all shareholders with taxable incomes who receive dividends find themselves being taxed first as owners of shares on profits as they are earned by corporations and later as income recipient, when dividends are paid out. Thus, to corporation taxes, which may amount to as much as 80 percent of corporate net income, may be added personal-income taxes on any earnings paid out as dividends at rates ranging from 19 to 88 percent. The question is pertinent, Does it profit the shareholders to invest their funds in the corporations? What is left after all tax liabilities are met? The issue must be faced: Can private enterprise continue to attract capital under such terrific rates of taxation?

Not only do our heavy corporate and personal-income taxes dull the incentive to invest and produce, they also deprive corporations of funds from their earnings which they would like to set aside for future capital requirements. The most convenient and economical source of equity capital has always been found in the earnings held back and reinvested. Of course, the critics of corporations would like to com-

pel them to come to the Government or the capital markets it controls for funds. These critics would extend Government control over business enterprise by imposing confiscatory taxes. We believe, however, that the continued existence of our enterprise system is highly desirable and that our taxes should not be raised to the point where they will destroy vision and discourage risk-taking and where they will consume the savings which should be retained for the great needs for funds after the war.

In weighing the effects of our high-rate taxes upon corporations, we should note that many corporations have not been blessed with prosperity during the war. We hear about concerns here and there which have enjoyed tremendous gains, but little is said about the struggling establishments not engaged in war production which are trying to overcome scarcities of equipment, materials, and manpower, hoping that the war will end before they collapse. Many enterprises have suffered losses, even during the war boom, and many more have experienced earnings too small for their continued existence. These concerns will not be good credit risks after the war.

Some will say that the threat of runaway inflation calls for heavier corporate taxation. We in Pennsylvania believe this is a faulty reasoning. The menace of inflation, to the extent that it exists, arises from an excess of purchasing power in the hands of the masses. This purchasing power comes only to a negligible extent from corporate dividends, which have been rather stationary, are only a very small fraction of the income received by our population, and which go mainly to those who would rather save than spend. If we wish to strike at the sources of inflationary spending by new taxation, the most suitable device would be a general retail-sales tax, which would be diffused broadly among all of those who are spending their funds in the markets for luxuries and nonessentials.

Excessive corporation taxation is, in effect, inflationary. It curbs the incentives to greater and more efficient production, encourages extravagant expenditures and higher costs, consumes funds which should be reserved to finance larger production, weakens the capacity for employment, and operates, in general, to raise costs and prices and to limit output at a time when production should increase and prices should be lowered.

Before concluding I would like to reiterate our opposition to advancing the excess-profits tax beyond the present very high rate of 90 percent and to any reductions in the invested capital credits, which would operate indirectly to raise the tax rate. Lowering these credits would have unequal effects upon our corporations. It would penalize enterprises whose investment has not increased in order to hit those with growing resources. We believe that our tax policies should now encourage, and not discourage, the reinvestment of earnings.

I have indicated a number of reasons why the excess-profits tax and other corporation-tax rates should not be increased at this time because of their harmful effects upon corporations and our productive organization. I might point out, moreover, that the present high tax rates will secure larger tax payments from corporations as their earnings increase. Higher rates would yield temporary revenue gains to the Treasury, but future tax payments would be endangered by the adverse effects of the rate increases upon the production of the national income.

Intelligent and sincere businessmen in Pennsylvania are worried over the outlook for business after the war. They are eager to do their part to find work for all and to raise still higher the American standard of living. It is the opinion of these businessmen that it would be detrimental to our economy, to workers as well as to employers, to consumers as well as to producers, to raise our heavy corporate-tax rates at this time. Instead, we should seek to lower the corporate-tax rates at the earliest moment possible and should also endeavor to provide tax deductions for funds set aside to meet the urgent demands for increased productive facilities now and after the war.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Turner.

Mr. Gubman.

STATEMENT OF JOSEPH G. GUBMAN, REPRESENTING GUBMAN & FISCHMAN

The CHAIRMAN. You are here on the bowling tax?

Mr. GUBMAN. That is right, sir. My name is Joseph G. Gubman.

The CHAIRMAN. We had a witness on that yesterday.

Mr. GUBMAN. I am informed the witness yesterday appeared in behalf of the bowling public. I appear in behalf of the proprietors.

The CHAIRMAN. I think he had some slight interest in the proprietors as well as the public; but go ahead.

Mr. GUBMAN. I am a member of the law firm of Gubman & Fischman, who are the attorneys for the Eastern Bowling Proprietors Association, which is a membership corporation of New York, and consists of bowling proprietors of that State. I also appear in behalf of the New Jersey Bowling Proprietors Association, which is also a membership corporation, consisting of the bowling proprietors of the State of New Jersey.

This appearance is in opposition to that provision of the proposed tax bill which contemplates an excise levy of 20 percent of the charge to patrons for bowling. The Treasury has estimated that the excise tax will result in a revenue of $27,000,000.

This type of tax, like any tax, is a hardship both on the taxpayer as well as on the industry upon which it is imposed. If the degree of hardship were approximately equal to that borne by other industries, commensurate, of course, with the amount of revenue to be derived, then this industry would be more than willing to share its part of the tax burden along with the rest of the Nation. It is urged upon this committee, however, that this tax will subject the industry to unnecessary and excessive hardship in the light of resulting revenues.

Senator WALSH. What do you charge for a string of bowling?

Mr. GUBMAN. Usually about 25 cents.

Senator WALSH. What is the average number of strings bowled by a patron?

Mr. GUBMAN. There is no average, sir.

Senator WALSH. Do the people limit themselves to one game?

Mr. GUBMAN. They do not, sir. They come in and bowl either one, or sometimes bowl for hours.

Senator WALSH. Is there any average you can strike?

Mr. GUBMAN. Not that we know of.

Senator WALSH. If a man spent $2 he would have to pay a 40-cent tax?

Mr. GUBMAN. Exactly.

Senator WALSH. There are usually two to a string?

Mr. GUBMAN. No; individual games.

Senator WALSH. The loser usually has to pay for the game?

Mr. GUBMAN. Occasionally.

Neither the scope nor the magnitude of this tax are probably important, I suppose, to this committee, but they are very serious and very real to the people engaged in this industry. It is the opinion of this industry that this tax will not yield $27,000,000 to the Treasury, for a number of reasons:

In the first place, this estimate made by the Treasury of $27,000,000 is based upon some information or some statistics that the Treasury has available to it. I know of no recent survey that was made in this industry, but in any event, whatever information or statistics the Treasury used, they are now completely and thoroughly obsolete, for two reasons: In the first place, this is due to the steady decline in the volume of business and also to the more urgent condition, namely, the loss of employees by this industry.

As the members of this committee know, the operation of the individual bowling alley depends upon the services of an employee called a pin boy. The vast majority of these pin boys are of draft age and have been inducted into the armed forces. Most States do not permit younger boys to work in this field. Older men and girls are not able to handle this type of job.

Consequently, this industry has suffered a loss of help in greater proportion than most other activities. This loss of help, in turn, affects the gross income of the business more directly than in any other business. For example, the loss of one pin boy means that two bowling alley lanes must be shut down, notwithstanding that the establishment may be full of patrons who are ready and willing to bowl. The loss of additional pin boys means an additional two lanes for each pin boy lost must be shut down.

The situation is unlike that which obtains in motion-picture theaters or skating rinks or boxing exhibitions or other forms of entertainment, where reduction in staff does not affect the gross income. In such cases the quality of the service may be impaired, but the business goes on just the same. In bowling the gross income is directly proportionate to the number of employees. The rate of loss of employees is becoming progressively worse, to such an extent that any figures or statistics available to the Treasury, upon which this estimate of $27,000,000 is based, has been rendered completely obsolete by this cause alone.

The industry has even been unable to meet the Government request, made by the Federal Security Agency, that bowling facilities be extended to furnish opportunities for recreation to war workers. As a result, the anticipation of any definite amount of tax revenue is not supported by the facts as they presently exist.

This change of condition is more rapid than any possible revision of the Treasury's estimate.

The second reason is that the industry has lost to the armed forces a great many of its patrons. It has also lost many customers who have

moved to war work centers, away from the bowling-alley establishments. Unlike the entertainment field, the war has very seriously affected the bowling industry adversely, rather than improved it. It will lose additional trade as the result of the reduction of the purchasing power of the public due to other taxes. It is therefore expected that if the 20-percent excise tax be imposed upon bowling there will be a further substantial decline in business which, coupled with the other causes, will so reduce gross income that the tax will not yield $27,000,000, and will, on the contrary, ruin the industry without even the apparent justification by way of sufficient tax income.

Third, bowling by its nature is unlike any of the other activities subject to excise or admission taxes. It is not an amusement, but rather a facility for recreation. The proprietor affords no commodity or entertainment to the patrons. He merely has the facilities and supplies the necessary labor. It is the labor of the pin boy that is sold to the public. The bowler knocks down the pins if he can, and the pin boy sets them up again. These pin boys are members of local labor unions throughout the country. Their wages are on a per game basis, fixed by contract. Their labor is what the public buys.

The proposed tax is the only one I know of where the amount of the tax is directly proportionate to the labor employed by the industry, and is independent of any other factor. Moreover, since these pin boys are paid on a per-game basis, this tax will very likely reduce the number of games played and thereby reduce the income of those of the pin boys we have left.

I am authorized to say for the local union representing the pin boys in New York City that they are definitely opposed to this proposal.

This form of recreation is properly comparable to golf. The club or organization owns the golf links, like our members own the alley beds. The patron in each instance engages in his own recreation or sport. In golf, a caddy renders the service; in bowling, pin boys render a similar service. In neither case does the proprietor or the management contribute any further element to the patron's sport or recreation. Bowling merely differs in that it is available to more people because of its accessibility, and because it lends itself to people not otherwise athletically inclined. Notwithstanding the similarity between the two, a like comparison with tennis or swimming, or gymnasia, bowling is the only sport or recreation subject to an excise tax under the present tax law or under the proposed bill.

Of course, an additional element to be considered is the problem of collecting this tax. The present tax is $10 per alley bed, paid by the proprietors. This tax is simple to administer and easy to collect. The contemplated tax based on gross receipts is another matter. It requires additional record keeping by the proprietors and substantial administrative cost to the Government.

It is estimated that there are approximately 70,000 alley beds in this country. Each establishment averages about 10 alley beds. There are, therefore, about 7,000 establishments in the United States. Each establishment now pays about $100 in excise taxes, based upon the rate of $10 per alley bed. If the Treasury guess is correct, these 7,000 establishments must bring in $27,000,000, or approximately an average of $3,860 each. This sudden jump from $100 to $3,860 is more than any industry can stand, even though it is to be paid by the public.

These small individual establishments cannot hope to collect from their patrons the additional $3,860 on top of all other forms of taxation that the proprietors pay. In fact, it may precipitate an unfortunate tendency on the part of a few of the operators not to report this tax correctly. Necessity, or the threat of ruin may bring on this regrettable practice by a few, resulting in a premium on carelessness, or on dishonesty, both of which are possible under this type of tax.

The Treasury probably had this in mind in fixing the new tax on billiards. There the present tax is also $10 per table. The proposed bill raises it to $20 per table. Although the tax is double, it is not so drastic as the change from $10 per alley bed, or approximately $100 per establishment to $3,860 per establishment.

Bowling is a small industry, and the proprietors are small entrepreneurs. It cannot be considered big business. The tax on bowling may be a very small matter to the Congress as compared with the tremendous and serious problems of fiscal policy facing the legislators, but to each of the bowling proprietors it is a most serious, although personal, matter. This tax will seriously impair the status of the industry without sufficient income to the Government, and I respectfully urge this committee to give this item more consideration than it would seem to warrant on the face of the bill. It is expected that this committee will not permit an entire industry, however small, to be prejudiced, without at least commensurate revenue to the Treasury. The industry does not plead for relief, completely from a selfish point of view. Although this tax is to be paid by the public, it is recommended that it be deleted, or at least substantially reduced, or, in the alternative, the proprietors recommend that the present tax of $10 per alley bed be doubled, to $20, and the proprietors will pay it themselves without additional cost to the public, and without additional cost to the Government in collecting it.

Thank you.

The CHAIRMAN. We thank you, sir.

Gentlemen, we have here some seven or eight witnesses on luggage and handbags. Do I understand that you, Mr. Bernard, and Mr. Cart, and Mr. Kates, are combining your statements?

Mr. BERNARD. That is right, sir. I have a combined statement for three of us, to save the committee's time.

The CHAIRMAN. You may proceed.

STATEMENT OF GEORGE S. BERNARD, REPRESENTING THE SEWARD TRUNK & BAG CO.

Mr. BERNARD. Mr. Chairman, this is a joint statement of H. G. Kates, president of the Luggage & Leather Goods Manufacturers Association of America; George S. Bernard, chairman of the board of the American Hardware Co. of Petersburg, Va.; and Theodore Cart, president of the Atlantic Products Corporation of Trenton, N. J., all being members of the Advisory Committee of the War Production Board and Office of Price Administration having to do with the production and sale of luggage. The statement is being read by Mr. Bernard.

We are truly grateful for the opportunity afforded to present our views as to why there should be no change in the present excise tax covering the sale of luggage.

Luggage now carries an excise tax of 10 percent of its wholesale price, collected by the manufacturer and remitted every month to the Treasury.

The CHAIRMAN. How much was it proposed to be increased in the House?

Mr. BERNARD. To 25 percent of the retail value, from 10 percent of the wholesale value.

Senator WALSH. Are any handbags exempted by reason of the small price?

Mr. BERNARD. No, sir.

Senator WALSH. There are none exempted at all, the dollar bag would be taxed as well as the $200 bag?

Mr. BERNARD. That is right.

In the 1943 revenue bill, as passed by the House of Representatives, it is proposed to change this tax to 25 percent of the retail price, which is none other than a sales tax on this particular commodity and an extremely heavy one at that.

This proposed sales tax of 25 percent is undoubtedly predicated on the theory that luggage is a luxury.

Senator WALSH. Do you use leather?

Mr. BERNARD. No, sir; they have stopped us from using leather. I have some samples of wartime luggage and some prewar luggage just outside that I was hoping I could show the committee, and I would be very glad to have you see it.

Senator WALSH. Will you leave it here, or do you want to take it back with you?

Mr. BERNARD. I will be glad to leave it here for your examination at your convenience.

Senator WALSH. Usually, samples are left with the committee. [laughter.]

Mr. BERNARD. I will be glad to leave it here. You won't charge us storage on it, will you?

Wartime luggage, gentlemen, is not a luxury. It is a mistake to include wartime luggage in the same category with such luxuries as jewelry, furs, amusements, etc. It is a definite necessity. Those of us who have prepared this statement are all members of the Luggage Advisory Committee of the War Production Board. You may not realize that it was the original intention of the War Production Board to eliminate the manufacture of luggage for the duration. However, the Board modified its original position upon the strong insistence of both the Army and Navy that luggage was definitely essential for its personnel.

A survey by the War Production Board indicated quite clearly that luggage in a wartime economy was definitely essential, and the War Production Board, after several conferences with our Advisory Committee and representatives of the Army and Navy, decided upon eight styles of simple luggage as a minimum of essential wartime luggage, replacing literally thousands of styles made under pre-war conditions.

Besides reduction in models and elimination of the use of leather the industry further operates on a rigid quota basis, the cuts being as high as 50 percent.

Let us look at just what the increased tax will mean to the consumer. The O. P. A. has entered the luggage picture with its pricing formula

MPR-476, which prescribes a fixed ceiling. For example: A suitcase sold by the manufacturer for $10 will have a retail ceiling of $19.20. Of this amount 10 percent of the manufactuer's price or $1 represents the present tax. Let us follow this through. If the present 10 percent tax is replaced by the 25-percent tax at retail the purchaser will pay $4.55 or 25 percent of $18.20, this representing four and one-half times the present tax.

It cannot be your intention, gentlemen, to tax the essential traveler who must of necessity purchase wartime luggage four and one-half times the present tax.

If we understand this tax measure correctly, its primary purpose is to raise additional revenue. If that is so, then the size of this proposed tax on luggage is indefensible because it will defeat its purpose for the following reasons:

No leather luggage, no wardrobe trunks—in fact—no expensive, luxurious luggage is now permissible, and only the simplest types of luggage can be made under W. P. B. Order L-284.

At the present time all luggage is taxable at 10 percent. Under the contemplated 25-percent tax, luggage sold in post exchanges and ship's service stores will be tax-free. Soldiers and sailors who buy in post exchange or ship's service stores are not required to pay any taxes. Sponsors of this proposed tax apparently were not aware of the fact that there is no revenue to be derived from the sale of luggage through post exchange and ship's service stores, and that from 40 percent to 50 percent of all luggage sold is distributed through these stores at the present time.

It is reasonable to expect, moreover, that the proposed increase in the tax will discourage and curtail sharply the sale of luggage and will thus further reduce the tax yield. It follows, therefore, that since from 40 percent to 50 percent of all luggage is currently sold through post exchanges and ship's service stores, that sponsors of the increase have probably not taken into consideration the fact that this luggage under the proposed bill is tax-free.

It is also important in this connection to bear in mind that at the present time the Federal excise tax is easily collectible from the manufacturer at relatively little cost to the Government, but if the tax is collectible at the retail level its collection is much more cumbersome and vastly more costly. Under the present tax there are some 300 manufacturers who report and pay monthly. Under the proposed new tax there will be not less than 15,000 to 20,000 retailers, most of them very small, reporting these taxes. Furthermore, the Government now gets its tax within 30 days from the time the sale is made, whereas under the proposed plan there will be a lag of from 6 to 12 months, because it takes at least that much longer for retailers to move their stocks.

In conclusion, we would like to have you understand that wartime luggage is a definite necessity and not by any stretch of the imagination a luxury. The wartime purchaser is probably 85 percent to 90 percent an officer, soldier, sailor, government official, business executive or other type of essential traveler. It cannot be your intention to increase a tax four and one-half times its current rate to this group of consumers on merchandise developed and constructed as an essential wartime necessity under direction of the War Production Board, particularly since it is a cumbersome one that will not be productive of any substantially increased revenue.

This small industry is alone in the number and kind of restrictions that presently weigh it down. It operates on a drastically curtailed number of styles—eight, all told—it operates further on a rigidly reduced quota basis. It operates further under unique O. P. A. regulations. It is a mistake to impose additional burdens upon an industry that is now so sharply curtailed and restricted.

The CHAIRMAN. Thank you very much, Mr. Bernard.

Mr. BERNARD. Seriously, can we leave this luggage here for you to examine at your leisure? We would like to do it.

The CHAIRMAN. Yes. It is in the anteroom and it will be perfectly safe.

Mr. BERNARD. Thank you.

The CHAIRMAN. Mr. Berkowitz.

Mr. MITTENTHAL. I am appearing for Mr. Berkowitz and also I am making a combined statement for Mr. Wettels and Mr. Shapiro.

The CHAIRMAN. Very well.

STATEMENT OF ABRAHAM MITTENTHAL, DIRECTOR, NATIONAL AUTHORITY FOR THE LADIES HANDBAG INDUSTRY

Mr. MITTENTHAL. Mr. Chairman, and members of the committee, to begin with, I want to correct the impression that the handbag industry and the luggage industry are one and the same thing. They are entirely different industries, and in the calendar we are listed as "luggage and handbag." The handbag industry is entirely separate from the luggage industry; our methods of operation are different and our method of sales is different.

I am a director of the National Authority for the Ladies Handbag Industry. A national association of manufacturers of ladies' handbags. The membership of the association comprises manufacturers of ladies' handbags located in all parts of the United States. The association represents approximately 75 percent in sales volume of all ladies' handbags manufactured in the United States. The industry is governed by trade-practice rules approved for the industry by the Federal Trade Commission August 18, 1936.

There are approximately 350 manufacturers of ladies' handbags in the United States located in 17 States: Maine, Vermont, Massachusetts, Connecticut, Rhode Island, New York, New Jersey, Pennsylvania, Maryland, Virginia, Florida, Texas, Illinois, Ohio, Wisconsin, Missouri, and California.

The industry employs approximately 20,000 workers, of whom approximately 16,000 are females and 4,000 males. Most of the males employed are men over 40 years of age, the majority of whom have worked in the industry many years. A good many have worked from 25 to 50 years.

In the year 1939 the Department of Commerce statistics gave the dollar volume of sales of ladies' handbags at $558,806,000 at wholesale. We estimate in the year 1943, the dollar volume will be approximately $65,000,000.

At present, the industry is restricted from the use of many of the important materials formerly used in the making of ladies' handbags. Calfskins, kips, and cattle hides and many kinds of goatskins and kidskins are no longer available for handbags. Imitation leathers,

from which most of the cheaper grades of handbags formerly were made, are not obtainable.

Metals of all kinds used for closures on handbags are still restricted. The industry at present uses no critical materials needed for the war effort.

The handbag industry is a small industry but a very essential one to the women of America. A handbag is not an article of adornment or luxury, it is an article of necessity to every woman. It serves the same purpose to women that pockets serve to men. Just because a woman chooses to carry the articles she needs for her daily use in a receptacle instead of carrying them in pockets which she does not have in her clothes, should not be a reason for placing a tax on her substitute for pockets, and surely the Government would not think of taxing men's pockets, at least not empty pockets.

The importance of handbags to women is demonstrated best by the importance placed upon handbags by the Government itself. As a necessary article of equipment for the women in the service, the WAC's, WAVES, SPARS and Nurses are all equipped with handbags designed and purchased by the Government. During the years 1942 and 1943, the Government purchased more than 500,000 handbags at an average price of $5 each. Women in the services were not required to carry a handbag as an article of adornment. They are required not only to have a handbag, but they are told even how it should be carried, by the use of a long strap thrown over the shoulder.

If we were permitted to do so, we could bring a thousand women who would testify as to how important a handbag is to their every-day living. After all, I think we can agree that since she is the consumer who would be required to pay the tax, her testimony as to the importance of a handbag should mean more than our opinions. Ask your wives, ask any woman, ask this lady, let them tell you whether a handbag is a luxury or a necessity. Handbags are made to sell to consumers at 29 cents, 59 cents, 79 cents, $1 and upwards. The little schoolgirl who carries her 29-cent handbag to hold her carefare, handkerchief, and perhaps a key is being asked to pay a 25-cent tax on that article of necessity, while the woman who buys a pair of earrings for $1,000 for adornment only is being asked to pay a 20-percent tax. That seems all wrong.

Eighty percent of all handbags sell at retail for less than $7.50 each. Of this 80 percent, more than 60 percent are sold at retail for less than $3 each. All the way down to $2, $1, 59 cents, and 29 cents each, including bags for children.

A tax on all handbags will affect the great mass of consumers who must of necessity buy the lower-priced handbags. The handbags that retail for more than $10 each do not amount to more than 10 percent of the total of all handbags sold. The present excise tax of 10 percent on handbags and purses applies only to handbags and purses with frames, snaps, catches, buckles, or clips made of or ornamented, mounted, or fitted with precious metals or imitations thereof. The term "precious metals" includes platinum, gold, silver, and other metals of similar or greater value. The term imitation thereof includes platings and alloys of such metals. This definition definitely stamps such handbags and purses as article of jewelry and for that reason were taxed 10 percent as being an article of jewelry.

Surely, it is not the intention of the Government to raise the tax on jewelry from 10 percent to 20 percent and to place a tax of 25 percent on handbags regardless of the materials they are made of. Jewelry, as defined in the excise regulations includes articles designed to be worn on the person or apparel for the purpose of adornment. Jewelry admittedly a luxury, is being taxed 20 percent and handbags 25 percent.

A handbag is a cost-of-living item, an article of necessity to women in the service, to women in every walk of life. A handbag is the most important of all the accessories worn or carried by a woman. From handbags, all other accessories are geared. It is more important than gloves, yet a tax on gloves would be regarded as inflicting a hardship on women. We do see women on the streets without hats, without gloves, and even without stockings. Observe whether you ever see a woman on the street without a handbag. Women are conscious of their handbags; they know the value of handbags; they know the feel of leather, quality of linings. Ninety percent of all handbags are bought for their utility value.

If the Government finds that certain types of handbags should be classified as articles of jewelry and therefore deem it to be an article of luxury, we are in accord with any decision to continue the tax on such articles, but to tax handbags used by the millions of women for utilitarian purposes just because their clothes do not happen to be made with pockets seems discriminatory and unfair. As men, I feel we are not capable of knowing the importance of a handbag to women, what articles are necessary for them to carry with them in their handbags for daily use. Just because that handbag is made in one shape or another or made of one material or another or in any particular size should not make them taxable.

Shoes are not taxed because they are made of alligator leather instead of calf. Gloves are not taxed because they are made of leather instead of cloth. Women's hats, belts, scarves, all items admittedly less essential than handbags are not taxed at all.

The handbag industry has accepted shortages and restrictions of materials cheerfully and understandingly. The industry is contributing its share of taxes to the support of the Government. Any tax as is contemplated, if placed upon handbags, is certain to be a hardship upon the industry. Women may continue to carry handbags but they will be the best they know how to make themselves, the nontaxable kind.

I should like to submit a brief to the committee.

The CHAIRMAN. You may do so.

Senator WALSH. Did you appear before the Ways and Means Committee?

Mr. MITTENTHAL. No, sir; we did not.

Senator WALSH. So you first learned of this after the bill was reported by the Ways and Means Committee of the House?

Mr. MITTENTHAL. That is correct.

Senator WALSH. You had no opportunity to present your views.

Mr. MITTENTHAL. None at all.

The CHAIRMAN. At present your tax is 10 percent?

Mr. MITTENTHAL. Only on certain types of handbags that are ornamented with precious metals or imitations.

The CHAIRMAN. And this is a 25-percent tax?

Mr. MITTENTHAL. The proposed tax is 25 percent.

The CHAIRMAN. And covers all types of handbags?

Mr. MITTENTHAL. Yes. There is no definition given of what a handbag or price is.

Senator WALSH. The proposed tax on luggage is a wholesale tax?

Mr. MITTENTHAL. Yes. That was a wholesale tax; this is a retail tax.

The CHAIRMAN. Thank you.

Mr. Walinsky.

STATEMENT OF OSSIP WALINSKY, REPRESENTING THE POCKETBOOK WORKERS UNION OF NEW YORK

Mr. WALINSKY. My name is Ossip Walinsky; I reside at 100 West Thirty-second Street, New York City. I represent the Pocketbook Workers Union of New York.

Mr. Chairman, on behalf of labor in the handbook and pocketbook and leather goods novelty industry, I join in support of all the arguments presented by Mr. Mittenthal on behalf of the National Manufacturers Association. I ask for about 5 minutes time to supplement a few of the facts presented to you.

The CHAIRMAN. You may proceed. We will be glad to hear you.

Mr. WALINSKY. The handbook industry prior to the war was on the verge of bankruptcy because of the nature of the trade and the competition from Offenbach, Germany. When I came to this country from England in 1912 I know that the English had surrendered to the German competition, but here in the United States we have managed to make some progress, so much so that prior to the present World War we had become a country not only supporting the 54,000,000 women of America with ladies' handbags and pocketbooks, but we had been exporting handbags to England, to South Africa, to Australia, New Zealand, Cuba, and the South American countries.

This is about the first time since our small manufacturers—and the average number of workers employed in our factories is only between 18 and 22; it is a struggling and pioneering industry—a poor industry. The employers are poor and the workers are poor. I have been here listening to billions, and astronomical figures, and for the first time I found myself in good company—railroads and natural gas.

We are dealing with purses and key cases. A laboring woman, trudging the streets in the darkness of night, from the night shift, and carrying a key case to open the door, is being asked to pay a 25-percent excise tax; and the soldier carrying a billfold, with a little leather-backed frame, carrying the most precious thing in life, namely, a picture of his mother or his sweetheart or his sister, they are being called upon to pay an excise tax on that billfold in the amount of 25 percent, and the workers of our industry really do not understand what this great country of ours is coming to.

I represent a city, one of the 17 cities that Mr. Mittenthal spoke about, namely, the city of New York, and in the city of New York we have the so-called men employees in the industry. All other States have female labor, but the pioneers of our industry, the men who have been struggling for the last 35 to 50 years, live and labor in the city of New York. These men are members of the union that I represent. These men are still working; they are not on the relief

rolls and they do not want to be on relief. They do not want to apply for old-age pensions, but if the volume of business should be cut, as it must be cut, to the extent of 30 percent at least, my members will have to go on relief. There are no war jobs available for these advanced-age men.

Handbags are being distributed alongside of shoes. The shoe shops are the largest distributors, the shoe chains, of handbags. A handbag is an item of women's apparel. Is it the intention to single out the 20,000 workers in the handbag industry for discrimination and assassination? Is it the intention of you gentlemen to tax tomorrow shoes or clothing or any other item of women's apparel? We do not understand that.

That is why, Mr. Chairman and gentlemen of the Senate Finance Committee, we ask for the privilege to present a brief stating the views of labor in the industry, and, in support of my contention, the contention of labor, Mr. Shavok, of the American Federation of Labor, is present here and he authorizes me to tell you that ladies' handbags and pockets, billfolds and key cases are a budget item, affecting the family budget, and the women wage earners of America.

We say to you, take into consideration on one hand that labor is asked to hold the line, hold the line, we must not ask for more wages. We have ceilings. Wages have been frozen. On the other hand, we are being called upon every day to pay more for the necessities of life, the key case, the billfold, the handbags, all of which are in this category.

I thank you.

The CHAIRMAN. Are ordinary billfolds taxed under the House bill at 25 percent?

Mr. WALINSKY. Everything. They are, in our opinion, absolutely singling out our industry for ruination.

The CHAIRMAN. Have you had a tax on them before?

Mr. WALINSKY. No, sir; and this is the first time we have been appraised as to the pending tax.

The CHAIRMAN. That is, you had no tax on ordinary billfolds unless they came under the category of jewelry?

Mr. WALINSKY. Yes, sir; as interpreted by the Treasury Department of the United States.

Thank you, sir.

The CHAIRMAN. Thank you very much.

Mr. Morris, you are appearing for Mr. Sutherland?

Mr. MORRIS. Yes. My name is Logan Morris, 837 Munsey Building, Washington, D. C. I am a partner of Mr. Satterlee. Unfortunately he was ill and unable to come today, and in order to present the points he had in mind discussing, I would like to present the statement which he prepared for the committee. I think I can do it in that way more quickly and accurately.

The CHAIRMAN. Very well.

STATEMENT OF HUGH SATTERLEE, REPRESENTING SATTERLEE, GREEN & SHER

Mr. MORRIS (for Mr. Satterlee). In part as chairman of the committee on taxation of the New York County Lawyers' Association and

in part as an individual lawyer, I respectfully submit the following recommendations regarding the revenue bill of 1943:

Antiwindfall provision of Current Tax Payment Act of 1943: In addition to the increase in income tax for 1943, amounting to 25 percent of the tax for 1942 or 1943, provided for by subsections (a) and (b) of section 6 of the Current Tax Payment Act of 1943, subsection (c) provides for a further increase equal to 75 percent of the excess of the tax for 1942 or 1943 over such a tax for 1942 or 1943 as would result if the sum of the surtax net income for a base year (meaning any one of the taxable years 1937 through 1940) plus $20,000 constituted the surtax net income for the taxable year 1942 or 1943. The antiwindfall provision was designed to reach the limited group of individuals whose incomes have increased greatly in 1942 and 1943, due to war profits. However, its effect is also to penalize arbitrarily and unjustly other classes of individuals not sharing in war profits.

In addition to individuals whose earnings have normally increased from year to year as they grow older and more experienced, there are individuals in whose situation radical changes occurred fortuitously between 1940 and 1942. Many citizens of war-torn countries, who have become residents of the United States, particularly since the occupation of France, Belgium, and Holland in 1940, have brought within the ambit of Federal taxation considerable income from their investments or services. Such income may be and in most cases probably is less than the income which they received in their own lands, although none of it or very little of it was taxable income in any of the years 1937 through 1940 as derived from sources within the United States. Consequently, in its present form the windfall provision would in effect tax income for prior years from sources outside the United States, which this country could not and did not attempt to tax.

Again, prior to 1942 many wives, separated from their husbands by divorce or otherwise, received annual alimony, the amount of which was determined by the courts or by mutual agreement with the knowledge that such payments were not taxable to the wife and were not deductible by the husband. Beginning in 1942 alimony payments have been subjected to tax to the wife and allowed as a deduction to the husband. This change, although sound in principle, has resulted in considerable hardship to many recipients of alimony fixed in years when its receipt was free from tax. Added to this burden would be the serious effect of the windfall provision, since in the base years these wives whose income was confined to alimony payments had no taxable income, because the income which they received was attributed and taxed to their husbands.

Another class of unfortunates comprises the wives, children, and other beneficiaries of the estate of a decedent who died in the period between 1940 and 1942 or whose estate was distributed during that period. The receipt of income from such source by such beneficiaries in 1942 and 1943 does not warrant duplicating the tax, since presumably the income from the same property was subjected to tax to the decedent or his estate in the base years. A similar situation arises where a beneficiary of a trust first receives income therefrom after the base years, although the income from the same trust corpus was taxed to a previous beneficiary or to the trust in each of the earlier years. Similarly, an individual in the period just before 1942 may

have become the donee of an annuity, the donor of which had in previous years been taxed on the income from the funds used for the purchase of such annuity.

Following is a draft of proposed amendment to section 6, which it is believed would relieve the inequity in subsection (c) without appreciably affecting the revenue.

SEC. 505. Section 6 of the Current Tax Payment Act of 1943 is hereby amended as of the date of enactment of such act by inserting at the end of subsection (c) the following:

This subsection shall not apply (A) in the case of an alien who became a resident of the United States in 1940 or thereafter, and for the purpose of determining whether or not this subsection is applicable and of computing any additional increase in the tax for 1943 under this subsection there shall be included in the surtax net income for the base year (B) in the case of a wife receiving payments included in gross income under subsection (k) inserted in section 22 of the Internal Revenue Code by section 120 of the Revenue Act of 1942 an amount equal to such payments for 1942 or for 1943, as the case may be, and (C) in the case of a beneficiary of a trust, or of a distributee of an estate, or of the holder of an annuity, an amount equal to the excess of the income from the trust, or from the estate, or from the annuity, for 1942 or for 1943, as the case may be over the income from such trust, or from such estate, or from such annuity, for the base year.

Deduction of accrued State income taxes: In connection with its consideration of a revision of New York income-tax statutes the State tax commisison has suggested the propriety and equity of permitting the deduction from gross income for Federal income-tax purposes of accrued State income taxes in the case of individuals who file their returns on a cash basis. It often happens, because of the fluctuations in income from year to year, that a taxpayer who had comparatively little income in the next preceding year and accordingly a small State tax payable for that year, in the taxable year has substantially greater income from which only the State tax for the previous year may be deducted, although for the current year the State tax is substantially greater. The deduction of the State tax based on income of the same year as the Federal tax would prevent distortion.

The following is a proposed amendment to section 43 of the Internal Revenue Code, which it is believed would accomplish the result proposed:

SEC. 118. Section 43 of the Internal Revenue Code (relating to period for which deductions and credits taken) is amended by inserting after the first sentence thereof the following:

"A taxpayer whose net income is computed upon the basis of the cash method of accounting may deduct income, war-profits, and excess-profits taxes imposed by any State of the United States which shall have accrued in the taxable year, provided no such tax shall be deducted in more than one year."

Gifts to bar associations: Although bar associations are held to be in the nature of civic leagues which are exempt from tax on their income, in certain decisions gifts to a bar association have been denied deduction as contributions to a corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes. It is believed that gifts to bar associations, which help materially in the improvement of the administration of justice, should be encouraged.

It is urged, therefore, that section 23 (o), relating to the deduction from gross income of charitable and other contributions, section 812 (d), relating to transfers at death for public, charitable, and religious

uses, and section 1,004 (a) (2), relating to charitable, and so forth, gifts inter vivos, be amended to provide for the treatment similarly to educational institutions of domestic bar associations, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Acquisitions to avoid income or excess-profits tax: The revenue bill of 1943 proposes in section 115 to insert a new section 129 in the Internal Revenue Code, providing for the disallowance of deductions, credits, or allowances, where any person acquires an interest in, or control of, a corporation or property, and the Commissioner finds that one of the principal purposes for which such acquisition was made or availed of is the avoidance of Federal income or excess-profits tax by securing the benefit of a deduction, credit, or other allowance. It is assumed that this provision is directed primarily at the practice of acquiring corporations with a large invested capital, but small present assets. But the provision goes much further than that and would furnish a fertile field for litigation and for arbitrary exactions by the Treasury Department.

As the language of the section now stands, it could be interpreted by the Treasury Department to cover, for example, the case of an acquisition by an individual through an exchange for other property of an office building or apartment house, which for lack of tenants may have comparatively little value, and one of the considerations in the mind of the purchaser may be that deductions for depreciation will help him to carry the property until it becomes profitable. Certainly it cannot be the intention of the new section to prevent or penalize such business transactions. Through bitter experience with section 102, in which the element of purpose is the controlling factor, we know that a finding of purpose by the Commissioner, however unwarranted, is almost impossible to overcome.

If the section is to remain in the bill, it should be limited in its scope. It is suggested in any event that the words "or property" after "corporation" be eliminated.

Trusts for maintenance or support of certain beneficiaries: By section 116 of the bill, section 167—relating to income for benefit of grantor—is amended to provide that income of a trust shall not be taxable to the grantor merely because such income, in the discretion of another person or the trustee, may be applied or distributed for the support or maintenance of a beneficiary whom the grantor is legally obligated to support, except to the extent that such income is so applied or distributed. This provision was inserted to avoid the effect of the *Stuart* decision in the Supreme Court, which construed the statute differently from its previous consistent interpretation over many years.

However, it is not clear whether or not the proposed amendment would cover the case of discretion in the trustee to apply a portion of the corpus to the support of a beneficiary whom the grantor is legally obligated to support. Section 166 of the code provides that where the power to revest in the grantor title to any part of the corpus is vested in any person not having a substantial adverse interest, then the income of such part of the trust shall be included in computing the net income of the trust to tax to the grantor simply because of an unexercised right in the trustee to apply principal to the benefi-

ciary's support than there is in the case of an unexercised right to apply income.

In order to avoid uncertainty and possible confusion it is accordingly suggested that a new subsection (b) be inserted in section 116 of the bill, providing substantially as follows:

Section 166 (relating to revocable trusts) is amended by adding at the end thereof the following:

"Income of a trust shall not be considered taxable to the grantor under this section or any other provision of this chapter merely because any part of the corpus of the trust, in the discretion of another person or the trustee, may be applied or distributed for the support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain, except to the extent that corpus of the trust is so applied or distributed."

Appointment of new trustee of certain discretionary trusts not transfer subject to gift tax: By section 502 of the bill, section 1000 of the Internal Revenue Code is amended by inserting provisions relating to discretionary trusts, the law with respect to which has been hopelessly confused by recent decisions of the courts. The section is salutary, but seems to require some revision.

One source of much doubt and uncertainty in respect of trusts created many years ago has been the inclusion in the trust agreements of a right in the grantor to appoint new trustees. Even in cases where the grantor has not exercised such right to the extent of appointing himself one of the trustees, the question arises whether the mere existence of such a right would subject the grantor's estate to estate tax and whether the relinquishment of such a power would subject the grantor to gift tax, even though the grantor in no way interfered in the affairs of the trust.

It is urged, therefore, that in order to meet this situation clause (1) of the proposed provision should be amended to read as follows, the new matter being italicized:

(1) no appointment, *nor the relinquishment of the right to appoint*, prior to January 1, 1945 of a new, successor, or additional trustee, or new, successor, or additional trustees * * *.

General sales tax: The foregoing proposals have been made in the interest of correcting inequities and defects in the law. They might to a minute degree diminish the revenue. As a means of substantially increasing the revenue, I advocate and have advocated for nearly 25 years the imposition of a general sales tax in the form of a turn-over tax or, in the alternative, a retail-sales tax. I have followed the arguments of its opponents for many years and, although they have shifted their ground from time to time, they have not improved the weakness of their position. One old argument was that, if the sales tax were imposed in this country, everybody would go to Canada or Mexico to make their purchases. It was also asserted that, even though a country-wide sales tax might not be disastrous, sales taxes limited to individual States and municipalities were simply out of the question. Of course, there are now sales taxes in more than half the States, and even a sales tax in New York City was pronounced a great success by Mayor LaGuardia, formerly an opponent of general sales taxes.

The principal present argument against the sales tax is that it is regressive. Practically all taxes are, except income taxes, which are admitted by most people to have reached their zenith. A combination

of income taxes and a general sales tax, each complementing and supplementing the other, is sound and logical. No one asks that the sales tax supplant income taxes.

Since the sales tax has not been tried on a national scale, it would appear sensible to impose a tax at a comparatively low rate, perhaps 2 percent if a turn-over tax, and 5 percent if a retail-sales tax, until it could be found what inequities and defects, if any, need to be ironed out. No one will ever know how a general Federal sales tax would work until it shall have been put into effect. There has been altogether too much theorizing without any basis in experience. The income tax has been tinkered with constantly since its enactment in 1913, but no one advocates its repeal because it constantly requires revision.

A general sales tax appears inevitable, if the revenue requirements of the country are to be met.

The CHAIRMAN. All right, sir; thank you very much.

Mr. MORRIS. Thank you for this opportunity.

The CHAIRMAN. Perhaps we have time to hear one additional witness. Mr. Weaver, did you wish to appear this afternoon?

Mr. WEAVER. If it is convenient to you.

STATEMENT OF H. R. WEAVER, FIRST VICE PRESIDENT AND TREASURER, INTERNATIONAL PAPER CO.

Mr. WEAVER. Mr. Chairman and gentlemen of the committee, my name is H. R. Weaver. I am appearing in behalf of International Paper Co. of which I am first vice president and treasurer. International does the largest volume of business and is one of the oldest paper companies in the United States: It engages in nearly every phase of the industry. It sells its newsprint to newspapers published in practically every State east of the Mississippi River and in several States west of it. The operation of its kraft paper plants and of its timber holdings in Louisiana, Alabama, Mississippi, Florida, Arkansas, and South Carolina represents one of the principal industrial activities in each of these States. Its continuing welfare is, therefore, of more than ordinary interest to the people of an extensive section of the country.

I have appeared before this committee in the past and I do not think it necessary to burden you again with a recital of my qualifications in regard to corporate taxation. Suffice it to say that I have been in business for over 34 years and have had charge of the corporate income taxes of International Paper Co. for over 26 years.

In August 1942 I argued before you that the tax bill as then proposed was unfair to corporations whose excess profits exemption was calculated on the invested-capital basis. I gave you an example showing how the taxes on a typical so-called invested-capital corporation had been increased since 1940 far out of proportion to the increase in the taxes of a comparable average-earnings corporation. Nevertheless, the 1942 act was passed continuing and even further exaggerating this discriminatory treatment.

The House has now passed a bill which further discriminates against the large invested-capital corporations by reducing, by another 1 percent, the percentage allowed on invested capital in the calculation of the excess-profits exemption.

The following table shows how these percentages rates have been continuously reduced up to and including the proposals for 1944 and the corresponding reduction in dollars in the excess profits exemption, while during the same period the exemption for the average-earnings companies increased materially:

	First $5,000,000 of invested capital	Second $5,000,000 of invested capital	Excess up to $200,000,000 of invested capital	Over $200,000,000 of invested capital	Exemption based on $150,000,000 invested capital plus 30 percent net left in business	Exemption based on $15,000,000 average earnings in base period
	Percent	*Percent*	*Percent*	*Percent*		
1940	8	8	8	8	$12,005,000	$12,010,000
1941	8	7	7	7	10,881,819	14,255,000
1942	8	7	6	5	9,640,733	14,255,000
1943	8	7	6	5	9,255,440	14,225,000
1944 (proposed)	8	6	5	4	8,473,266	14,260,000

Assume a corporation had an invested capital of $150,000,000, and was on the invested-capital basis, and it left in the business 30 percent of its net earnings each and every year. Its excess-profits exemption would have gone down from $12,005,000 in 1940 to $8,473,266 in 1944 under the House bill, and in that same period of time, if we take the average-earnings corporation and assume that they earned $15,000,000 in the base period, having the same invested capital of $150,000,000, which would be 10 percent, on its invested capital, their excess-profits exemption went up from $12,010,000 in 1940 to a proposed $14,260,000 in 1944.

These figures show clearly how the excess-profits exemption has been reduced continuously to the large invested-capital corporation while it was actually increased in 1941 for the average-earnings corporation and has since so remained.

Let me show you exactly how these reductions in the excess-profits exemptions affect unfairly the total taxes of a typical large invested-capital company as compared to a similar average-earnings company. Let us assume that both companies have invested capital of $150,000,000 as of January 1, 1940, and that the taxable earnings of each were $25,000,000 in each of the years 1940–44. The invested-capital corporation, however, earned an average of only $7,000,000 per annum in the base period 1936–39, while the average-earnings corporation averaged $15,000,000. Assume that the former company has left 30 percent of its net cash earnings in the business each year beginning in 1940. This figure is on the low side from the standpoint of sound corporate practice, but as will hereafter appear even this will probably, under the House proposals, seriously affect dividend disbursements. Assume further, that the excess-profits-tax refund for 1942

and 1943 further increases its invested capital. The following table will show the taxes for each company for each of these years:

	Taxes paid by invested-capital company	Percent	Taxes paid by average-earnings company	Percent	Difference in favor of average-earnings company
1940	$9,451,500	37.8	$9,449,000	37.8	$2,500
1941	12,583,311	54.2	12,186,690	43.6	1,396,621
1942	[1] 16,297,299	65.2	[1] 14,405,450	57.6	[1] 1,891,849
1943	[1] 16,208,270	64.8	[1] 14,405,450	57.6	[1] 1,803,820
1944	[1] 17,519,664	70.0	[1] 14,886,700	59.5	[1] 2,632,964
Total					7,727,754

[1] After deducting excess-profits-tax refund.

The invested-capital company in 1940 would have paid $9,451,500 in taxes; the average-earnings company, covered by this example, would have paid $9,449,000, or approximately the same amount of taxes. Without reciting the figures through each one of the years, in 1944, under the proposed House bill, the invested-capital company would pay $17,519,664 in taxes, and the average-earnings company would pay only $14,886,700, and both of these figures are after deducting the excess-profits-tax refund.

From this table two things are apparent:

(1) That during the period from 1940 to 1944, both inclusive, the invested-capital corporation will have paid approximately $7,700,000 more in income and excess-profits taxes than the comparable average-earnings corporation despite the fact that they both had identical invested capital at the beginning of 1940 and identical annual earnings and started at the same rate of tax in 1940;

(2) That in 1944 (as is now proposed) and presumably thereafter for the indefinite future, the invested-capital corporation will pay at the rate of approximately $2,600,000 more per annum in income and excess-profits taxes than the average-earnings corporation although they both had identical invested capital at the beginning of 1940 and identical annual earnings thereafter. In other words, our invested-capital corporation which had the same amount left after taxes as our average-earnings corporation in 1940, from and after 1944 has annually over 26 percent less in the treasury after taxes.

Senator WALSH. Did you appear before the Ways and Means Committee?

Mr. WEAVER. This provision was not in the former law and we had no advance notice that the Ways and Means Committee intended to insert such a provision in the law.

Senator WALSH. Then you did not present to them the argument you are presenting here?

Mr. WEAVER. No, sir.

If two such corporations were in competition, the effect of such discriminatory treatment is too obvious to merit argument.

I realize that the example I have given could not possibly measure the effect of the discrimination on all corporations but it does show the relative effect in one instance which is not by any means extreme.

The CHAIRMAN. I think we will have to go over to vote. Either you can return tomorrow morning or file your statement.

Mr. WEAVER. I would like particularly to cover this section that is coming. May I go on first tomorrow morning?

The CHAIRMAN. Yes. Were you originally assigned——

Mr. WEAVER. I was originally assigned for tomorrow morning and they were short of people and I was asked if I would be ready to go on today and I said I would.

The CHAIRMAN. Thank you very much. The committee will recess until tomorrow at 10 o'clock.

(Thereupon, at the hour of 5:55 p. m., a recess was taken until 10 a. m., Wednesday, December 1, 1943.)

REVENUE ACT OF 1943

WEDNESDAY, DECEMBER 1, 1943

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

The committee met, pursuant to adjournment, at 10 a. m., in room 312 Senate Office Building, Senator Walter F. George (chairman) presiding.

Present: Senators George (chairman), Walsh, Barkley, Clark, Byrd, Gerry, Guffey, Johnson, Vandenberg, Davis, Taft, Thomas, Butler, and Millikin.

The CHAIRMAN. The committee will please come to order.

Mr. Weaver——

Senator VANDENBERG. Mr. Chairman, Senator La Follette called me this morning. He is still ill. He is very anxious to have a witness from the Post Office Department to testify as to whether or not the change in the postal rates will have any effect on the volume of mail, and whether it is a practical idea.

The CHAIRMAN. Did he indicate whom he would like to have?

Senator VANDENBERG. No. He suggested that the Postmaster General be requested to furnish us a witness who could give us authentic information on the subject, and I think it is a good idea.

The CHAIRMAN. Very well.

Mr. Weaver, you may proceed.

STATEMENT OF H. R. WEAVER—Resumed

The CHAIRMAN. Mr. Weaver, you were in the midst of your statement yesterday when we had to recess on account of the vote in the Senate.

Mr. WEAVER. Yes, sir.

The CHAIRMAN. You may proceed.

Mr. WEAVER. Just so we get a starting-off point, I have been arguing against the decrease in the percentage rate allowed in determining the excess-profits credit for invested-capital corporations, and I had presented tables that show how the invested-capital credit had been decreased continuously for invested-capital corporations and it had been increased for the average-earnings corporations.

I also showed what the exact effect of the tax is, taking a typical example of two corporations each having an invested capital of $150,000,000, but one of them being on the average-earnings basis and one being on the invested-capital basis. I then come down to this part of my statement.

The report accompanying the House bill attempts to justify the added discrimination now proposed as follows:

> Under the invested-capital method, corporations are permitted to increase their invested capital by plowing back into the business earnings which have not been subject to taxation in the hands of the individual shareholder. However, corporations using the average-earnings method are not permitted to increase their earnings base by plowing back into the corporation profits which have not been subject to taxation in the hands of the shareholders. * * *
>
> In view of this obvious advantage of the invested-capital method over the average-earnings method, it does not seem unreasonable further to reduce the invested-capital credit, particularly with respect to capital in excess of $5,000,000.

It is hard for me to believe that anyone familiar with the actual practical figures involved would seriously suggest that the advantage referred to is anything like commensurate with the advantageous treatment which has been accorded the average-earnings corporation since 1940.

Had there been no change in the rates allowed large invested-capital corporations in computing excess-profits exemptions (actually, of course, they have been reduced) and had the typical invested-capital corporation described in my example left in the business 80 percent of its net earnings after taxes each year plus the excess-profits refund for 1942 and 1943, its excess-profits exemption would have been increased from 1940 to 1944 by $1,265,567 (8 percent on $15,819,590). As against this the exemption of the similar average-earnings company given in the example was increased $2,245,000 in 1941 and this has been since left untouched. Thus the average-earnings corporation has, in this alone, had an advantage almost twice as great as the advantage accruing to the invested-capital corporation from 1940 through 1944.

But there is still another angle to the situation: This consists in a comparison of the tax benefits to be derived from leaving net earnings in the business in the year 1943 (which, in substance, is the House's justification for reducing the excess-profits credit in 1944) with the detriment inflicted by the reduction in the excess-profits credit and the consequent increase in taxes thereby produced.

Earnings left in the business—again on the 80-percent basis plus the excess-profits refund for 1943—would increase the excess-profits exemption $179,566, whereas the reduction in rate would decrease the exemption $1,602,650, or nearly 10 times as much. In terms of taxes the advantage would be $81,702 and the disadvantage $729,205 for 1944.

These figures make it clear that there still remains a serious discrimination against the large invested-capital corporation after allowing for the effect of earnings left in the business. This discrimination is unfair and cannot be justified by any sound economic principle.

I would just like to say a few words that are not in the statement. The discrimination here seems to arise solely on the question of size. I have no argument at all with the 8-percent rate which was in effect for every size corporation using the invested-capital method. For 1940 that was correct but in subsequent years that exemption of 8 percent has been reduced in each and every year with the exception of 1943, of course, but based only on size. That is, the corporation that has more than $5,000,000 invested capital gets kicked down 1 or 2 percent.

Then, over that, up to $200,000,000, it is reduced some more, and over $200,000,000 they have now got it down to 4 percent.

I do not believe mere size in and of itself should be a factor that would cause increased taxes to be imposed against the corporation. It is not true in the average-earnings corporation. You do not increase the tax burden by allowing a smaller exemption merely on account of size, you give them their average earnings which they should have no matter what their average earnings were in the base period.

Now, let us take the type of corporation that is affected, just speaking very generally. Of course, we have no definite and accurate statistics on the subject, but Standard Statistics made quite a study of it in 1941, and, speaking generally, there are four big groups in our business life that fall in this invested capital class. Those are the railroads, the steels, public utilities, and the paper companies. Now, of course, there will be certain companies within those groups that will be in average earnings, and surely those constitute four of the most important groups in the country for the winning of the war effort. Every one of them is doing a vitally needed effort in this whole situation, and I do not see why they should be discriminated against, merely on size. Of course, you realize a large corporation is large because it is more economical for it to be large. It has to handle big activities and it must, of necessity, be large.

The CHAIRMAN. Mr. Weaver, I do not think it is on account of the size of the invested capital so much. It is a fact that some of the corporations have such a high invested capital until they pay no excess-profits taxes. They are directly in the war work. It might be said if they do not pay it they haven't earned any excess profits. I believe that is an answer that might well be made, but there are a few companies, the largest in the country, with a very heavy capital investment whose credit against excess-profits taxes have kept them out of the excess-profits brackets, although they are engaged directly in the war work. So, I think that may be more the reason than the size that you put your emphasis on.

Mr. WEAVER. It may be. I was merely referring to the fact it works out that way in the rates.

The CHAIRMAN. That is true.

Mr. WEAVER. So much for the discrimination angle.

Now, let us look at the effect of these proposed rates on our typical invested capital corporation. Let us look independently of any comparison at the effect these reduced excess-profits exemptions would have on an invested capital corporation. I am fully in accord with the theory that real corporate excess-profits should be taxed heavily to help pay the cost of the war. Parenthetically, however, I should like to observe that in my judgment a 95-percent rate tends to defeat its own purpose under the law of diminishing returns and to take away practically all incentive for economy.

I said that I did not oppose high excess-profits taxes. But I am very much concerned with the definition of what constitutes excess profits; in other words, the manner in which the excess-profits exemption is calculated, particularly for large corporations which are forced to use the invested capital basis.

Going back to the example I previously gave you, an invested capital company having original invested capital of $150,000,000 (and increasing this to $165,265,327 by 1944 by leaving 30 percent of its hypo-

thetical net profits in the business each year) and taxable earnings of $25,000,000 would have $17,519,664 net, in income and excess-profits taxes for 1944 under the rates proposed in the House bill. This would leave the corporation net income after taxes of $7,480,336.

To determine the cash earnings available to the corporation, we would have to deduct from this figure the excess-profits tax refund of $1,570,039 which is not immediately available in cash, leaving only $5,910,297 available for corporate purposes and return to stockholders. If we assume that 30 percent of net cash earnings is a reasonable amount to leave in the business—and we have already remarked that this is on the low side from the standpoint of sound financial practice—then we find only $4,137,207 left available for stockholders—a return in a good year of 2.75 percent on the original capital of $150,000,000 (or less on the present capital if we give effect to the increase produced by the earnings assumed to have been left in the business since 1940).

If one-half of the capital of the corporation were in the form of a 5 percent preferred stock, the dividend on the preferred stock (5 percent on 50 percent of original capital=2.5 percent of original capital) would practically exhaust the total amount available for all stockholders leaving almost nothing for the common stock.

EFFECT OF SUCH TAXATION ON FUTURE OF THE CORPORATE SYSTEM

I submit that when taxation is used to limit returns to stockholders, in a good year, to any such return as in the example just given, you are setting the stage so that common stock will ultimately disappear as a medium of corporate finar cing. Who would want to put their money in a security which in good years, with no preferred stock outstanding ahead of it, could pay a maximum of 2.75 percent and in bad years nothing or with a reasonable amount of preferred stock ahead of it could pay nothing even in good years?

Common stock is the foundation of the corporate system. Only after a substantial portion of the required capital has been raised from this source can additional capital be raised by the sale of preferred stock or bonds. Thus, if comon stock becomes unsalable the end of the corporate system is in sight.

I should like to emphasize the importance of the large corporation in the development of our country up to the present time, but more especially its importance as a vehicle for further development in the post-war period. The resources of our country have been developed by corporations because they offer the best medium for raising large amounts of capital from all classes of our population and using this capital efficiently. They have made profits and distributed these profits to investors, thus encouraging further investment and business expansion.

If now, in order to raise a relatively small amount of additional revenue, you tax an important number of these corporations so heavily that the whole system loses the force and the opportunities it has had in the past, then in truth have you killed the goose that lays the golden egg. And likewise you have eliminated one of the best agencies for carrying on an expanding business in the post-war period which will be so sorely needed if our boys are to have jobs when they come home again.

I submit that this is unwise.

SUGGESTIONS TO REMEDY THE SITUATION

I believe that the percentage rate allowed on invested capital in determining excess-profits exemptions should be a flat 8 percent with no gradings based on mere size. Statistics show that more than 50 percent of the stock of large corporations is owned by people having an annual income of $10,000 or less. Small corporations may be and frequently are owned by a few rich individuals. There is no fundamental soundness or propriety in allowing a stockholder in a $5,000,000 corporation a larger return on his investment than a stockholder in a $50,000,000 corporation. Mere size means nothing.

I also believe that preferred stock and preferred stock dividends should be treated respectively at the option of the taxpayer as debt and interest on debt.

These two steps would go a long way in restoring the confidence of the investing public in corporate stocks with resultant benefits to the country as a whole, particularly in the post-war period.

WITH REGARD TO LOSS OF REVENUE

The additional revenue proposed in the House bill to be derived from lowering the excess-profits credit for large "invested capital" corporations by one percentage point has been estimated to be about $156,000,000. This added burden imposed on the country's corporations will all be paid by the larger corporations reporting on the invested capital basis. Not one penny will be paid by the small "invested capital" corporation or by the "average earnings" corporation, regardless of the size of the latter's invested capital.

The loss of revenue which would be suffered by refraining from imposing this additional burden on the already discriminated against large "invested capital" corporations will not amount to $156,000,000 however. A reduction in corporate taxes—or, put another way, the failure to raise them—would be offset by an increase in the amount of personal income taxes. It is axiomatic, particularly now that most corporations have accumulated sufficient working capital to conduct business at today's pace, that higher corporate taxes cause lower dividends, therefore, lower personal taxable income and vice versa. I have never seen this point covered in figures put out by the Treasury purporting to show the effect on total taxes of changes in corporate rates.

So the actual revenue loss to the Government from not adopting the House proposal would be relatively slight in any event. If deemed important enough, the amount could be made up by anyone of a number of rate adjustments which would not be nearly as onerous or fundamentally dangerous as the added burden proposed to be placed upon large "invested capital" corporations.

I thank you.

The CHAIRMAN. Thank you very much, Mr. Weaver.

Senator Scrugham wished to appear, but he has not come in yet. We will get back to him when he does come in.

Mr. Richmond.

STATEMENT OF KENNETH C. RICHMOND, REPRESENTING NATIONAL RETAIL DRY GOODS ASSOCIATION

The CHAIRMAN. Mr. Richmond, you are representing the National Retail Dry Goods Association?

Mr. RICHMOND. Yes, sir.

My name is Kenneth C. Richmond. I am vice president and treasurer of Abraham Strauss & Co., Brooklyn, N. Y.

The CHAIRMAN. You may proceed.

Mr. RICHMOND. The National Retail Dry Goods Association for which I am appearing as chairman of its tax committee has been in existence for more than 30 years, and has been interested in the problems of taxation throughout that period. The association is composed of more than 7,000 retail dry-goods, department, and specialty stores located in every State in the Union.

We wish, first, to compliment Congress for having recognized, in connection with the new revenue bill, the burden of taxes which has already been placed on taxpayers of all classes. In appraising this year's problem, you have wisely, justly, and properly given recognition to the inability of our citizens to pay further substantial increases in direct taxes in view of their existing obligations and commitments. The present tax burden is already causing unbearable hardship to a large section of our citizens.

Millions of white collar workers are caught between the pincers of wage stabilization, rising costs of living, a 20 percent withholding tax, a deduction for Social Security, an obligation to pay 25 percent of their 1942 tax in 1944, and a patriotic duty to purchase war bonds. Any substantial increase in our present income tax rates would destroy initiative, throw thousands of our citizens into bankruptcy, and, as far as retailers are concerned, would cause substantial write-downs in receivables. Because Congress has recognized this situation, we do not come to you in a critical spirit regarding the provisions of the bill but would like to briefly direct your attention to the few points which we feel should have your consideration.

PERSONAL INCOME TAXES

The proposed Revenue Act of 1943 includes new tables of withholding tax amounts, effective January 1, 1944. A change at so early a date following the passage of the bill would require over 2,000,000 employers to completely revise the amount of tax to be withheld for each of their employees. It would also require them to inform each of their employees regarding the new amounts to be withheld and to obtain a new declaration of each employee's marital status and number of dependents. Employers using addressograph equipment or card-punch machines or notations on their pay-roll records will be compelled to make a tremendous amount of revisions prior to the first pay-roll week of January 1944. This will be a particularly busy period for all employers, because in January an individual statement of 1943 earnings must be prepared for each employee to comply with present law.

The new tables for withholding eliminate certain inequities in the present bracket system but do not develop amounts to be withheld

substantially different from the tables now in use. Under either set of tables the amounts withheld by the employer only approximate the tax amounts due from employees. In order to relieve the confusion of changing to a new schedule of withholding tax amounts by January 1, 1944, it is suggested that the new withholding tax tables be made effective April 1, 1944; that is, at the end of the first quarter rather than at the beginning of the year.

The new withholding-tax schedule has gone too far in eliminating the inequities of the present withholding tax bracket system. For instance, in the weekly pay period table there are 86 wage bands, by reason of using $1 brackets up to 59.99, $2 brackets from $60 to $99.99, $5 brackets from $100 to $149.99, and $10 brackets between $150 and $200. Eighty-six lines are too many for easy application in a pay-roll operation. The inequities of the present $5 bracket system can be corrected by taking $2 brackets up to $59.99, $5 brackets between $60 and $99.99, and $10 brackets from $100 to $200. This would reduce the number of wage bands to 46 and make it much easier to explain to employees and to apply by employers. No material over collection or under collection of tax will result from this simplification. Comparable adjustments could be made in the tables covering other pay-roll periods.

Our association originally proposed, before it was first enacted, the earned income credit for personal income taxes. We opposed its decrease to the present 10 percent. We deeply feel the inequity of eliminating it altogether. If eliminated it must be, we urge that provision now be made for its restoration beginning with the year which follows the termination of hostilities in the present war.

We make a similar recommendation in respect to the restoration of the right of individual taxpayers to deduct from their income excise taxes on nonbusiness purchases or expenses. We believe the Revenue Act of 1943 should automatically include the restoration of this right beginning with the year which follows the termination of hostilities. The injustice of imposing a tax on a tax can only be condoned by wartime considerations and should not be perpetuated.

CORPORATE INCOME TAX

The bill before you lowers the excess-profit tax credit under the invested capital basis by 1 percent on capital investment in excess of $5,000,000. At the same time it increases the excess-profits tax rate from 90 to 95 percent. A 95 percent rate will remove what little incentive there now remains to operate efficiently and to earn profits in excess-profit tax brackets. Furthermore, the House bill retains the present 10 percent rate for post-war refund of excess-profits taxes paid. Thus the House bill not only fails to make provision for post-war reserves but in many ways it deprives corporate taxpayers of their already inadequate opportunity to provide for necessary post-war adjustments. Corporations with debts are further deprived of the opportunity to repay such debts out of current earnings. In view of the recent and extended discussions of the need for post-war reserves for retailers, it seems to us that the least Congress can do is to maintain the opportunities, however limited, under present tax law to provide for this problem. We believe that the rate for post-

war refunds of excess profits taxes should be increased from 10 to 15 percent if it is necessary to increase the excess-profits tax rate from 90 to 95 percent.

RETAIL EXCISE TAXES

The proposed bill increases the excise taxes on the retail sale of jewelry, furs, and cosmetics from 10 to 20 or 25 percent, and changes the excise tax on luggage from 10 percent at the manufacturing level to 25 percent at the retail level. We are already having serious difficulty in determining the proper application of the present 10-percent tax on the retail sale of jewelry and furs. For example, the tax on jewelry applies to the sale of any article ornamented, mounted, or fitted with gold or silver or imitations thereof whether the article is jewelry or not. The Bureau of Internal Revenue has interpreted this tax to apply to such articles washed or sprayed with gold or silver where the plating, spraying, or washing equals one one-hundred thousandths of an inch or more in thickness. As retailers, we do not know nor have we any method of ascertaining whether the gold wash on the frame of a handbag or on a compact, umbrella handle, or coat button is more or less than one one-hundred thousandths of an inch in thickness. We do not know in many cases whether the article has even been washed or plated.

The present tax on furs applies to the sale of any article where fur is the material or component of chief value. In the case of women's and children's hats ornamented with a small piece of fur, children's toys in the form of hair-covered animals, and particularly in the case of women's and children's fur-trimmed cloth coats, we as retailers have no way of knowing whether fur is the material of chief value and whether the article is taxable or nontaxable.

To remedy this situation, we have requested the administrative agencies to require manufacturers to identify all taxable articles on their invoices or other evidences of sale to us. We have been told that there is no authority under the present law for such a requirement. Under the proposed rates of 20 and 25 percent and the penalties attached thereto, it becomes imperative that the manufacturers be required by statute to inform retailers as to which of the articles we purchase are taxable so there may be no unintentional violation of law by the retailers. This would also furnish the Bureau of Internal Revenue with a clear basis on which to examine our tax returns. Manufacturers know whether the articles which they manufacture have been plated with gold or silver. Their cost records show whether fur is the material of chief component value. In order to assure careful information on this point to retailers, manufacturers should be required to state the taxable status of the articles sold to us and to be exposed to some penalty for making misstatements. This will avoid manufacturers carelessly stating items to be taxable when, in fact, they are not taxable, and it will avoid consumers in such cases having to pay increased prices on items which Congress did not intend should be subject to these taxes.

RETAIL SALES TAX

For the last 2 years the National Retail Dry Goods Association has favored the imposition of a 5-percent tax on the sale of all tangible personal property at retail, including food. Such a tax would, of

course, reduce purchasing power and increase our difficulty in selling merchandise. We offered a sales tax as a partial solution to the extraordinary need for wartime revenues and because of the deflationary effect of such a tax, Congress has not yet imposed such a tax in recognition of the inability of our citizens to bear further tax burdens. We are glad that Congress has recognized the inability of our citizens to pay increased tax burdens of the magnitude last proposed by the Treasury.

In the process of reducing the recent demands of the Treasury Department for additional revenue, Congress has, however, increased the retail excise taxes on jewelry, furs, cosmetics, and luggage.

Retail excise taxes on selected items introduce insurmountable administrative difficulties and confusion, relatively low yield in proportion to the irritation and expense involved, and invite evasion. The collection of excise taxes on selected items of retail merchandise involves special accounting mechanisms and determination of special amounts of sales. A general sales tax on all items of merchandise at a single flat rate is simpler to administer and collect because the amount of sales to which it applies will generally correspond with the total sales figure now required on the income-tax return of the retailer. On the other hand, excise-tax returns on a selected list of items can only be verified by a large additional force of auditors at a much greater expense per audit. The present increases in the retail jewelry, fur, cosmetic, and luggage taxes discriminate severely against thousands of jewelry stores, fur shops, drug stores, and luggage shops and thousands of specialized manufacturers and wholesalers of these items as well as their employees, who derive their incomes from the production or distribution of these goods. While the taxing of so-called luxuries seems to have merit from a revenue point of view, it is also inflationary to the extent that customers are deterred from buying luxury items and so have funds to bid for scarce and essential goods. If it is necessary to increase tax revenues beyond the $2,140,000,000, in the present bill we favor a general retail-sales tax at a flat 5-percent rate rather than the further extension of so-called luxury taxes.

INCREASE IN POSTAGE RATES

The proposed bill calls for an increase of 50 percent in the first class postage rate in respect to local deliveries. Department stores transact from 40 to 70 percent of their business in a manner requiring them to render monthly bills or statements to local customers. We object to the proposed increase in the rate because of the burden it will place upon retailers who are already squeezed between frozen prices and unfrozen costs. Due to manpower problems, and the lack of mechanical equipment, a great many retailers are installing a new and simplified form of billing by which a copy of each salescheck is mailed to the customer at the end of the month in lieu of copying the transaction on the bill. The limit on the number of saleschecks that may be sent in the local area is such that in a sizable proportion of cases at least double the one-ounce rate is necessary. To increase this postage bill to the extent of another 50 percent will have a retarding effect on the number of stores who otherwise could be expected to adopt the new procedure as a desirable war-time measure. In view of the fact that

present first class mail rates are now self-supporting we believe the proposed increase in postage should be abandoned,

3-PERCENT TAX ON THE TRANSPORTATION OF PROPERTY

The hope of the retail trade and business in general, that the 3-percent tax on the transportation of property would be terminated in this revenue act has not been fulfilled. On the contrary it has been extended to include fourth class mail, i. e., parcel post. This tax is inflationary because it applies at each step in the process of manufacturing and distribution. It becomes an element of cost and exerts pressure on all price ceilings. The yield to the Government is not substantial since it is an allowable deduction from taxable income. If this tax cannot be repealed, we ask that an inequity be removed in its application to retailing.

In various cities otherwise competing stores have consolidated their deliveries to customers through mutually owned companies or a similar type of delivery service. In the past year several stores have given up their delivery systems at the suggestion of the Office of Defense Transportation to conserve tires, gasoline, automobiles and manpower. These stores are now penalized for cooperating with the objectives of a Federal agency because the mutually owned delivery company is subject to the 3 percent tax as a truckman for hire. Any individual store which continues to maintain its own delivery service escapes the tax on deliveries to its customers. In order to eliminate this inequity we suggest that the tax should not apply to a forwarder controlled by two or more persons for the exclusive purpose of transporting merchandise sold at retail by them, or exclusively engaged in transporting merchandise sold at retail by two or more persons.

REDUCTION OF GOVERNMENT EXPENDITURES

In conclusion, no matter what additional revenues are found practical at this time, they will, of course, fail to balance Governmental expenditures. When merchants find themselves in a similar predicament they reduce every outlay to the least possible amount. While the making of appropriations is not the function of your committee, we want you to know that we admire the very real accomplishment of the Byrd Committee on Nonessential Expenditures. We respect the courageous suport that both political parties in Congress have given its efforts. We urge you to continue support of the Byrd committee and similar activities. In these times of extreme manpower shortage, merchants are having to struggle along with totally inadequate working forces. Many citizens whose income has remained relatively stationery are suffering under increased tax imposts. This is no time for avoidable waste in Government expenditure.

The CHAIRMAN. Any questions, gentlemen?

If not, we thank you very much, Mr. Richmond.

Senator Scrugham, did you wish to appear this morning?

Senator SCRUGHAM. Yes; if you please.

STATEMENT OF HON. JAMES G. SCRUGHAM, UNITED STATES SENATOR FROM NEVADA

Senator SCRUGHAM. In normal metal mining operations a certain amount goes for the extraction of the ore, and even a larger amount goes for the development of new ore bodies, in making them available for extraction. The manpower shortage has had this effect: The whole force they have available is in extracting ore, and they have what is known as a deferred development. It looks like a very large excess profit, and yet it is not because it has got eventually to be spread, as soon as manpower is available, in developing the mine. I ask the committee to consider that phase of it and make an allowance in what is termed deferred developments.

The CHAIRMAN. In the case of metal mines?

Senator SCRUGHAM. Yes.

Senator VANDENBERG. Was that suggestion presented to the House committee?

Senator SCRUGHAM. No.

Senator WALSH. What is the amount you have in mind, Senator?

Senator SCRUGHAM. Pardon me?

Senator WALSH. Have you any amount in mind?

Senator SCUGHAM. No; I have not, but I can submit the actual figures from various mines before the emergency, that is, copper, zinc, and the other mines.

The CHAIRMAN. Will you furnish us a memorandum on it, Senator Scrugham?

Senator SCRUGHAM. I will do that.

The CHAIRMAN. Thank you, sir.

Senator SCRUGHAM. Thank you.

The CHAIRMAN. Mr. Schieffelin.

STATEMENT OF W. J. SCHIEFFELIN, JR., CHAMBER OF COMMERCE OF THE STATE OF NEW YORK, NEW YORK CITY

Mr. SCHIEFFELIN. Mr. Chairman and gentlemen, my name is W. J. Schieffelin, Jr., 16 Cooper Square, New York City.

The CHAIRMAN. Do you prefer to read your brief or comment orally?

Mr. SCHIEFFELIN. Mr. Chairman, I expect to skip some of this brief and the reading will take less than 15 minutes, plus three additions. We did not have time to get them in print, sir, but it will take less than 15 minutes.

The CHAIRMAN. All right, you may proceed.

Mr. SCHIEFFELIN. I represent the oldest commercial organization in our country, the Chamber of Commerce of the State of New York, with 1,800 members, responsible for directing hundreds of thousands of citizens working in scores of our Nation's leading industries.

On August 6, 1942, you gave courteous hearing to the testimony I presented on behalf of the New York chamber, and a number of your members asked detailed questions particularly on our proposal of a general graduated retail stales tax, which we were among the first to urge. In October 1942 Congress approved and embodied in the present tax law seven of our recommendations, namely, I would

like to comment that last year your chairman was kind enough to say our average was pretty good when the previous law had two of our recommendations—

1. No higher social security taxes.

At this point, I would like to add two further comments on No. 1, no higher social security taxes.

I should like to quote from the Associated Chambers' testimony to the House Ways and Means Committee, which we thoroughly endorse, and we feel it is very important:

All provisions for automatic increases in the rates of the old age and survivors' insurance pay roll taxes should be eliminated from the law, and the present 1-percent rate should be continued until the necessity for an adjustment is made to appear. A surplus of $4,268,000,000 had been accumulated in the trust fund on June 30, 1943. This is 4.4 times the highest annual benefit cost, as officially estimated, in the ensuing 5 years, and therefore well in excess of the amount required to meet the "3 times" test prescribed by the present law. In 1939, and again in 1942, Congress, by postponing scheduled increases in the rates, asserted its belief that additional pay-roll taxes were not needed at that time. That was true in 1939 and 1942 and is still true today.

Gentlemen, we feel those taxes have no part in raising revenue for conducting the war.

2. No mandatory joint returns.
3. No tax on tax exempt State and municipal bonds.
4. Annual declaration of value for capital-stock tax.
5. 40 percent instead of 45 percent normal corporation income tax.
6. Relief on retroactive taxes for fiscal year corporations.
7. Continuation of exclusion from gross income of income earned from sources without the United States.

We believe strongly that nonprofit organizations under section 101 should be required to file anual returns as in the House bill before you. Only those with something to hide can have any real objection to this provision.

ECONOMY

We back with all our hearts the recommendations of Senator Byrd's committee. May I quote from our October 12 testimony before the Ways and Means Committee:

We are glad that Congress is already seeking exact information as to what expenditures will actually be, and we urge Congress to force that $10,000,000,000 saving and more if practicable.

Part of it should come from those at least 300,000 surplus Federal employees the Byrd committee asks you and the executive agencies to fire. As one of your draft board chairmen for the past 3 years I want to see some of them sent into the armed services along with the pre-Pearl Harbor fathers I am now necessarily and properly drafting. Many believe that more than 300,000 Federal civilian employees should be separated from the public pay rolls with benefit to the entire Nation.

CAPITAL-STOCK TAX AND DECLARED-VALUE EXCESS-PROFITS TAX

In urging again repeal of this harassing, guesswork tax, already approved by the Senate and the Treasury, we feel we are entirely consistent with our stand of not asking for reduced total corporate taxes now. If its repeal could be proved to reduce corporate tax payments appreciably—by more than a very few millions—we should have to endorse a small fractional increase in the normal rate. We are satis-

fied that is not the case for the reasons stated by the associated State chambers:

Namely because these taxes "do not in fact serve the purpose of imposing some tax burden upon all corporations which carry on business, since a corporation which anticipates no net income may declare a nominal value. With small taxpayers as well as large, they create a feeling of irritation, inequity, and injustice which is out of all proportion to the amount of revenue involved." For corporations with income, a large part of these taxes will be paid anyway, ranging up to 80 percent.

We believe these taxes should now be repealed, as the Senate repealed them last year and then in conference it was thrown out.

GENERAL

In the bill now before you we think the House has on the whole done a fairly good job considering the President's intimation that he would veto a sales tax. We cannot leave that subject however, without again recording our conviction that a steeply graduated retail sales tax would still be the soundest and best for our country.

What the House has done in effect is to accept part of our recommendation, namely a high retail sales tax on luxuries. The major proposals before you levy selective taxes on certain goods and services. We think this list should be broadened by the addition of at least gasoline and tobacco, and that additional revenue from these consumer products should replace the proposed increases in personal and corporation taxes.

We applaud the peremptory turning down of the Treasury's request for greatly increased corporation and individual taxes. Combining the Victory tax with the regular income tax without exempting 9,000,000 present taxpayers is directly in line with our recommendation that this be done to simplify tax returns. We consider, however, that the increases, namely, 95 percent excess profits, reducing invested capital credit, and eliminating earned-income credit, are so picayune that they are not worth the harassment and ill will they will engender in the already resentful taxpayers. Taxpayers are not resentful and restive over paying the maximum to win the war; they are however fed up with the piddling tactics that seek to chisel here and there comparatively small sums where the perpetrators think the voters will notice it least.

Do please leave the high rates on both corporations and individuals where they now are, remembering that you have already raised individuals 12½ percent for the next 2 years.

Gentlemen, I do not think it was intended that an income of a half million dollar has, after the present taxes for the next 2 years, $7,500 left, which is approximately the same as an income of $10,000 has, and over $500,000, the bigger incomes, the few of them are already in the red, paying in the next 2 years more under the present taxes than they receive.

We are glad to note that the Treasury has raised its estimate of the yield from the present law. We submit however that this estimate may still be as usual too low. For the first quarter of the present fiscal

year, July 1 to September 30, the Treasury itself reports the receipt of $10,000,000,000, $500,000,000 in Federal Government revenues of all sorts. The first quarter of the fiscal year nearly always runs low. It is probable, therefore, that total Government receipts during the fiscal year 1943–44, even under existing tax laws will amount to at least $43,000,000,000, and perhaps as much as $45,000,000,000. Add 2,000,000,000 to either of these figures and you have fully half the reduced economy budget now happily under contemplation.

We think the statements issued by the Ways and Means Committee members are excellent. While we thought in our appearance before them in October that not less than $5,000,000,000 should be raised in new revenue, and that entirely from a new retail sales tax, economy and new fiscal facts now incline us to think that $2,000,000,000 may be enough for the immediate future both for revenue and for combating inflation provided "effective price control, rationing, and wage control" be impartially enforced.

We believe, however, that an additional billion, making a total of 3 new billions, can readily be raised by including tobacco and gasoline and perhaps a few more luxuries in the selective retail sales tax schedule. This would be sound, and the country can stand it far better than it can any corporate or personal increase.

EXCISE TAX VERSUS SELECTIVE RETAIL SALES TAX ON LUXURIES

We turn now to facts which we think need to be brought out with the utmost plainness. While circumstances seem to have made a general retail sales tax infeasible, the House has chosen certain services and luxuries and has imposed higher retail sales taxes on some, increased excise taxes on others. For years we have favored more revenue from liquor, tobacco, and gasoline, which are already bringing in more funds to the Treasury than any other consumer products.

We submit, however, that necessity has made obsolete the subterfuges by which the administration and the Treasury have for years been trying to keep from the majority of the voters the harsh fact that they must pay the major part of the costs of the war.

Excise taxes are nothing but hidden sales taxes imposed before the final point of sale in such a way that they almost always raise prices to consumers more than the amount of the taxes.

We agree with Mr. John W. Hanes, who on January 25, 1943, stated:

> This term, excise, should be eliminated from our tax vocabulary.

We think, however, that unnecessary dislocations would be caused if the existing tax structure were now to receive the thorough overhauling it must have some day. But we state emphatically that increased revenues from products already subject to excise taxes should come from retail sales or purchase taxes on those same products over and above the existing taxes on them. This would leave ceiling prices and present complicated price structures unchanged.

With particular reference to liquor we wonder if you realize that the $3 per gallon increase before you, taxes the poor man's drink double

that of the rich man. How? The $3 is levied regardless of price or quality; it amounts to 60 cents on the usual bottle (three times 2.40 gallons in a case of 12 fifths is $7.20 increased tax per case, or 60 cents per bottle). For the man who can only afford a $3 bottle this is a hidden sales tax of 20 percent, for the man who can pay $6 per bottle of better liquor it amounts to only 10 percent.

In view the Treasury's solicitude for that comparatively untaxed majority which receives four-fifths of the National income, does it not seem strange that the Treasury advocates and that the House has passed such a provision? To us it seems consistent only in that it is hidden from the voters. Perhaps it is a subtle effort to get more from the four-fifths and to let the overburdened one-fifth off lightly.

To us who also advocate more revenue from liquor—the only consumer product which is already yielding 1½ billions of revenue—the honest way is to levy a 15 percent luxury retail-sales tax under which the poor man will pay 45 cents on his $3 bottle and the rich man will pay 90 cents on his $6 bottle. This would raise more than the newspapers state is expected from the proposed $3 per gallon excise increase. A study by the joint tax committee, eastern State chambers of commerce, indicates that a 15 percent retail sales tax on alcoholic beverages should produce 800 million new revenue.

Furthermore, such bootleg liquors as might find their way into bars, grills, restaurants, and other pouring outlets would not escape this selective retail-sales tax, whereas excises on bootleg stuff are 100 percent lost to the Treasury. Pouring outlets would not dare not to charge a retail sales tax to their patrons, for that would at once give away the fact that they were serving bootleg liquor.

We do not think that even you gentlemen fully realize the terrific profit stimulant to bootlegging in even the present liquor taxes: Over 200 percent on distillers selling price but more than 590 percent on bottled cost.

While I will not take your time to read them, we think the following two schedules should be before you. They show in detail how liquors are already paying over 200 percent of distillers selling price in hidden taxes.

Schedule of taxes already in effect as of Dec. 1, 1943—domestic whiskey, 90-proof, case of 2.4 wine gallons

Cost at distillery	$7.00
Miscellaneous charges	.75
Internal revenue tax, at $6 per proof gallon	12.96
Rectification tax, at $0.30 per proof gallon	.648
Internal-revenue stamps	.12
New York State gallonage tax, $1.50 per gallon	3.60
New York City sales tax—1 percent of $45 per case of 12 bottles, at $3.75 per bottle	.45
Total	25.528

The total present cost of one case ready for sale in New York City contains taxes amounting to $17.778 or 228.4 percent of cost of $7.75 per case.

Schedule of taxes already in effect on one typical case of Scotch whiskey as of Dec. 1, 1943

Cost of 1 case Scotch whisky f. o. b. Glasgow, at 62 shillings ($4.04)		$12.520
Miscellaneous charges (ocean freight, consular fee, insurance, cartage, customhouse fees and bond, warehouse handling storage)		1.250
Landed cost, New York City		13.770
Duties and taxes:		
Import duty, at $2.50 per gallon	$6.00	
Glass duty, at 1/6 cent per pound	.03	
Countervailing duty	.075	
Internal revenue excise tax, at $6 per gallon	14.40	
Internal revenue strip stamp, at 1 cent each	.12	
New York State gallonage tax, at $1.50 per gallon	3.60	
New York City sales tax—1 per cent of $63 per case of 12 bottles, at $5.25 per bottle	.63	
		24.855
Total cost, f. o. b. New York		38.625

The total present cost of one case ready for sale in New York City contains duties and taxes amounting to $24,855 or 180.5 percent of cost of $13.77 per case. On lower-priced Scotches, of which there are a considerable number, duties and taxes approach 230 percent of the landed cost.

Every case of Scotch whisky in the State of New York is subject, in addition to the above taxes, to its proportionate part of the following annual license fees:

Importers must have New York State wholesale license in order to do business in New York State	$4,400
Wholesaler's license	4,400
Retailer's license	800
Warehousemen's license	100
Importers and wholesalers' salesmen must have a New York State solicitor's permit (each $10)	20
Total	9,720

The above total ($9,720) annual license fees must, under present laws, be paid to New York State before any one outlet can make any liquor sales to the public.

In New York State there are about 90 importers, 115 wholesalers (with some duplication), and 2,195 retail package stores, paying approximately $2,658,000 annual New York State license fees before the liquor industry even begins to make a sale.

This annual $2,658,000 is already a fixed charge against the public's home consumption and one which must be earned by the liquor industry before it has anything available for wages, expenses, and profits. This figure does not include the millions in license fees paid by hotels, clubs, and restaurants.

All domestic liquors are subject to all the above taxes, excepting import and countervailing duties.

The 15-percent retail sales tax we advocate should be over and above all these present taxes. Present price ceilings will remain unchanged, and the Treasury should receive more money than from the proposed excise.

If after careful consideration of the above facts you decide to tax the poor man twice as much as the rich man on their liquors, as is now done in the bill before you, we urge that you make the increase

33⅓ percent instead of 50 percent, a new excise of $8 instead of the proposed $9.

We do urge, however, that you take the fair open course of taxing each sale in proportion to the amount spent—a 15-percent retail sales tax on alcoholic beverages.

SUMMARY

(1) Economy.
(2) Repeal capital stock and declared value excess-profits tax.
(3) Leave social-security taxes where they now are at 1 percent.
(4) No increase in corporate or personal income taxes already increased by 12½ percent for the next 2 years, but simplify personal by integrating Victory tax with normal tax.
(5) Increase no existing excises, but raise up to $3,000,000,000 by new retail sales taxes on selected list of goods and services.

Congress is again writing a tax bill of its own in accordance with its exclusive constitutional power. Of that your fellow citizens are duly proud—and grateful. Will you gentlemen of the Senate who have been improving tax bills for years do an even better job on this one than the House has already done? Raise now something more than the House has, and make it stick for the balance of the war.

We urge you to adopt the modified recommendations we here make. With Executive and Treasury opposition to a general retail sales tax—still in our judgment what should be imposed—we believe your approval of these five points will be the best and soundest action you can take under present conditions for our country's welfare.

Senator GUFFEY. May I ask a question?

Mr. SCHIEFFELIN. Yes.

Senator GUFFEY. What is your position with the New York Chamber of Commerce?

Mr. SCHIEFFELIN. I am a former chairman of the committee on taxation. I am today a member of the committee on taxation in charge of the Federal program as opposed to local and State taxes.

Senator GUFFEY. In my more than 40 years' contact with the chamber of commerce you are the first one that has ever advocated something for the poor man. I congratulate you for that.

Mr. SCHIEFFELIN. Thank you.

Mr. Quill.

STATEMENT OF MICHAEL J. QUILL, PRESIDENT, TRANSPORT WORKERS UNION OF AMERICA, CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. QUILL. My name is Michael J. Quill. I am president of the Transport Workers Union of America and representing the Greater New York Industrial Union Council, C. I. O.

Mr. Chairman, I have a statement that I wish to leave here.

The CHAIRMAN. You may put your statement in the record.

Mr. QUILL. I just want to add that we in the C. I. O., we working people, are opposed to any form of taxation that would further burden the workingman who is now making less than $3,000 a year. It

has been proved that in order to maintain a home, two parents with two children, they have difficulty now in carrying on with less than $3,000 a year. It has been said that 62 percent of the wage earners of this country, and it has been proven, are making less than $2,500 a year.

We in the labor movement, and the working people generally, are doing their all to win this war. Our men and women are in the various branches of the armed services, and our workers in the factories, the offices, and farms are doing their utmost to produce.

We believe that the burden of taxation should be placed on those who can afford to pay for the winning of this war, and who have the privilege of making profits; that corporate profits should be taxed, not as the Treasury says, up to 50 percent, but 55 percent.

We have here a statement to show that the demands of the Treasury Department must be met. They are asking for a little better than $10,000,000,000, and this bill proposes to give them something better than $2,000,000,000. These taxes must be found somewhere, and I have a suspicion where they will be found in the long run, unless you gentlemen do something to block it. The taxes will come from the pockets of the poor people who cannot afford to pay.

Let us take at random two or three or four corporations and their profits, out of probably hundreds of companies throughout the country. It shows here, after wages, salaries, and taxes are paid, that the American Car & Foundry before 1942, after salaries and taxes were paid, had a profit of $72,000. In 1942, after wages, salaries, and taxes were paid, they had a profit of $7,000,000. If I were in your shoes, gentlemen, I would chop off a couple of million dollars from the American Car & Foundry. Let them do a little paying.

The American Locomotive Co., before 1942, after all salaries, wages, and taxes, made a profit of $1,462,000, but after 1942 they made a profit of $7,552,000.

Now, while the sons and daughters of American mothers are in the camps, in the armed forces generally, and are fighting on the battle front, and while 8,000,000 will not be home for their Christmas dinner, I would grab hold of the American Locomotive Co. and take $7,000,000 off of them. That is the way to get the taxes.

The Budd Manufacturing Co. had before 1942 a profit of $250,000. They made a profit since 1942, and it is steadily increasing, of $5,222,000. If there is an honest attempt made to get taxes and to meet the demand of the Treasury, let us climb upstairs and secure those taxes from those who are making over $3,000, $5,000, or $25,000, who are the privileged people. I think it is not too much to ask them to sacrifice some of their huge profits at a time when democracy is at the crossroads and when American people are making this great sacrifice.

I hope you gentlemen will give this full consideration, because on your shoulders is placed a great responsibility, and I hope that those who are proposing taxation down to the $2,000-a-year man and $1,000-a-year man and woman will reconsider the great wrong they are doing. This is highway robbery, plain, ordinary hijacking, common, low-down theft. It makes no difference whether you steal the wages of the workers with a hifaluting bill and big words or whether you take the wages at the point of a sawed-off shotgun. This is criminal.

We are speaking for a cross section of the American workers, and we are sick and tired of seeing our people bled white. We dread the

inflation that is bound to come if you gentlemen put through this type of bill. We ask you again to give it your fullest consideration so you will let the ranks of labor help win the war in the shortest possible time.

I thank you.

Senator GUFFEY. I would like to ask him a question.

You have not taken into consideration at all the renegotiation of contracts. There is one firm I know there, that you mentioned, the Budd Manufacturing Co. in Philadelphia and Detroit. What would be a fair profit for the Budd Manufacturing Co. with the output of $120,000,000 a year?

Mr. QUILL. That is quite a lot of money, sir.

Senator GUFFEY. What would be a fair profit? Do you think 1¼ percent would be a fair profit on that output? They have taken $9,000,000 from them.

Mr. QUILL. I am not very keen on percentages, sir.

Senator GUFFEY. I know, but you haven't given that consideration in your statement, sir, about these renegotiated contracts.

Mr. QUILL. You have asked the question, and I would like, in my own small way, to answer.

Senator GUFFEY. Go ahead.

Mr. QUILL. I am not very keen on percentages, but after paying wages, salaries, and all taxes, I would give that outfit a profit of $25,000. It is much more than the man who is dying in the jungles in the South Pacific——

Senator GUFFEY. They employ 15,000, and you would give them $1.50 a year per man?

Mr. QUILL. That is right. That is much more than I would give them for the duration of the war. It is too much.

Senator GUFFEY. I am glad to get your viewpoint.

Mr. QUILL. This viewpoint is going to come from labor more and more as we roll along.

Thank you, gentlemen.

The CHAIRMAN. Thank you, sir, for your appearance.

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

BRIEF OF MICHAEL J. QUILL

Mr. Chairman and Members of the Senate Finance Committee:

The Greater New York Industrial Union Council, of which I have the honor to be vice president, represents more than 500,000 Congress of Industrial Organizations workers in the city of New York.

In my previous testimony before the House Ways and Means Committee, on the 1944 tax program, I stressed the undemocratic character of the sales tax. I pointed out that 62 percent of working families in the United States received an income of less than $2,500 a year, that these families therefore do not have any excess purchasing power and that the so-called inflationary gap cannot possibly apply to them.

The Ways and Means Committee was apparently impressed by the testimony of 15 Congress of Industrial Organizations representatives who appeared on the same day that I testified in opposition to the sales tax and in favor of a democratic tax program based on ability to pay. The sales tax has been eliminated from the bill now before you, and I sincerely trust that this committee has no intention of restoring it.

The Ways and Means Committee, however, wrote a new tax on the poor into the new bill. This stax, which calls for a minimum normal tax on the income of carried couples earning more than $700 per annum, is no better than the Victory tax which was eliminated from the House bill. Gentlemen, we simply cannot

diminish further the incomes of workers earning less than $3,000 per year without greatly endangering their health, morale, and efficiency and thus endangering maximum production.

The Congress of Industrial Organizations in New York City feels strongly that the bill before you fails to meet wartime needs and to prevent inflation by tapping the excess purchasing power in the hands of those persons earning more than $3,000 per year and the heavily swollen war profits of corporations.

The need for post-war reserves cannot possibly justify the failure on the part of the Ways and Means Committee of the House to raise the normal corporate profits tax from 40 to 55 percent or at least the 50 percent proposed by the U. S. Treasury Department.

Of 29 representative American corporations selected at random, all but 6 doubled their normal peacetime incomes after taxes in 1942. Several gained 5 times as much. Their 1943 earnings are even better than 1942. Here are some examples:

The American Car & Foundry Co., prior to 1942, averaged $72,000 profits after taxes. In 1942 its profits jumped to $7,000,000. The American Locomotive Co. jumped from $1,462,000, prior to 1942, to $7,552,000 in 1942. Its profits for the first 6 months in 1943 are twice as great as for 1942. The Budd Manufacturing Co. jumped from $250,000 per annum between 1936 and 1939 to $5,222,000 in 1942. The Bath Iron Works jumped from $200,000 per annum in the period 1936-39 to $3,743,000 in 1942. Its profits for the first 6 months of 1943 are up 129 percent over the 1942 profits for the same period.

We urge acceptance of the Treasury Department proposals to increase gift and estate taxes by lowering the estate tax exemption from $60,000 to $40,000. We also ask an end to the present special privilege enjoyed by holders of State and municipal bonds who are exempt from Federal taxation. We likewise ask an end of the special privilege of separate returns and the high depletion allowances for owners of oil and mining properties.

The provision inserted in the new bill by the Ways and Means Committee which requires trade unions and other nonprofit organizations to file tax returns is a wholly gratuitous proposal. Its only purpose is to furnish vital information to labor hating employers who wish to smash the trade-union movement. I urge, Mr. Chairman, that you and your committee vote to eliminate this antilabor provision.

In closing, Mr. Chairman, I wish to place the strength and the will of my organization squarely behind President Roosevelt's anti-inflation program. You, gentlemen, can best carry out an important part of that program by amending the bill before you so that the $10,500,000,000 requested by the U. S. Treasury Department can be raised through a democratic tax program based on ability to pay.

The CHAIRMAN. Mr. Kelly.

STATEMENT OF THOMAS F. KELLY, THE HOOVER CO., NORTH CANTON, OHIO, REPRESENTING THE VACUUM CLEANER MANUFACTURERS ASSOCIATION

Mr. KELLY. I have a very brief statement, Chairman George and gentlemen. My name is Thomas F. Kelly. I represent The Hoover Co. at North Canton, Ohio, but in this particular instance I represent the entire Vacuum Cleaner Manufacturers Association, and on behalf of the vacuum-cleaner industry we respectfully suggest that the manufacturers' excise tax on vacuum cleaners be removed.

In making this request we are not asking for any present revenues to be decreased—no vacuum cleaners are being manufactured—we are asking that the excise tax be removed now so that we will be able to sell them as reasonably as possible to the large number of people who need vacuum cleaners and thereby enable us to sell more and employ more people and help lessen unemployment in the post-war years.

Many new manufacturers' excise taxes were imposed in the Revenue Act of 1941, but excise taxes were removed in the Revenue Act

of 1942 on the following items: electric signs, commercial washing machines, rubber articles, optical equipment, certain cash registers.

We are asking that vacuum cleaners be treated in the same way and that this industry be given an equal opportunity to sell its product to the housewife as is given to similar competing articles on which an excise tax is not imposed.

The excise tax was put on electrical appliances in 1941 not at the suggestion of the Treasury Department but at the suggestion of Mr. Leon Henderson, to curtail the use of materials then needed for war purposes.

This situation no longer applies to vacuum cleaners. They have not been manufactured since April 30, 1942, and as the need for curtailing materials will not exist when we again start making cleaners, there is no more reason for having an excise tax on vocuum cleaners than on brooms, carpet sweepers, mops, or any other appliances used in helping to keep the home clean.

Senator CLARK. Mr. Kelly, how much did it raise by that excise tax?

Mr. KELLY. How much money altogether, sir?

Senator CLARK. Yes.

Mr. KELLY. I could not answer that. It was a 10-percent manufacturers' tax when it applied. We are asking for the same treatment accorded to these other articles. Please do not continue to discriminate against us.

When excise taxes were levied generally on electrical appliances they were not imposed on a number of household electrical appliances, such as washing machines and sewing machines, but were placed on vacuum cleaners, and yet no other electrical appliance has done more to relieve drudgery in the home, save the time of the busy housewife, help to solve the moth problem, preserve home furnishings and contribute to the health of the family and the Nation than the vacuum cleaner.

So-called luxury items, such as jewelry, have been taxed, but, gentlemen, a vacuum cleaner is not in that category. A vacuum cleaner is needed in every home—the home cannot be kept clean otherwise. There is no substitute for a vacuum cleaner, such as there are for other appliances that are not taxed. The housewife can buy a dress. She does not have to make it and she can send it out to be cleaned with the rest of her laundry, but there is no place where she can send her home to be cleaned.

Then I would ask you how about the over 2,000,000 farmers that recently have been served with electricity through the R. E. A. These people want vacuum cleaners. Are you going to force them to continue to pay greatly increased prices because of an excise tax when they don't pay excise taxes on other comparable articles used on the farm?

At the present time the vacuum-cleaner industry is entirely converted to the manufacture of war goods and doing an outstanding job, and a number of Army and Navy E awards have been given its members. However, we are looking to the future and want to be in a position to sell vacuum cleaners as reasonably as possible when they are again manufactured.

In other words, gentlemen, we are making our plans for the postwar period and we think it is unfair to ask us to continue to be saddled

with an excise tax when we have to sell in competition with these other household appliances and articles.

It is a fact that the imposing of a manufacturer's tax on a vacuum cleaner raises the retail price sufficiently to affect materially its sale and over encourage the purchase of other appliances not burdened with this excise tax.

If we assume that 300,000 vacuum cleaners are manufactured in the first year after production is again permitted, the situation would be about as follows:

The manufacturers' excise tax is 10 percent based on manufacturers' selling price, and at an average dealer billing price of $27 the manufacturers' sale would amount to $8,100,000.

The excise tax would amount to $810,000, but to provide the usual 100-percent cumulative mark-up for the distributor or wholesaler and the retailer on the manufacturer's price—including the tax—the retail price of the cleaner would be increased $1,620,000, or, to raise $810,000 in taxes, the ultimate purchaser has to pay $1,620,000 in addition to the regular price of the cleaners.

Instead of the average price of a vacuum cleaner being $54, because of imposing an excise tax of $2.70 the average price of a cleaner becomes $59.40—an increase of $5.40.

In fairness to the purchaser and the vacuum-cleaner industry, contrasted with these other appliances, such as washing machines and sewing machines, this excise tax should be removed for the following reasons:

(1) The vacuum cleaner, the same as the washing machine and the sewing machine, is a great labor-saving appliance and for this reason no tax should be applied to it. It should be made available to all as reasonably as possible; in other words, extend to the vacuum cleaner the same consideration given the washing machine, the sewing machine, the broom, the carpet sweeper, and other household articles.

(2) When cleaners are again permitted to be manufactured the vacuum-cleaner industry wants to be in a position to employ as many people as possible, and the lower the price the more will be sold and the more people employed.

(3) The distributor or wholesaler and the retailer demand a mark-up on the price he pays for his merchandise, and the compounding of this excise tax places a great discriminating hardship on the ultimate purchaser, and for this reason no manufacturers' excise tax should be applied to vacuum cleaners.

In closing I would ask you not to continue to discriminate against the vacuum cleaner—grant our request that the excise tax on vacuum cleaners be removed in the tax bill now under discussion.

I thank you very much.

The CHAIRMAN. Mr. Kelly, the House did not do anything with the vacuum-cleaner tax?

Mr. KELLY. Unfortunately, sir, the association was slow in moving. The hearings were over before we had an opportunity to present our statement.

The CHAIRMAN. There has been no increase made?

Mr. KELLY. No, sir.

The CHAIRMAN. It is simply a manufacturing tax, and now they are not being produced?

Mr. KELLY. That is right; there is no revenue from it now, but we are looking, as I say, to the post-war years. We are hoping in the second or third quarter of next year, when vacuum cleaners will be needed, and they are needed, if materials are available and the manpower situation will permit it, I believe they will be manufactured, and therefore we want to be in the same position as all of these other appliances at that particular time.

The CHAIRMAN. We get your point, Mr. Kelly. Thank you very much.

Mr. KELLY. Thank you.

The CHAIRMAN. Senator Butler had present a witness, Father Flanagan, who I believe has retired from the room.

Senator BUTLER. Mr. Chairman, it was impossible for Father Flanagan to remain longer. I will appreciate his statement being entered in the record. It is his hope that the committee will be inclined to give favorable consideration to the idea expressed in H. R. 3472. This may be accomplished through a committee amendment to H. R. 3687.

(The statement of Father Flanagan is as follows:)

STATEMENT OF FATHER FLANAGAN RE H. R. 3472

I favor the principle that our tax laws should permit that anticipated contributions to religious and charitable institutions should be deducted before applying the withholding tax on wages. It has long been the law that 15 percent of an individual's net income was exempt from taxation if so contributed. The acceptance of this principle would make it possible for the millions of taxpayers, whose sole income is their pay check, to carry on with their religious and charitable contributions.

Father Flanagan's Boys' Home has been primarily supported by the small contributor—the man who usually has the problem of supporting his family on a rather limited income. He is usually the type of man who has a kindred feeling of sympathy for the worth-while charity which will try to alleviate the sufferings of the underprivileged. It is a decided hardship on such a man to be compelled to pay a tax on such contributions.

Therefore, I favor most heartily, this bill before the Congress, H. R. 3472, introduced by Congressman Carl Curtis, to permit the taxpayer to take credit, each time the tax is taken out, for his contributions. This would give an opportunity to all people willing to help worthy causes, and particularly the man with the small pay check, to be generous to their church and charitable enterprises.

As the tax burden grows, and the tax gatherer takes more and more of the wages and incomes of our people, the question of survival of our institutions of service and mercy and learning and our religious institutions themselves, becomes an ever greater one.

(The above-mentioned bill is as follows:)

[H. R. 3472, 78th Cong., 1st sess.]

A BILL To permit the amount of charitable contributions made or to be made to be taken into account in computing the tax required to be deducted and withheld on wages

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 1622 (h) of the Internal Revenue Code (relating to collection of income tax at source on wages) is amended by inserting at the end thereof the following:

"Any employee may include in his withholding exemption certificate a statement of the amount of contributions he has made or will make in the calendar year which are allowable as deductions under section 23 (o) in computing net income. If such a statement is so included, the amount so stated shall be prorated to pay-roll periods beginning with that with respect to which the certificate first takes effect and ending with the last pay-roll period which ends in the calendar year, and for the purposes of subsection (b) (1) (A) the family status withholding exemption for each such pay-roll period shall be

increased by the portion of such amount so prorated to such period. If the employer exercises his election under subsection (c) (1) (relating to wage bracket withholding) the tax to be deducted and withheld for any such payroll period shall be that determined without regard to this sentence decreased by 17 per centum of the amount so prorated to such period, except that in no event shall the amount to be withheld and deducted be less than that prescribed as the minimum amount to be withheld and deducted in cases in which the number of dependents is in excess of the largest number shown on the applicable table."

SEC. 2. The amendment made by this Act shall take effect January 1, 1944.

The CHAIRMAN. Is Mr. Hampden in the room?

Mr. HAMPDEN. Yes, sir.

STATEMENT OF WALTER HAMPDEN, REPRESENTING THE LEGITIMATE THEATER

The CHAIRMAN. I understand you want to appear at this time, if possible. How much time will you need?

Mr. HAMPDEN. I have a very short little notation here to read to you gentlemen on the subject of the admission tax.

The CHAIRMAN. We have a large number of witnesses on the admission tax. I hoped there might be some consolidation of the statements.

You may proceed.

Mr. HAMPDEN. I should think it would be perhaps three or four minutes. Then I would like Mr. Dowling, if he should be allowed approximately the same time, to make a statement in connection with it.

The CHAIRMAN. You may proceed.

Mr. HAMPDEN. Mr. Chairman and gentlemen of the Finance Committee, I am here on behalf of the legitimate theater to urge you not to accept that section of the tax bill passed by the House of Representatives that provides for an increase in admission taxes from 10 to 20 percent.

The CHAIRMAN. You are not representing the movie industry?

Mr. HAMPDEN. No, sir; the legitimate theater entirely. I am here, I might say, because I suppose after 43 years' appearing on the legitimate theater my fellow workers feel I have seen some of the history and, in the passage of time, what it has done to the legitimate theater.

The spoken drama is a most speculative business. Of 10 plays produced within a given period, 2 will probably succeed, 4 or 5 will fail completely and promptly. That leaves 3 or 4 that are on the ragged edge. Methods to nurture them must be found. These consist of various inducements, such as reduced prices, adjustments downward of expenses, including actors' salaries, and the like.

I might say those are generally fixed charges, because there are minimums. This is a unionized business, and the ordinary reduction in prices which can happen in an industry does not apply to the legitimate theater. The legitimate theater is an individual enterprise and it is dealing entirely with services. Where a technological improvement comes along and a reduction of price can be effected in an industry, that is not possible in the theater. If anything, it would raise the price. If you have a special new lighting equipment of a technological kind that improves the show, it costs more.

Senator VANDENBERG. You can meet the mortality problem by producing Walter Hampden.

Mr. HAMPDEN. Walter Hampden has known also what it is to be on his last legs at times. The way we have met that, and it has happened in my own case, sir, is that at times people who get the larger salaries have made great personal sacrifices. I know in my own case I took a company 21 weeks from the central West to the far West and around all the way to the coast instead of closing, and I played myself as manager, director, producer, star actor, and the burden was on me for actually my hotel bills. I gave 40 people work for 21 weeks. At the end I was able to pay them all the salary which I had asked them to deduct so as to make that possible, but there was nothing left for me to receive myself. That is a common occurrence. The people who get the larger money do reduce their salaries in the interest of keeping the show alive and keeping the work going, and because they love the theater, they believe in it as a cultural institution, that this thing must go on, they take their chances in the future on something else happening.

The present 10 percent tax, which has been going on for 25 years, has been really, we feel, a sufficient burden to put upon the theater, and we feel an additional 10 percent would really destroy the possibility of saving these 30 to 40 percent of the new plays, and undoubtedly if they do not weather these storms there would be greater unemployment among the actors, the theater attachés, and the realty values involved in the theater would suffer seriously. It is a special type of building, it is not suited for anything else.

The legitimate theater situation over the past dozen years has been such that many of these theaters are in receivership or the hands of banks or other financial institutions. I am told that at least one-third of such theaters in New York are in that condition.

We have recently acquired a new audience. This has come about through shifts in populations and the possession of surplus money for the first time by certain people due to the war. They are seeing for the first time the spoken drama, the great classics of the theater and the famous players in person, such as thrilled our fathers 40 to 50 years ago. The radio and the motion pictures have been the chief entertainment of this group, and after tasting the pleasant experience of the spoken drama and receiving the cultural benefits therefrom, we are to lose them because the tax on our tickets, if the higher rate is passed, will exceed the average entire admission price to see a motion picture.

I again point out that the theater is an individual enterprise, and the picture, for instance, or the radio is definitely an industry.

Now, there is another group that we have lost practically instead of gained, and we would like the opportunity really to try to regain that group to the theater. Those are the people in what we might call the middle class, the salaried employee and small businessman who has earned from $5,000 to $15,000 a year, who is feeling the impact of his taxes and reductions in his business through the scarcity of materials, so that he can hardly afford enough to go to the legitimate theater, and we feel again that the admissions tax and the increase in tax would militate against the recapturing of those people.

The admissions tax on the theater, I might say, is one which is an advertised tax. It is not a tax which is absorbed in the usual way by just increases in price, but we have to advertise the increase in taxes on the tickets. I think if you saw a tax go up in the box office from 10 to 20 percent it would give you pause before you bought your ticket. There is no way to cancel it.

There has been advocacy of a sales tax. Its most ardent supporters have never suggested more than 5 percent. Here we are bearing and have borne for 25 years a 10 percent sales tax. In fact, the present tax ranges from 13 percent to 20 percent in States that have local admission taxes. It seems unfair that an industry that is regarded as so important to the morale of the Nation and has served so well for conveying the Government's messages to the people of the country should be singled out for excessive taxation.

Furthermore, the amount hoped to be realized from the legitimate theater is negligible compared to the total asked for by the Treasury Department. If the increased tax is put into effect, the amount collected would probably be less than the present revenue, under the law of diminishing returns. It is an easy tax to collect, but we do not feel we should be penalized because it is easy to collect.

I am not speaking for any group in our industry. I am speaking for all of the legitimate theaters. I have seen the legitimate theater in operation for 43 years. I am president of the Players Club of New York and I know what the actor's life is. I am constantly in touch with it. I have produced my own plays, operated my own theater, and appeared for other managements. I feel complimented on being asked to be a spokesman for the living theater, and I implore you gentlemen not to accept this tax increase. If there must be one, let it be on the basis of the rate proposed by Mr. Stam, chief of staff of the joint committee, of 2 cents in each 15 cents.

I thank you gentlemen.

The CHAIRMAN. Mr. Dowling.

STATEMENT OF EDDIE DOWLING, REPRESENTING THE LEGITIMATE THEATER

Mr. DOWLING. Mr. Chairman and gentlemen of the Senate: There is not much I can add to what Mr. Hampden has said. One thing I might say—and I do not say it facetiously—and that is I thank Senator Vandenberg for his compliment to Mr. Hampden. It is awfully nice to think that people have this great interest and regard for people in our business. It was a lovely compliment to give to an artist who has spent 43 years of his life in the theater.

I might supplement the remarks of Mr. Hampden by just saying this: We, who are one of the great nations in the world, are the only great Nation where the cultural arts are not subsidized. In passing, this might not only be interesting but amusing for you to hear, I might say on the night President Roosevelt recognized Russia it was my distinguished privilege to be in the room along with perhaps one or two other people who were not involved in the immediate business to be transacted in this recognition. My purpose was to ask the President

to use his influence with Mr. Litvinov, or perhaps Troyanovsky, to bring the great Russian Ballet to this country. I thought it would have a great influence on cementing our friendly relations with that great country that is now our great and wonderful fighting ally. They all agreed it would be a wonderful thing to let the Americans see the arts have not suffered under the Communistic form of government as exemplified in the great Moscow Art Ballet. After the business of the recognition was all finished and I was introduced to Mr. Litvinov and my purpose was explained to the President of the United States, the purpose of my being there, Mr. Litvinov said this, Mr. Chairman and gentlemen of the Senate, that there was not any doubt in his mind that the Russian Ballet would create a wonderful impression in this country, as the institution was something like a thousand years old, there was nothing like it in all the world of art, but that they could not spare it in Russia, that Mr. Troyanovsky during his reign as Ambassador to Japan and during the Manchurian trouble had asked for the ballet to go to Japan in order to bring about better relations between the two countries, but Mr. Stalin and the rest of the commissars said, "No, no," that when there was trouble, political or otherwise, the one way to overcome that trouble was not by local warfare or local policing, it was to bring the ballet out, at which time all the tensions subsided promptly and all the contending elements stood in line waiting to get tickets for the ballet. He said he would like the ballet to come here, but he did not think it was possible. We went to great extremes to get it, but we could not. Mr. Stalin turned us down; he would not allow the ballet to come here.

I tell that for this reason, that Mr. Hampden and the other members of the profession making up the legitimate theater feel we are a part of the cultural progress of our country. I am sure that you know, Mr. Chairman and gentlemen of the Senate, that the extent of our knowledge about the Grecian empires and the great Roman empires that went before us thousands of years ago, the only written words we have about them are the words written by the great dramatists and the words expressed and acted in their forums and great temples of art. Practically all our great history, going back a thousand years, was recorded through the medium of drama. We like to feel we are the humble exponents of that art.

Now, to go back to the fact that we are the one great Nation in the world that does not have a subsidy that helps us carry on these great things, that we have to compete with the free radio, the motion pictures, wonderful talking pictures at all sorts of prices, we feel to impose a 20 percent tax on us would be a burden that we do not know the results of.

We have struggled very hard in the past. No other business in the world was hit as hard as we were during the years of the depression, and now for the first time we have really seen daylight, and I ask you as one of that profession to be as lenient with us as you can.

It might further help our cause if I said to you, while I have been a star for 24 years and have won three Critic's prizes in a row and the Pulitzer prize, and have had the distinction and honor to participate in such plays as Shadow and Substance by Paul Vincent Carroll,

The White Steed, also by Paul Vincent Carroll, The Time of Your Life, by William Saroyan, and have received the Carrie M. Sennie award and the Esquire award for the best American actor in the season of 1940 and the season of 1942, in the last 5 years my returns from the drama have been so meager that I haven't been able to pay my Government tax as my butcher could pay, and the milkman could pay.

To impose, as I say, a 100 percent increase in my taxation, in my art, really I feel is going a long way. We will be most appreciative—I speak for myself—and all the people in my profession I feel sure will be most appreciative—for any consideration you give us, but keep us as close to the present tax as possible.

I thank you for this opportunity to talk to you and to see so many of our friends again.

The CHAIRMAN. We thank you.

Mr. Wollheim.

STATEMENT OF OSCAR WOLLHEIM, NEW YORK CITY

The CHAIRMAN. You are appearing here on the sales tax?

Mr. WOLLHEIM. Yes, sir.

The CHAIRMAN. Will you give the reporter there your name and how you appear, that is, whether for yourself as an individual or what organization you are representing?

Mr. WOLLHEIM. My name is Oscar Wollheim. I am appearing here merely as an expert.

Senator WALSH. Representing yourself?

Mr. WOLLHEIM. Myself.

The CHAIRMAN. You may proceed. Have you a brief that you wish to put in the record?

Mr. WOLLHEIM. No; I have no brief. I shall give my opinion without that.

The CHAIRMAN. All right.

Senator WALSH. Are you in favor of or against the sales tax?

Mr. WOLLHEIM. I would advocate a particular kind of sales tax. I will call it graduated manufacturer's sales tax, which, about 20 years ago, was created in the Austrian Republic. I was at that time head of the assessment division in the Austrian treasury department and, in this capacity, entrusted with originating the sales-tax law founded on a structure that never before had been adopted in any other country. Having afterward administered the sales tax for several years, I had ample opportunity of gathering experiences in this domain.

Before entering into details, I would like to mention that I am impressed with the fact that the public discussion concerning sales taxes in this country always seems to have been limited to a flat-rate retail sales tax. Never, as far as I can see, have the other kinds of sales taxes been taken into consideration, and especially not the one about which I want to speak, that has proved to be so successful.

When I advocate the pattern of the Austrian sales tax—and I want to stress that very much—I do not mean that it could be simply transferred into another country, especially not into a country so widely different from my native country as the United States is. I am keenly

aware of the immense differences that exist. Austria was a small country, not very highly industrialized. The United States is a continent in itself, industrialized as perhaps no other country in the world. That makes a difference, but still I believe, and even am convinced, that the ideas underlying the Austrian sales tax law could be in some way, perhaps with large modifications, utilized for the benefit of this country in case that a sales tax should be established here.

I certainly do not underrate the potential merits of a retail sales tax, nor am I in any way theoretically opposed to it, but I think I can prove that the way the matter was handled in my native country has definite far-reaching advantages, which the retail sales tax has not and never can have, because of its basic characteristics.

Now, I would like briefly to discuss the main characteristics of the sales tax that I am advocating, but I believe that this tax cannot be understood without knowing the conditions under which it was originated.

My country at that time, a few years after World War I, was in a high emergency condition. Inflation had reached an enormous stage and was raging with daily increasing vigor.

I mention that only for a special reason. It is often said that the sales tax is an inflationary tax. I think that a tax that has had so great success in helping to curb inflation in a country where this economic disease had reached such a high degree, that the money was devaluated to 0.014 of its original value, cannot be an inflationary tax, at least not in the way it was made in my native country.

As to the characteristics of the tax, I have only a few words to say. First the Austrian sales tax was levied at the source, as as near the source as practically possible, that is, at the manufacturer's sale. The manufacturer's price was the base of the tax. This had several advantages about which I will speak presently.

Secondly, it was a graduated tax, and the graduation was originated in the following way: Primarily, the Austrian Government intended to adopt the tax pattern that was at that time prevailing in central and western Europe—Germany, France, and several other countries—establishing a "turn-over tax." This kind of tax is levied from every single turn-over, beginning with the raw materials on their way to the manufacturer, and further following all the turn-overs of semifinished and finished commodities on their way from the manufacturer to the consumer. But the Austrian Government soon realized that it would not have been equal to the task of officially controlling this network of innumerable turn-overs, and therefore resolved to unify and simplify the tax by levying it only once for the whole set of turn-overs of every single commodity.

This led to a graduated tax tariff. The tax rates were differentiated for every kind of commodities according to the average, but independently from the actual number of turn-overs to which the respective kind of commodities is subject, taking into account the average price increases that subsequently occur at every stage of the commercial process. For every single kind of commodities—say foodstuffs, or shoes, or textiles—the question had to be answered: What tax rate has to be applied to the manufacturer's or the producer's price of a given commodity in order to yield the same or approximately the same

amount of tax that would be levied if a turn-over tax of say 2 percent was imposed on all the single sales of the same commodity?

The way in which the commuted tax rates were calculated can be easily shown by a schematic example. Let us assume that we have a given commodity of a total value—that is, the manufacturer's price—of $1,000, and that on an average 30 percent of this commodity was sold by the manufacturer directly to the consumer at the price of $300, that 50 percent of this commodity was sold by the manufacturer to the retailer at the price of $500, while the retailer, adding 40 percent for his cost and profit, sells these goods to the consumer at the price of $700, and that finally the remaining 20 percent of the commodity was sold by the manufacturer to the wholesaler for $200, while the wholesaler, adding 20 percent for his cost and profit, sells the goods to the retailer for $240, and the latter to the consumer for $336; on this basis the total of the 2 percent turn-over tax for all these sales would amount to $45.52, and that is about 4.55 percent of the manufacturer's price of $1,000. Thus, the commuted single tax for this kind of commodity would be fixed at 4.55 percent of the manufacturer's price.

As mentioned before, the tax was as a rule levied at the source, while the subsequent turn-overs, including the retail sale, were tax exempt.

The tax-tariff, practically comprising all existing commodities, was drawn up with the help, and according to the advice of the boards of industry, trade, agriculture, and labor. It was periodically revised and amended. Its application proved to be remarkably easy for the taxpayers, since every one of them generally had to deal merely with one or two kinds of commodities.

The differentiation of the tax rates afforded the opportunity, while building the tariff, of adapting them to the requirements of economic life. This I believe to be the most important merit of the system. The utmost care was taken that the indispensable goods, especially foodstuffs, fuel, clothing, though not tax-exempt, were so sparingly taxed that no economic damages could result. As a matter of fact, no impairing of the minimum of existence as consequence of the sales tax ever became noticeable in my native country.

The CHAIRMAN. Can you tell us how the tax ranged comparable to our own money? For instance, the tax on food, how was it raised.

Mr. WOLLHEIM. I can give some examples.

The CHAIRMAN. Just give us an illustration so we may get the point.

Mr. WOLLHEIM. Certainly. For instance, flour—there was a tax of 4.8 percent on the meal price, but no tax on all the goods that were made of meal and so bread was tax-exempt.

The CHAIRMAN. The tax was levied at the source?

Mr. WOLLHEIM. At the source, and at a very low price level, so one can say that the tax involved in the bread price was so low that it was not really felt. We never experienced any desire for wage increases, and therefore never had any difficulties in that way, nor were inflationary consequences ever threatening on account of the tax.

I could mention several other tax rates—poultry, 4 percent; fish, 3.5 percent; living cattle, if to be butchered, 4.35 percent, and if for breeding, 2 percent; butter was tax-exempt, and cheese as well, because we took a low tax from the milk that also covered its derivative products.

The tax for cotton tissue (6.4 percent) covered the tax for the raw materials as well as the tax for the semimanufactured and the finished commodities made out of this tissue. The tax for leather covered the tax for finished leather goods, so that, for instance, the sale of shoes was practically tax-exempt.

I may also mention that we did not pedantically stick to the rule that the producer has to act as taxpayer. We thought it better, for instance, that the tax for milk should be paid by the dairy, the tax for flour by the mills, the tax for timber by the saws. That made the matter more easy, and on this account, the farmers were not bothered by such payments.

Now, I do not know whether I have time enough to give some other views, especially concerning the relation of this tax to the retail sales tax. Whatever may be the advantages of the retail sales tax, its administration and control are certainly very difficult and costly. In the United States of America the control would have to embrace nearly 2,500,000 taxpayers. The administration and control of the Austrian sales tax was as cheap as any tax administration ever was. A very small staff of auditors and comptrollers was sufficient, so that we could consider the net revenue out of this tax as about equal to the gross revenue. The difference was negligible. Fraud and evasion were practically nonexistent.

The retail sales tax, being difficult to administer as a flat tax, would impose even much more serious difficulties if it were graduated. I think that would probably kill the tax, because the retailers, numerous as they are, and different in kind, are not as the manufacturers can be expected to be, expert in bookkeeping (at least a large part of them are not) and the greatest confusion or evasion would result if a graduated retail tax were established. That is certainly a great advantage.

Most advocates of the retail sales tax believe it necessary to make exemptions for foodstuffs, for clothing, and different other goods. If this would be done the revenue would be curtailed to about half of the expected amounts. This draw-back could be avoided by the Austrian sales tax. We evaded as well the necessity of exempting on one side and overtaxing on the other side. I think that is one of the greatest advantages of the Austrian system.

Now, may I also mention the problem of inflation. The sales tax is meant to be anti-inflationary. The kind of tax that was existing in Austria certainly was. Experience proved it, and it is also theoretically quite clear that a tax that takes so many billions—I am speaking now in American terms—out of the inflationary gap must be intrinsically anti-inflationary.

On the other hand, the opponents to the sales tax think it would be inflationary and assert that the anti-inflationary consequences would be at least counterbalanced by its inflationary consequences. This assertion certainly does not apply to the Austrian pattern.

The reason why inflationary consequences are feared consists in the fact that it is a flat tax. If you raise all the prices by 10 percent, then, the opponents believe, it would be easy for the workers to say: "Our cost of living will be increased by so many percent and we therefore want compensation in higher wages." Whether this prognostic is correct, I do not venture to decide. But it is beyond doubt, that it would not be correct in regard to the Austrian tariff where no flat rates ex-

isted and therefore a demand for wage increases neither arose nor could have been justified.

The fears concerning inflationary results of the retail sales tax are sometimes based on the assumption that the farm prices would be raised by the amount of sales tax that the farmers themselves would have to pay for their machinery, their tools, and so forth. Well, I think this to be a merely theoretical assumption, not anyway practically confirmed, and it certainly did not prove true in Austria.

A further advantage of a Federal sales tax built on the Austrian pattern, in contrast with a Federal retail sales tax, would, I believe, consist in the fact that it would in no way conflict with the existing sales taxes in the States.

Finally, permit me to mention some minor items concerning the Austrian sales tax.

(1) The adaptation of the underlying principles to practical life led to permitting small firms as well as the handicraft businesses to pay their sales tax duty in a lump sum, preliminarily agreed upon between them and the Government and founded on their average turn-over.

(2) The Austrian tax was also levied on services, with a fixed tax rate of 2 percent.

(3) For reasons of equity the tax embraced also on the goods consumed by the producer himself; that is to say, the farmers for instance had to pay a sales tax on their own products as far as they did not sell but consumed them in their own families.

(4) Special regulations were made concerning imports. It is self-evident that imported goods had to be taxed as well as domestic goods, but considering the fact that the price of domestic finished goods always contained sales taxes for their constituent materials, the imported goods, in order to avoid any privilege in their favor, had to be subjected to a slightly higher tax rate than the similar domestic goods.

(5) On the other hand, exports were tax exempt, and, moreover, the exporter was entitled to a refund of the taxes that had been paid for the constituent materials out of which the exported goods had been manufactured.

(6) The opponents to the sales tax sometimes mention the difficulties caused by the so-called valuation problems. They consist in the fact that while the manufacturer's price is to be the base of the tax, it sometimes occurs that the taxable sale is not made at this price level but, for instance, at the retailer's price level. These difficulties, in themselves of minor importance, were easily overcome by the Austrian tax tariff, because it was the taxpayer's task to prove that the actual price was higher than the price to which, according to law, the tax would have to be applied.

(7) Another argument of the opponents to the sales tax is based on the fear that the establishment of such a tax would be in collision with the existing price-ceiling regulations. I believe that it is comparatively easy to avoid such a collision by decreeing that the taxpayer, as well as the subsequent sellers of the goods, are required to indicate the exact amount of the tax in their invoices. But that is a mere technicality.

(8) Similar views hold true concerning the so-called pyramiding, that is the eventual tendency of the wholesalers and retailers to apply their usual mark-up percentages to the price increased by the sales

tax, instead of restricting it to the price of the commodity. This would lead to a price increase higher than the tax, but could, as a rule, be avoided in the same way as mentioned in paragraph 7.

(9) Some kinds of goods considered as luxuries were subject to a luxury tax of 12 percent that was in a way organically linked with the general sales tax. Its financial importance was very inconsiderable.

Concluding remarks:

Whether or not a pattern similar to the Austrian sales tax would be fit to be adopted for the Federal tax program, I personally cannot judge, but I believe that if it would prove to be adaptable to the American conditions, the outstanding advantages that were obtained in my native country would also apply in this country.

As to the revenue that could be obtained, no direct statistical figures are, of course, available, but I tried to make a kind of evaluation founded on the comparison with the Austrian revenues obtained from this tax, and I came to the conclusion that there would be a fair chance to obtain a revenue of $7,600,000,000 if the tax rates were on an average not higher than the tax rates initially adopted in Austria. Later on the tax rates had been doubled in Austria without doing any harm to the economic life of that country, and so it would perhaps not be exaggerating that in this country a somewhat higher tax rate could be adopted, and I think, according to my tentative evaluation, in this country the total net revenue of about $11,000,000,000 could be expected.

Now I have two letters that I sent to the New York Times, published, one on October 3, 1943, and another on October 19, 1943, which state in more concise language than I have been able to state to you here today the workings of this tax, and which I will leave with you if you care to have them.

The CHAIRMAN. They may be inserted in the record.

(The letters as printed in the New York Times are as follows:)

[From the New York Times, Sunday, October 3, 1943]

AUSTRIA HAD PLAN

SALES TAX WORKED UNTIL THE NAZIS TOOK OVER

To the EDITOR OF THE NEW YORK TIMES:

In a letter published in your issue of Sept. 19 Emery Reves proposed the establishment of a Federal progressive retail-sales tax, the progressiveness of the rates being based on the degree of "necessity of consumer goods." Though interesting and, in its aims, basically sound, this suggestion is, to my belief, subject to severe misgivings.

First. Progressiveness of rates, desirable as it may be, could not be made dependent from so arbitrary and disputable a criterion—Mr. Reves himself calls it a "relative notion"—without engendering perpetual controversies. Practically, the conflicting interests would presumably bar any agreement. Second. The tax advocated by Mr. Reves would be a retail tax, sharing the drawbacks inherent to retail-sales taxes in general. It seems obvious that progressiveness of rates would tend highly to enhance these drawbacks to the point of overthrowing the system.

AUSTRIA TRIED PLAN

It may perhaps not be generally known that, 20 years ago, the Austrian Republic was the first country to adopt a sales tax with graduated rates. Founded on a structure never before adopted, this tax deserves, I believe, special consideration, not only on account of its originality but even more so because of its remarkable financial and economic success. Established in 1923, it was effective for 15 years, till the Nazis' conquest of Austria.

The Austrian sales tax was originated under very critical conditions. Inflation was ravaging the country, the currency value had sunk to less than one fourteen-

thousandth of its original standard, and the race between wages and prices was raging with daily increasing speed. The sales tax ranked foremost in helping to save the republic in its emergency and to curb inflation. Its chief characteristics were—

1. It was originally planned as a turn-over tax, to be levied on every sale of a commodity on its way from the producer to the consumer. But, in order to avoid insuperable administrative difficulties, it was unified into a single tax for every set of turn-overs. The tax was levied at the source, as a rule from the manufacturer's (producer's) sale, while the subsequent turn-overs, including the retail sale, were tax exempt. The manufacturer was thus the only taxpayer, but entitled to shift the tax to the buyer of the commodity. The base of assessment was the manufacturer's price. For imported goods the tax was levied at the custom house. Exports were exempt from any tax.

RATES WERE GRADUATED

2. The rates were differentiated for every kind of commodities, graduated according to the average, but independent from the actual number of turn-overs and taking into account the average price increases that subsequently occur at every stage.

3. The tariff, practically comprising all existing commodities, was drawn up with the help and according to the advice of the boards of industry, trade, agriculture, and labor. It was periodically revised and amended.

4. Though levied on the manufacturer's sales, it was nevertheless an anti-inflationary tax, as it was ultimately paid by the customer. The whole revenue, of course, served to diminish the inflationary gap.

Owing to the flexibility of the system, which contrasted favorably with the rigid rates of similar taxes in Canada, Australia, France, and Great Britain, the Austrian administration managed to avoid most of the economic drawbacks generally attributed to a sales tax.

Tax administration and control were simple, easy, and cheap, operated by a very small staff of officials. This was due to the fact that tax payment, bookkeeping, and filing of returns were as a rule, restricted to a comparatively small number of producers who could be expected to be skilled in bookkeeping, while minor tradesmen had in no way to deal with the matter.

LARGE REVENUE SEEN

If the Austrian pattern were adopted in building the tax program, I am convinced that its advantages would also prove true on the larger scale of this country. The financial results would presumably be gigantic. Provided the tax rates were settled on a reasonably high level, there would be a fair chance for obtaining a revenue of at least six or seven billion yearly.

The Austrian system would be definitely preferable to a Federal retail-sales tax. Efficient control of the returns and payments of 1,800,000 retailers, generally not equal to the duty of accurate bookkeeping, would obviously prove to be an exhausting task for the administration, while the costs of such control would absorb a considerable amount of the gross revenue.

Last but not least, the system here advocated would presumably—in contrast with a Federal retail-sales tax—make any conflict with the existing retail-sales tax legislation, now established in 23 of the States, avoidable.

OSCAR WOLLHEIM.

NEW YORK, SEPTEMBER 27, 1943.

The writer of this letter, as head of a division in the Treasury department of the Austrian Republic, originated and developed the Austrian sales tax and handled its administration.

(From the New York Times, Tuesday, October 19, 1943)

MANUFACTURERS' SALES TAX URGED

To the EDITOR OF THE NEW YORK TIMES:

Phillip Murray, president of the Congress of Industrial Organizations, in the hearings held by the Ways and Means Committee, came out very forcibly against a Federal sales tax, which, he said, would be "the equivalent of a military defeat," that "organized labor would be compelled to demand a proportionate increase in wages to make up for this unjustified wage cut," and that "such a tax

would be a violation of the obligation given by the Government to the working people of America that wages and prices are to be stabilized."

It seems to have escaped Mr. Murray's notice, as well as that of other opponents, that their criticism merely applies to one particular type—retail-sales tax with an undifferentiated tax rate.

In my letter to you, published in your issue of October 3, I pointed out that the Austrian Republic 20 years ago, under conditions of severest emergency made a successful attempt to solve the problem of establishing a graduated manufacturer's sales tax. Experience has shown that through graduating the tax rates and levying the tax at the source it is possible to avoid the economic drawbacks of the retail tax.

As a matter of fact, the Austrian tariff managed to adapt itself to the requirements of economic life. Foodstuffs and other indispensable goods, though not exempt, were so sparingly taxed that no wage increases, no impairing of the minimum of existence, ever became noticeable. Thus the tax, far from promoting inflation, efficiency served to curb it. Equal results, I am convinced, could be obtained in this country.

OSCAR WOLLHEIM.

NEW YORK, OCTOBER 16, 1943.

The CHAIRMAN. The committee will take a recess until 2 o'clock today.

(Whereupon, at 12 noon, the committee recessed until 2 p. m. of the same day.)

AFTER RECESS

(The committee resumed at 2 p. m., pursuant to recess.)

The CHAIRMAN. The committee will come to order, please.

Mr. Bennett.

STATEMENT OF HUGH M. BENNETT, ON BEHALF OF THE NATIONAL RETAIL FURNITURE ASSOCIATION AND NATIONAL ASSOCIATION OF CREDIT JEWELERS

Mr. BENNETT. Mr. Chairman, this statement is offered on behalf of the National Retail Furniture Association and the National Association of Credit Jewelers. The first association has approximately 9,500 members and the second association has approximately 1,000 members.

Its purpose is to direct the attention of the committee to severe inequities arising from the second antiwindfall provisions of the Current Tax Payment Act of last June so as to bring about a repeal of such provisions.

Although only about 6 months have passed since the second antiwindfall tax provisions were enacted, yet scores of inequities have already appeared. Some of these inequities were emphasized yesterday by the statements to the committee made by Mr. Stans, of Chicago, and on behalf of Mr. Satterlee, of New York City. They touched upon only a few of the scores of inequities. I shall point out many more, but time does not suffice to name as many as are evident.

The large number of tax inequities make wholly impractical the amendment of these second antiwindfall tax provisions to remove the inequities to try to make the law reasonably fair and just. If as many relief provisions were written into the law as needed, many complex provisions would be added covering many pages of the statutes, all for a tax provision which only has a 1-year life. The second antiwindfall tax is only a makeshift tax to cover the transition to the current payment of the income tax beginning this year. The inequities

are so numerous and the need for relief so great and the impracticality of writing relief provisions to fit every inequity is so evident that the best solution is found in the repeal of the provisions themselves.

These tax hardships do not affect corporations because the second antiwindfall tax affects only individuals. It is most disastrous on small businesses operated either by a sole proprietor or by partners. Many hardships arise where no business at all is conducted.

An illustration of this last-mentioned great hardship arises in the case of a widow who suddenly finds herself bereaved because of the death of her husband in 1941 after he had made a very foresighted and generous provision for her through his will. She had no income in the base years 1937–40. Her grief will not be assuaged by the second antiwindfall tax which she must pay. The $20,000 cushion granted to her on top of a zero base does not protect her from this tax when she has an annual income in 1942 and 1943 of $25,000 or more. The widow is thus required to pay this second antiwindfall tax in addition to individual normal and surtaxes because of the thoughtfulness, care, and foresight of her husband in providing for her so generously after his death and not because of any war profits. This was never intended by the Congress.

Another illustration of hardship arises in the case of a small businessman who as a sole proprietor sustained large losses in all of the base years. When he is about to get on his feet through net profits in 1942 and 1943 and pay off his debts and bank loans, he is faced with the prior obligations which he owes to the United States under the second antiwindfall tax. He has no choice other than bankruptcy or receivership.

Consider the case of the individual who has received a $30,000 or $40,000 salary in every one of the base years but who had large losses during every one of those years either from causualties or from bad investments. Even if he received no more salary in 1942 and 1943 than was paid to him in the base years he must still pay a very heavy second antiwindfall tax because the $20,000 cushion does not protect him. He has received no war profits. The Congress did not intend that he should pay such a tax.

An analogous situation arises in the case of a nonresident executive of a United States corporation. During all of the base years he lived in South America to advance the business interests of his company. His income, because he was a nonresident, was not subject to the Federal income tax during any of those base years. His company directed him to return to the United States in 1942. After that they continued to pay him the same $50,000 annual salary which he received while in South America. He is required to pay a very heavy second antiwindfall tax because the $20,000 cushion added to a zero base does not relieve him from that unintended tax burden. He received no greater income in 1942 or 1943 than he did in the base years and should be subjected to only the individual normal and surtaxes.

Another great hardship is shown by the case of a daughter who has a remainderman interest in a trust created under the will of her mother. The income of the trust was paid to her father prior to his death in 1941. Her income for 1942 was approximately $168,000 and will be approximately $182,000 for 1943. Her highest surtax net income, however, in the best base year was only $13,400. The 1943 tax is $142,000, to which must be added 25 percent of the 1942 tax, or $30,375. The

second antiwindfall tax is $76,000. Thus her total tax for the transition year of 1943 is $248,375. No windfall tax would have been payable at all if her father had lived or if he had died conveniently during any one of the base years. However, because he died in 1941, about 135 percent of the $182,000 of income for 1943 will be exacted in Federal income taxes.

Senator DAVIS. Do I understand this case you are giving us is one which comes to you out of your own experience?

Mr. BENNETT. Out of my own experience, and experience which has been brought to me by accountants, tax consultants, and other lawyers.

The business of a sole proprietor will be ruined by the second antiwindfall tax as is shown by the following illustration which is an actual, not a hypothetical case. The 1943 income of this man's business will be approximately $2,000,000. The 1943 tax will be approximately $1,800,000. The tax computed on the 1942 income was approximately $800,000. The highest surtax net income in the base years did not exceed $40,000. The profits have been plowed back into the business; that is, they have been reinvested in inventory and equipment. To the $1,800,000 of tax mentioned above must be added 25 percent of the 1942 tax under the Current Tax Payment Act, or $200,000, and to these two tax amounts must be added the second antiwindfall tax of $565,000. Thus 130 percent of the large 1943 income is required to pay all of these taxes. This takes the working capital of this man's business.

The serious tax inequities and gross hardships of this freak tax are particularly evident in the cases of sole proprietors and partnerships which conduct installment business and report on the installment basis under the provisions of section 44 (a) of the Internal Revenue Code. The inequities are due chiefly to the "bunching" of income by regulation W imposed by the Federal Reserve Board. Many retailers, who sell on the installment plan, report on the installment basis. Under this basis, they pay their taxes on their profits from the installment sales as they collect their installment accounts receivable.

However, no longer can an installment retailer sell for 5 or 10 percent as a down payment. In most instances he is required to receive no less than 30 percent as a down payment. No longer can he sell on terms of 24 or 30 months. Generally he cannot extend credit terms longer than 9 months under regulation W. Thus his income is "bunched" in 1942 and 1943. Before regulation W he was permitted to spread it out during the long period of time for which he extended credit.

His income is further "bunched" by the collections which he is making in the high tax rate years in 1942 and 1943 on installment sales made in the lower tax rate years of 1940 and 1941. Thus he has to pay a second antiwindfall tax on business which he never did in 1942 or 1943. He also has to pay a second antiwindfall tax because of regulation W which he cannot avoid.

Many of these installment retailers are small businessmen whose working capital will be consumed in the payment of this second antiwindfall tax. Their best base year plus $20,000 does not begin to approximate the amount of their "bunched" surtax net income in 1942 and 1943, which must be the situation if they are to avoid the payment of the second antiwindfall tax.

With the second antiwindfall tax, many installment retailers, because of this bunching of their income, who report on the installment basis, must pay a normal tax and a surtax greater in the aggregate than their accrual net income. Frequently the result is that, instead of 75 percent of the tax for 1942 or 1943—whichever is the lower tax year—being forgiven a merchant on the installment basis, only 15 percent or 20 percent is actually forgiven.

Senator DAVIS. Have you prepared an amendment to cover this particular subject?

Mr. BENNETT. The only effective remedy which we believe is possible would be a complete repeal, because if we were to attempt to correct these various hardships by amendment, it would require a special provision in the law for each case of hardship. You could not have a blanket amendment that would cover them all. It would require separate treatment in each instance. There have been only two instances of separate treatment in the antiwindfall law, and that treatment takes over a page and a half of the bill of last June. If we had 30 instances it would take at least 30 pages of special treatment, and to us that does not seem at all practical. We feel, since this revenue is only for one year, the United States will not be deprived of a permanent source of income. The only fair and equitable thing to do is to repeal the tax in toto, and that is the recommendation of these two associations, on whose behalf I appear.

Senator DAVIS. Do you know the total amount that would be involved if the act was repealed?

Mr. BENNETT. That would be a matter for the Treasury. That is the only thing I can say.

Senator DAVIS. Can you make an estimate as to what it would be?

Mr. BENNETT. I do not think it would be a great deal more than $75,000,000. That would be the top figure, in my humble opinion. I am not an economist.

The CHAIRMAN. The Treasury estimated it was more than that when we passed the bill, but I agree with you it is not going to produce a lot of revenue, this second windfall provision.

Mr. BENNETT. Thank you, Senator.

The CHAIRMAN. It will work a terrific hardship in specific cases, but it will not apply to a high enough percentage of cases to produce a very big volume of revenue.

Mr. BENNETT. In this connection, I hope the members of the Finance Committee can verify the accuracy of information which has been given to me to the effect that the Treasury favors a repeal of this second antiwindfall tax, and that it may have written a letter last June to that effect when this very measure was under consideration. I am merely asking that you verify that.

Several exhibits are attached showing actual cases where this is the situation. In a great majority of these installment-basis cases total taxes must be paid, if the second antiwindfall tax remains in the Internal Revenue Code, from 100 percent to 175 percent of the average annual net income on the accrual basis for 1942 and 1943.

Thus, there is in this second antiwindfall tax something that looks very much like a capital levy.

Most installment basis merchants if they were on the accrual basis, would have no second antiwindfall tax to pay. However, being on

the installment basis a large proportion of them have a very heavy second antiwindfall tax to pay. The competitor who may be on the accrual basis will see his neighbor on the installment basis taxed out of business if the second antiwindfall tax is not repealed.

Installment basis corporations got relief under the 1942 Revenue Act in section 736 (a) from the excess profits tax. This second antiwindfall tax is analogous to an excess-profits tax on individuals. Individuals should now get relief from it. The only adequate relief because of the great number of hardship cases, which cannot be separately provided for in the law, is through a repeal of the second antiwindfall provisions.

The repeal of these provisions does not mean a continuing loss of revenue to the Government by any permanent decrease in tax rates. It is only to be effective for one year. The speaker believes that the Finance Committee can verify the accuracy of information given him to the effect that the Treasury favors the repeal of the second antiwindfall tax, and may have written a letter to that effect when that tax was under consideration last June.

Accountants, lawyers, contractors, architects, authors, and many others are permitted to spread their fees for work which they did over a period longer than 36 months throughout the several years during which the work was being done, when they compute their respective income taxes. However, installment-basis taxpayers, because of regulation W, cannot spread their incomes over any normal installment payment period. While the Congress should not nullify the provisions of regulation W, issued by the Federal Reserve Board, it could and should forever remove the tax hardships and gross inequities arising from regulation W by the immediate repeal of the second antiwindfall tax provisions.

Senator WALSH. You are not holding that against the lawyers, are you?

Mr. BENNETT. No, sir; I am just saying that with a smile, that the lawyers seemed to be present in the drafting room. That also applies to accountants, contractors, architects and authors who take more than 36 months to do their work.

The unworkable nature of this tax is shown not only because of the hardships and tax inequities heaped upon the taxpayers but also because of the advantage which some taxpayers get under these provisions to the prejudice of the United States. This is illustrated by the case arising from the forfeiture in 1938 by a lessee of his lease after having made valuable improvements on the leased premises. Under the Internal Revenue Code, as it was prior to the 1942 amendment, the fair market value of the improvements became taxable income to the lessor in 1938. Thus that base year is "blown up" for this taxpayer. The real-estate improvement had a fair market value of $500 000 which gives this taxpayer an abnormally "highest base year." This same taxpayer had an abnormally high income in 1942 and 1943 of $400,000 in each year over and above any one of his other three base years than 1938. Thus because of this lease forfeiture in 1938 this individual taxpayer does not have to pay any second antiwindfall tax despite the fact that he has $400,000 of "swollen income" in each of the years 1942 and 1943.

Then there is the case of alimony which was touched upon briefly by Mr. Satterlee yesterday. I wish to give you another illustration

showing a little different angle. By the Revenue Act of 1942, alimony is allowed as a deduction by a divorced husband in arriving at his taxable net income. In 1942 this ex-husband paid $25,000 alimony which he had also paid in each of the 4 base years, pursuant to a court decree. However, in the base years the Internal Revenue Code did not permit him to deduct these alimony payments. He had to pay an income tax upon them. Therefore those 4 base years are "blown up" to the extent of the $25,000 annual alimony payments. Thus in 1942 and 1943, when he can deduct these alimony payments in determining his taxable net income, he can have "swollen income" to that extent on which he has to pay no second antiwindfall tax.

If the second antiwindfall tax provisions are not repealed now thousands of businessmen must show an enormous tax indebtedness to the United States on their financial statements at the close of the year. These tax liabilities are prior claims on the assets of these businesses. Showing this liability, which they must do, will ruin the credit of these businessmen. They cannot borrow from the banks to tide over the exigencies of the post-war period but they will join the caravan of millions beseeching Washington for unsecured loans or for outright gifts so as to continue in business and to provide the jobs required for 9,000,000 returning soldiers and 20,000,000 war workers.

Simplification of tax laws is the objective of this session of the Congress. Repeal of the second antiwindfall tax provisions would go a long way toward attaining this worthy goal.

If it remains a part of the Internal Revenue Code it will be productive of many technical tax protests from taxpayers and also of much tax litigation. The settlement of tax liabilities, reflected by tax returns poorly prepared because of taxpayers' misunderstanding of the law's requirements, will be long delayed, if this law remains to be enforced. Any legislative action should be retroactive so as to eliminate it entirely from the Current Tax Payment Act.

The Bureau of Internal Revenue is greatly handicapped by the loss of men. This highly complex and ambiguous law will add greatly to the burden of the field staff who are now seriously handicapped because of want of manpower. No administrative official should be concerned with the enforcement of such a law.

Only a few of the inequitable situations have been sketched in this brief analysis of the second antiwindfall tax. If there were time, many more instances of severe hardships could be spread upon the record. These illustrations should suffice to show that special exceptions by way of relief cannot be written into this second antiwindfall tax law. The only way to bring about a just tax result is to repeal all of these provisions in toto.

EXHIBIT 1.—*Illustration from actual case*

A. NET INCOME

	1942	1943	Total
Accrual basis	$38,447.63	$65,231.77	$103,679.30
Amount realized from collections of accounts receivable arising from sales of prior years in excess of profit deferred on current year's sales	53,680.91	21,826.51	75,507.42
Installment basis	92,128.44	87,058.28	179,186.72

EXHIBIT 1.—*Illustration from actual case*—Continued

B. INCOME TAXES PAYABLE UNDER CURRENT TAX PAYMENT ACT OF 1943

[Personal exemption 1942 and 1943, $1,200; earned income credit accrual basis 1942, $802.50; 1943, $1,400; installment basis 1942, $1,400; 1943, $1,400]

	Accrual basis		Installment basis	
	1942	1943	1942	1943
Income taxes, including Victory tax for 1943	$17,350.27	$39,110.22	$57,526.61	$57,301.59
First antiwindfall tax:				
25 percent of 1942		4,387.57		
25 percent of 1943			14,325.39	
Second antiwindfall tax		None	25,472.59	
Total taxes payable under Current Tax Payment Act of 1943		43,497.79	97,324.59	
Average of 1942 and 1943 income		51,839.65	89,593.36	
Percent of total taxes to average annual income		83.9	108.6	
Percent of total taxes installment basis to average annual income accrual basis		172.8		
Total of 3 years income and Victory taxes		56,660.49	114,828.20	
Amount payable under current Tax Payment Act of 1943		43,497.79	97,043.89	
Amount forgiven		13,162.70	17,784.31	
Percent of amount forgiven		23.2	15.48	

C. EFFECT OF RELIEF REQUESTED AND COMPARISON

	Accrual basis	Installment basis under act	Installment basis with relief requested
Income and Victory tax	$39,110.22	$57,301.59	$57,526.61
First antiwindfall tax	4,387.57	14,325.39	14,325.39
Second antiwindfall tax		25,472.59	
Total	44,497.79	97,099.57	71,852.00
Reserve for unrealized gross profit end of 1943, $39,447.21.			

D. SECOND ANTIWINDFALL TAX

1. Under Current Tax Payment Act 1943:			
1943 surtax net income			$85,658.28
Highest base year 1940 plus $30,000	$34,957.53		
Normal tax		$2,097.45	
Surtax		14,035.37	
Income subject to Victory tax, $35,533.53, 5 percent $1,776.68			
Less post-war credit 40 percent or 500.00		1,276.68	
Total tentative tax			17,409.50
75 percent of 1943 tax, $57,301.59			42,976.19
Second antiwindfall tax			25,472.59
2. Had taxpayer been on accrual basis:			
Highest base year 1940, plus $20,000		44,440.26	
Normal tax			2,666.42
Surtax, $44,000		19,460.00	
63 percent, $440.26		277.36	
			19,737.36
Victory tax:			
Income subject to Victory tax		45,016.26	
Victory tax, 5 percent		2,250.81	
Post-war credit		500.00	
			1,750.81
Total tentative tax			24,154.59
75 percent of 1942, $17,550.27			13,162.70
Second antiwindfall tax			None

EXHIBIT 2.—*Illustration from actual case*

A. NET INCOME

	1942	1943, estimated	Total
Accrual basis	$81,847.84	$121,000.00	$202,847.84
Amount realized from collections of accounts receivable arising from sales of prior years in excess of profit deferred on current year's sales	47,097.41	9,000.00	56,097.41
Installment basis	128,445.25	130,000.00	258,445.25

B. INCOME TAXES PAYABLE UNDER CURRENT TAX PAYMENT ACT OF 1942

[Personal exemptions and credit for dependents 1942 and 1943, $2,250; earned income credit, $1,400 each year.]

	Accrual basis		Installment basis	
	1942	1943	1942	1943
Income taxes, including 1943 Victory tax	$47,952.31	$85,909.80	$87,321.97	$93,909.80
First antiwindfall tax 25 percent of second antiwindfall tax	47,952.31	$11,988.08	87,321.97	$21,830.49
Surtax income highest base year (1940) plus $20,000	74,420.00		46,354.00	
Normal tax	4,455.25		3,781.24	
Surtax	20,923.03		20,943.03	
Total tentative tax	$4,388.20		23,724.26	
75 percent of 1942 tax	35,964.23		65,491.48	
Second antiwindfall tax		None		$41,767.00
Total taxes payable under Current Tax Payment Act of 1943		$97,897.88		$157,297.00
Average of 1942 and 1943 net income		$101,173.92		$129,222.00
Percent of total taxes to average annual income		96.45		121.73
Percent of total taxes installment basis to average annual accrual income				156.47
Total of 2 years' normal tax, surtax, and Victory tax		$133,552.11		$181,021.00
Amount payable under Current Tax Payment Act 1943		$97,587.88		$157,297.00
Amount forgiven		$35,964.23		$23,724.00
Percent of amount forgiven		26.8		15.1

C. EFFECT OF RELIEF REQUESTED AND COMPARISON

	Accrual basis	Installment basis under act	Installment basis with relief requested
Income and Victory tax	$85,909.80	$93,909.80	$93,909.80
First antiwindfall tax	11,988.08	21,083.49	21,830.49
Second antiwindfall tax	None	41,767.22	None
Total	97,587.88	157,297.51	115,530.29

NOTE: This installment basis taxpayer still has estimated deferred profits at December 31, 1943 of $26,847.02 which will be subject to taxation upon liquidation of estimated receivables on that date.

D. SECOND ANTIWINDFALL TAX

Under 1943 Current Tax Payment Act:		
1942 surtax net income		$126,195.25
Highest base year, 1940	$26,354.00	
Plus	20,000.00	
Total	46,354.00	
Normal tax		2,781.24
Surtax, $44,000	19,460.00	
63 percent of $2,354	1,483.03	
		20,943.03
Total tentative tax		23,724.26
75 percent of 1942 tax	87,321.97	65,491.48
Second antiwindfall tax		41,767.22

EXHIBIT 2.—*Illustration from actual case*—Continued

D. SECOND ANTIWINDFALL TAX—Continued

Had taxpayer been on accrual basis:		
Highest base year, 1940	$54,420.90	
Plus	20,000.00	
Total	74,420.90	
Normal tax		$4,465.25
Surtax, $70,000	25,740.00	
75 percent of $4,420.90	3,183.05	
		30,923.05
Total tentative tax		44,388.30
75 percent of 1942 tax	47,952.31	33,964.23
Second antiwindfall tax		None

EXHIBIT 3

Mr. X, a taxpayer, reported the following incomes:

Year	Surtax net income	Normal tax net income	Year	Surtax net income	Normal tax net income
1937	$4,000	$4,000	1940	$5,000	$5,000
1938	3,800	3,800	1942	70,000	68,800
1939	2,700	2,700	1943	75,000	73,800

In computing Mr. X's "antiwindfall" tax he must make three computations, as follows:

I

A. 1940 surtax net income (highest "normal" year 1937-40)		$5,000
B. Add antiwindfall exemption		20,000
C. Amount on which fictitious tax is to be computed (1942 rates used since X's income lower in 1942 than 1943)		25,000
D. Surtax on $25,000		8,500
E. Normal tax on $25,000 (6 per cent)		1,500
F. Total fictitious tax		10,000

II

A. 1942 surtax net income (1942 chosen because lower than 1943)		70,000
B. 1942 normal tax net income (after deducting maximum earned income credit of $1,600)		68,800
C. Surtax on $70,000		25,740
D. Normal tax on $68,800 (6 percent)		4,116
E. Total 1942 tax		40,856

III

A. 75 percent of 1942 tax of $40,856 (see II-E)		$30,642.00
B. Less tax on fictitious $25,000 income (see I-F)		10,000.00
C. Equa's "antiwindfall" tax to be paid by Mar. 15, 1944, of		20,642.00

In other words, in addition to paying higher taxes because of higher rates and increased income, Mr. X must also pay a tax based on the extent of the increase of his income over the so-called normal years.

In this particular example Mr. X must, on the basis of a combined surtax net income of $145,000 for the years 1942 and 1943 pay the following taxes (exclusive of Victory tax):

1943 surtax on $75,000 (based on 1942 rates)	$40,340.00
1943 normal tax on $73,800 (6 percent) (after deducting maximum earned income credit of $1,600)	4,416.00
25 percent of 1942 surtax and normal tax of $40,856 (see II-E)	10,214.00
(This 25 percent is based upon forgiveness of 75 percent of the lower of 1942 or 1943 taxes.)	
"Antiwindfall" tax (see III-C)	20,642.00
Total tax	75,612.00

Thus Mr. X's actual forgiveness on his 1942 tax works out as follows:

Straight forgiveness (75 percent of 1942 tax of $40,856) (see II-E)	$30,642.00
Less "Antiwindfall" tax to be paid (see III-C)	20,642.00
Leaving a net forgiveness of only	10,000.00

Therefore, far from being a 75-percent forgiveness, Mr. X's net forgiveness is less than 25 percent on his 1942 tax of $40,856.

EXHIBIT 4.—*Illustration from actual case*

A. NET INCOME

	1942	1943	Total
Accrual basis	$48,183.45	$92,000.00	$140,183.45
Amount realized from collections of accounts receivable arising from sales of prior years in excess of profit deferred on current year's sales	13,961.87	3,000.00	16,961.87
Installment basis	62,145.32	95,000.00	157,145.32

B. INCOME TAXES PAYABLE UNDER CURRENT TAX PAYMENT ACT OF 1943

Personal exemption and credit for dependents, 1942 and 1943, $1,000; earned income credit accrual basis, 1942, $963.67; 1943, $1,400; installment basis, 1942, $1,242.91; 1943, $1,400]

	Accrual basis		Installment basis	
	1942	1943	1942	1943
Normal tax	$2,676.50	$5,322.00	$3,497.46	$5,502.00
Surtax	20,450.35	51,817.00	29,532.35	53,827.00
Victory tax (after deducting post-war credit)		8,468.80		8,518.80
Income and Victory tax, 1943	23,126.85	60,207.80	33,029.81	62,847.80
First antiwindfall tax, 25 percent of 1943		6,781.71		8,257.45
Second antiwindfall tax		None		8,581.31
Surtax income highest base year (1937) plus $20,000		37,668.80		35,045.52
Normal tax		2,261.33		2,102.91
Surtax		15,619.50		14,088.14
Total tentative tax		17,880.83		16,191.05
75 percent of 1942 tax		17,343.13		24,772.96
Second antiwindfall tax		None		8,581.31
Total taxes payable under Current Tax Payment Act of 1943		65,989.51		79,686.56
Average of 1942 and 1943 net income		70,091.73		78,572.66
Percent of total taxes to average annual income		94.14		101.42
Percent of total taxes installment basis to average annual accrued income			113.69	
Total of 2 years' normal tax, surtax, and Victory tax		83,334.65		95,877.61
Amount payable under Currency Tax Payment Act of 1943		65,989.51		79,686.56
Amount forgiven		17,345.14		16,191.05
Percent of amount forgiven		26.2		20.8

C. EFFECT OF RELIEF REQUESTED AND COMPARISON

Taxes payable	Accrual basis	Installment basis under act	Installment basis with relief requested
Income and Victory tax	$60,207.80	$62,847.80	$62,847.80
First antiwindfall tax	6,781.71	8,257.45	8,257.43
Second antiwindfall tax	None	8,581.31	None
Total	65,989.51	79,686.56	71,105.25

NOTE.—This installment-basis taxpayer still has estimated deferred profits at Dec. 31, 1943, of $16,843 which will be subject to taxation upon liquidation of estimated receivables on that date.

EXHIBIT 5.—*Individual furniture dealer in Maryland*

	Accrual	Installment
1942 income	$39,000	$61,300
1943 income	101,000	101,300
1943:		
Income tax and Victory tax	65,000	67,900
25 percent of 1942 income tax	3,800	5,200
Second antiwindfall		11,500
Total	68,800	67,600
Percent of tax to 1943 income	68	87

Net income realized in 1942 and 1943 from liquidation of installment accounts receivable	$22,600
Additional income taxes on installment basis over accrual basis—Taxpayer's liability for tax on profits from sales of years prior to 1942	$18,800
Percent of additional taxes to profits from sales of years prior to 1942	84%
Tax relief sought	$11,600

EXHIBIT 6

The following is the actual case of an individual who pays approximately 66 percent of the profits which he realized from prior years' sales when the tax rates were much lower, as taxes for 1943. He also pays over 75 percent of the profits which he realized from prior years' sales as the first antiwindfall tax. No relief is being asked, however, from this very unfair burden. Relief is urged only from the second antiwindfall tax.

	Accrual	Installment basis	Profit realized from years prior to 1942
Net income higher year	$102,350	$112,000	$9,650
Net income lower year, one-quarter	13,300	17,550	4,250
	115,650	129,550	13,900
Taxes payable:			
For 1943	71,755	78,200	6,446
First anti-windfall	7,136	10,250	3,114
Second anti-windfall		5,545	5,545
	78,891	93,995	15,104
Percent of tax to income of higher year, plus one-quarter of income of lower year [1]	68.2	72.6	108.7
Percent of tax to income of higher year	77.1	84.0	156.6

[1] Since 25 percent of the tax is payable under the first anti-windfall tax, its ratio to income is computed by using 25 percent of the income.

NOTE.—Taxpayer was on accrual basis in base year. Otherwise the tax would have been much higher.

EXHIBIT 7.—*Individual furniture dealer in St. Louis*

	Accrual	Installment
1942 income	$64,250	$91,600
1943 income	95,000	95,000
1943:		
Income and Victory tax	63,660	63,660
25 percent of 1942 income tax	8,820	13,960
Second antiwindfall	870	20,570
Total	73,350	98,190
Percent of tax to 1943 income	77	103

Net income realized in 1942 and 1943 from liquidation of installment accounts receivable	$27,370
Additional income taxes on installment basis over accrual basis—Taxpayer's liability for tax on profits from sales of years prior to 1942	24,840
Percent of additional taxes to profits from sales of years prior to 1942	91
Tax relief sought	19,700
Taxes in year of forgiveness	55,630
First and second antiwindfall tax	34,530
Amount forgiven	21,800
Percent of amount forgiven to total taxes	38

The CHAIRMAN. We thank you.
Mr. Gary.

STATEMENT OF J. VAUGHAN GARY, REPRESENTING THE NATIONAL ASSOCIATION OF STATE CHAMBERS OF COMMERCE

The CHAIRMAN. Mr. Gary, how much time do you wish?

Mr. GARY. I would say about 15 minutes.

The CHAIRMAN. I am going to ask you to be as brief as you can.

Mr. GARY. I have prepared my remarks with that in view, so there will be no chance of rambling, Mr. Chairman.

The CHAIRMAN. Proceed.

Mr. GARY. Mr. Chairman and gentlemen of the Finance Committee, I am J. Vaughan Gary, an attorney at law, of Richmond, Va. I represent the National Association of State Chambers of Commerce. Our organization is not a separate entity with a paid staff and separate personnel, but, as its name implies, it is an association of 33 State and regional chambers of commerce throughout the United States.

In framing the recommendations which I shall present to you, meetings of representatives of the State organizations were held, committees, the members of which were selected from different sections, were appointed, thorough studies were made, and reports were prepared. Our conclusions, therefore, have not been hastily conceived, but they are the product of careful study and deliberation and they have the active endorsement and support of the various member organizations.

Any consideration of fiscal policies at the present time must be approached with the full realization that we are engaged in a world war, the speedy and successful termination of which is of paramount importance in all our planning. It is an expensive war, but the people of America are united in the firm resolve that it must be won at any cost. Our differences of opinion relate only to the ways and means of insuring victory.

The adoption of an adequate fiscal program involves the consideration of both receipts and expenditures. The need for unprecedented expenditures is recognized, but the magnitude of our task demands the elimination of all extravagance and waste. This has been properly called the people's war, and our people are being urged by the Government to save and economize so that all available resources may be employed in the war effort. Surely, in this essential part of the program the Government should set the example by employing a rigid economy in Federal expenditures.

The Joint Committee on Reduction of Nonessential Federal Expenditures, of which Senator Harry F. Byrd of Virginia is chairman, has rendered an outstanding service for the American people in exploring the spending activities of the Federal Government and in making sound recommendations for economies. We commend to you the findings of that committee and urge your active support of its recommendations. Especially do we urge favorable consideration of the committee's report of June 18, 1943, which recommended that a reduction of at least 300,000 in personnel be promptly carried out by all departments and agencies of the Federal Government; and that the Civil Service Commission and the civil departments and agencies immediately cease all unnecessary recruiting of employees, particularly from sources outside the Government service. This recommendation, if adopted, would effect economies in manpower and expenditures.

The accomplishments of Senator Byrd's special committee have demonstrated the need for implementing the Congress with competent and adequate staff help to conduct a careful and continuous study of Federal spending practices. We, therefore, recommend the prompt enactment of House Concurrent Resolution No. 8, introduced by Representative Dirksen of Illinois, which would establish a permanent Joint Committee on Economy and Efficiency, composed of five Senators and five Representatives, to inform and advise congressional committees respecting the appropriations which may be deemed essential within the limits of sound, efficient, and economical administration for the various Governmental agencies.

For the past decade Federal subsidies have increased amazingly, both in dollar volume and in the number and variety of purposes served. Now is the time for Congress to reappraise the entire subsidy program with a view to determining which types of grants are economically and socially sound and which are unsound and wasteful. We recommend that the present trend of ever-increasing Federal subsidies be curbed and that no new Federal types of grants-in-aid be approved by the Congress except upon unquestioned proof that they are essential and sound.

The recent proposal to appropriate $300,000,000 annually for Federal aid to State school systems is a striking example of the appealing form which these subsidies assume. The cause of public education commands universal interest, but this measure would have inaugurated a new and ambitious program which eventually would have grown to enormous proportions and it also would have constituted a serious first step toward the federalization of our public school systems. We commend the Senate for its decisive defeat of the measure.

There are now pending in the Congress a number of proposals for the expenditure of huge sums for capital improvements after the war. In view of the large tax and debt burdens which shall be our portion for some years, we seriously question whether many of these measures can be justified, and in the interest of sound national economy we urge that all such proposals be carefully scrutinized.

Having enjoyed the privilege of serving in a legislative body, I know that frequently our people demand public improvements and then condemn the lawmakers when the inevitable day of payment arrives. Our association has taken cognizance of that fact and we have included in our program a recommendation to all of the chambers of commerce throughout the United States that they refuse their support of any measures designed to persuade the Congress to appropriate Federal funds for local improvements, the necessity for which is not universally recognized.

Considering now the opposite side of the ledger—the question of receipts—we are convinced that the rates of the corporation income and profits taxes should not be increased.

The tax rates upon corporation earnings have reached unprecedented heights, and for many corporations are excessively high. Such heavy taxes are weakening corporate initiative, are encouraging business inefficiency, and are preventing the accumulation of reserves for future needs.

We acknowledge the necessity for onerous, even oppressive, taxation of corporation profits during the war emergency. We believe, how-

ever, that to add to the tax burden already imposed would gravely threaten the continued existence of many corporations, especially the smaller concerns. Moreover, the capacity of industry to employ labor after the war would be seriously impaired, if not destroyed.

Higher corporate taxes would diminish the income available for distribution to the shareholders of the corporation, and would thus reduce Federal revenues from the taxes on the shareholders. Corporation taxes are in essence double taxation of income which at some time will be taxed to the individual owners. Such income should not twice be taxed. Further, higher corporate rates will not aid in curbing inflation since they will not reach the vast spending power engendered by wage and salary payments.

The massive weight of present corporation taxes is little appreciated. The combined normal tax and surtax rates now attain a maximum of 40 percent. The excess-profits tax exacts a rate of 90 percent, against which 10 percent thereof is allowed as a credit, and the House bill now before you for consideration proposes to increase this rate to 95 percent and to reduce the invested capital credit allowed in determining the tax. The total normal tax, surtax, and excess-profits taxes may amount to as much as 80 percent of taxable income.

We present herewith a table compiled from data published by the Department of Commerce showing the over-all picture of the trends in total annual corporation profits, taxes, and dividends for the calendar years from 1929 through 1942.

Annual profits, Federal taxes, and dividends

[Amounts in millions]

Year	Federal tax rates			Profits before taxes	Taxes	Profits after taxes	Dividends	Wage and salary payment
	Normal	Surtax	Excess profits [1]					
	Percent	*Percent*	*Percent*					
1929	11	.....	.....	$9,153	$1,181	$7,972	$5,778	$52,000
1930	12	.....	.....	1,979	700	1,279	5,658	47,000
1931	12	.....	.....	−2,836	389	−3,226	4,309	40,000
1932	13.75	.....	.....	−5,187	275	−5,462	2,652	31,000
1933	13.75	.....	.....	−1,969	421	−2,390	2,123	29,000
1934	13.75	.....	.....	725	596	129	2,697	32,000
1935	13.75	.....	.....	2,407	725	1,672	3,951	35,000
1936	15	.....	.....	5,089	1,191	3,898	4,735	39,000
1937	15	.....	.....	5,173	1,276	3,897	4,853	44,000
1938	19	.....	.....	2,375	860	1,515	3,375	40,000
1939	19	.....	.....	5,320	1,232	4,088	3,580	44,000
1940	24	.....	50	7,390	2,543	4,847	4,095	48,000
1941	24	7	60	13,938	7,061	6,857	4,440	60,000
1942	24	16	90	18,784	11,900	6,884	3,983	78,000

[1] Maximum.

It will be noted that this table includes the prosperity year of 1929, the depression years, the pre-war period and the first year of war.

While corporation profits, before taxes, doubled from 1929 to 1942, corporation taxes increased more than 10 times, with the result that profits after taxes were lower at the end of the period than at the beginning.

The total profits of all corporations were reduced to approximately $7,000,000,000 in 1942 by taxes. The slight increase of $27,000,000 over 1941 may quickly disappear after the war contracts have been renegotiated. After rising to a peak of nearly $8,000,000,000 during

the 1929 prosperity, profits after taxes slumped off, and by 1942 they had not yet climbed back to the 1929 level.

While corporate profits after taxes in 1942 were lower than they were in 1929, wages and salaries in 1942 amounted to $78,000,000,000 as compared with $52,000,000,000 in 1929. Thus wages and salaries increased 50 percent in this period.

Corporate dividends in 1942 were at the lowest level since 1939, which they exceeded by only a slight margin, and they aggregated only 70 percent of the dividends paid in 1929.

While the net savings of individuals soared upward to $26,900,000,000 in 1942, corporate net saving increased to only $3,600,000,000.

These data indicate that our corporations in general are not receiving swollen profits, nor have they been hoarding huge surpluses from their earnings in recent years, after we allow for the effects of their heavy taxes.

The present tax rates will provide increasing revenues when corporate earnings rise. In fact, there are many who believe that we have already passed the point of diminishing returns and that a decrease in the excessively high rates would result in an increase of revenue. Certainly, these high rates are fully adequate to take from corporations all of the revenues which may be withdrawn without seriously impairing their capacities for production and employment.

The corporation taxes rest onerously upon shareholders from all walks of life with varying net incomes and economic responsibilities. The fact that many investors have only moderate incomes is generally disregarded.

After the earnings of corporations which are employed to pay dividends have been taxed, the individuals who receive such dividends must pay an income tax upon them, without a credit for the tax already paid by the corporation. No other income payments are subject to such double taxation.

Corporate dividends, moreover, are relatively small as compared with wage and salary payments, and are not, in general, greatly increasing.

It is of little avail to place heavier taxation upon corporate profits in order to strike at inflationary consumer spending. This taxation would fail to reach the rapidly rising incomes of workers and farmers and would penalize the corporate saving necessary to meet the problems of post-war production and employment.

If our corporations are to survive the rigors of burdensome taxation, the smaller and weaker enterprises, as well as the stronger and larger, must be spared from excessive burdens.

The corporation taxes are essentially taxes upon investment, production, and employment and not taxes upon consumption. Increasing their weight will restrict production at a time when production should be enhanced and will impair the capacity for employment after the war.

If our tax system is to be directed more effectively against inflationary consumer purchasing, additional taxes must be placed upon consumption rather than upon production.

We conclude that any further increases in corporation tax rates would (1) weaken the incentives to efficient production, (2) deprive corporations of necessary reserve funds, (3) endanger the maximum

employment of labor after the war, and (4) would not aid in the battle against inflationary consumer spending. Therefore, we are opposed to any increase in the rates of the corporation income and profits taxes, and strongly urge that the increase of the excess profits tax rate and the reduction of the invested capital credit allowed in determining excess profits be stricken from the House bill.

It is essential that at the conclusion of the war business and industry have available sufficient accumulated funds to finance the transition from war to peacetime activities, to maintain employment, and to provide for other post-war requirements. The present tax rates are so high that they are preventing business and industry from making an adequate provision for such requirements. Some way of mitigating these rates must be found over and above the carry-back and carry-forward of losses and the unused excess profits tax credit.

In our judgment recognition of this need is of utmost importance.

American business and industry have no apologies to offer for their activities in this war. They have achieved a record of production which has startled the world and is hastening the approach of peace. Capacity for production has been fully demonstrated, but if our system of free enterprise is to be preserved the post-war requirements must be met.

A quarter century ago we fought to make the world safe for democracy, and yet 25 years after winning the war we saw democracy in the gravest peril in its entire history. Today our boys are carrying the battle to the far corners of the earth to preserve the American way of life. The fundamental basis of this American way of life is our system of free enterprise. What a tragedy it would be if we at home should fail to preserve that way of life and the sacrifices of this war should be in vain.

We commend the inclusion in the House bill of provisions for judicial review of proceedings under the renegotiation act. Our democratic processes are being too frequently jeopardized by entrusting authority to governmental agencies without adequate and proper review by the courts.

Believing that the original and principal purpose of the law has been accomplished and that under the present tax laws excess profits will be adequately recaptured, we favor a repeal of the renegotiation provisions of the law as of January 1, 1943.

If, however, renegotiation is retained in the law, we recommend amendments to the provisions of the House bill to provide that the law shall not be applied retroactively to profits accruing prior to the date of enactment, and that payments upon contracts or subcontracts shall not be withheld pending judicial review.

We recommend that the capital stock tax and the declared value excess profits tax be repealed.

These taxes represent primarily a guessing contest between the Government and the corporate taxpayer. Since they are deductible from the income which is subject to income tax and excess profits tax, the net revenue yield is very small. They do not in fact serve the purpose of imposing some tax burden upon all corporations which carry on business, since a corporation which anticipates no net income may declare a nominal value. With small taxpayers as well as large, they create a feeling of irritation, inequity, and injustice which is all out of proportion to the amount of revenue involved. Their repeal

has in the past been advocated by the Treasury Department and adopted by the Senate; it should now be effected.

We recommend the enactment of legislation whereby all forms of enterprise governmentally operated which compete with privately owned and operated business shall be subjected to the payment of Federal taxes on the same basis as the business with which they compete.

The purpose of this recommended action is to assist the Federal Government in closing one of the obvious loop-holes which permits the escape of hundreds of millions of dollars annually of needed Federal revenue for the successful prosecution of the war, and in eliminating the destruction and unfair discrimination that now exists.

In view of the current difficulty which corporations and industries experience in determining whether a particular pension or profit-sharing plan for employees is valid as a basis for deductions under the income tax law, we recommend that a study be made by the Joint Committee on Internal Revenue to determine more definite statutory standards, instead of leaving the matter to the discretion of the Commissioner of Internal Revenue.

The CHAIRMAN. In effect, that has been done already in the special bill.

Mr. GARY. The provision for the increase in the rates of old age insurance payroll tax which will become effective January 1, 1944, and all other automatic increases in the social security law should be eliminated from the law, and the present 1 percent rates should be continued until the necessity for an adjustment is made to appear.

The present rates of taxation are producing far more funds than are needed for the current payment of benefits. In 1942 tax collections amounted to seven and three-tenths times the amount expended, and the experience for 1943 is similar. A surplus of $4,268,000,000 had been accumulated in the trust fund on June 30, 1943. This is four and four-tenths times the highest annual benefit cost, as officially estimated, in the ensuing 5 years and, therefore, is well in excess of the amount required to meet the "three times" test prescribed by the present law.

In 1939 and again in 1942 Congress, by postponing scheduled increases in the rates, asserted its belief that additional payroll taxes were not needed at that time. What was true in 1939 and 1942 is still true today.

We commend the action of the House with respect to the taxation of the incomes of individuals. The present high rates cannot be increased without undue hardship on a large class of individuals who are facing increases in the cost of living without corresponding increases of income. The elimination of the Victory tax and the consequential adjustments in the rates were highly desirable in the interest of simplification. May we urge, however, that no further increases in the rates be approved at this time.

Mr. Chairman, we are not unmindful of the magnitude of your task; we trust that our studies may be of some assistance to you, and on behalf of our association I wish to assure you of our appreciation of your courtesy in so generously permitting us to trespass on your time.

The CHAIRMAN. Thank you very much, Mr. Gary, for your appearance.

It may not be recalled by everyone that the so-called Special Economy Committee, known as the Byrd committee, was created by a provision in the Tax Act that came out of this committee.

Mr. GARY. We think that has been very helpful and we think that committee has demonstrated the need for a permanent committee.

The CHAIRMAN. Some of us who are on the committee have not had the opportunity to serve as constantly in hearings as Senator Byrd, and he has carried the main burden, although he is a member of this committee likewise.

Thank you very much.

Mr. Goldman.

STATEMENT OF JULIAN GOLDMAN, PRESIDENT, GOLDMAN STORES CORPORATION, NEW YORK, N. Y.

Mr. GOLDMAN. Senator George, I stand here apparently as the only propone it of compulsory savings. I will require only about 12 minutes of your time.

The CHAIRMAN. Some of us on this committee have favored the general theory of compulsory savings, but the Treasury has not been able to see eye to eye with us on that.

Mr. GOLDMAN. I noticed that. I was at the Ways and Means Committee hearings and I spoke to the Secretary, and Mr. Paul.

My prime motive for coming here today is to make a last-ditch fight to enlist your efforts to stop inflation. I appeared before you in the summer of 1942 during a hearing of the revenue act of that year and I told you then that unless something was done to syphon off the excess consumer purchasing power, that we would positively have inflation. I predicted that notwithstanding the regulations that were imposed by the President in April 1942, that black markets and their accompanying lawlessness would envelop this country unless some means were taken to immediately drain this excess purchasing power and put it in such form that it cannot be used until after the war is over. I again impress upon you that the only sound plan to accomplish this is through the adoption of compulsory saving. I have been repeatedly stating for the past 2 years in messages that I sent to the President and to the Treasury Department that unless compulsory saving is adopted, nothing that you can do will stop inflation.

One of the most unfortunate aspects of this war, unprecedented in the history of civilization, because of its magnitude, is the fact that the Secretary of the Treasury has at no time had a sound, comprehensive plan for financing the war. It has been a case of trying to raise money when it was needed and then trusting to luck that it will all come out all right in the end.

To continue selling billions of dollars' worth of bonds to banks accelerates inflation. The public is not apparently sufficiently interested, or does not possess a strong enough desire to buy enough of the bonds and to retain them until after the war is over to make possible a proper and sound financing of the war. Were it not for the large insurance companies, finance companies, and many of the great corporations buying up most of the bonds, the Third War Loan drive would have been a failure because the small man and woman did not respond in the man-

ner that they were expected. Besides, many of the employees are purchasing bonds under a 10-percent plan that is forced upon them by their employers. However, the employers have no power to compel them to refrain from cashing these bonds at the earliest period that they are able to do so. Thus, many of these bonds are finding their way back into the banks.

In the recent published statements of national banks it was noted that five of the leading banking institutions in New York showed in their statements that their assets consisted of approximately 50 percent of Government securities. We are reaching a very serious danger point if the banks should be compelled to carry many more Government bonds than they now have.

Increased taxation is not the proper solution. We are now collecting in Federal and social-security taxes at a rate of between forty and forty-five billion dollars a year, according to the figures estimated by you, Mr. Chairman, and to increase this tax burden would mean menacing our entire economic structure.

You must be mindful of the fact, as I pointed out to you last year, that many people are now earning $100 a week who formerly only earned $30 a week. On the other hand, many individuals' incomes have been decreased because they have been thrown out of their regular employment due to priorities. You will find that today many of the working people who are receiving the highest compensation are, in most instances, those who were out of work previously or who could not secure a job because of incompetency. I personally know that many of our former employees, those who were least capable and never sure of their jobs because of that reason, went into defense plants and are paid three and four times as much as they earned in our stores, and then ridiculed and scoffed at our employees, much more competent than the ones who left, because they were earning so much less money.

You can not and must not tax further any of those people whose salaries have not been increased and who have had to bear the burden of the withholding tax, as well as to meet the problem of the increased cost of living due to the creeping inflation that is enveloping us.

The administration's method of letting contracts on a cost-plus basis has made it possible for employers to be indifferent in most instances to salaries that they pay to their employees and has thus created a situation where people are earning large sums, way beyond what their work merits.

In many instances girls who never worked before and have had no experience at all have started to work at $33 per week in the offices of aircraft plants, while on the other hand you find men with families, working in steel plants getting salaries of $35 a week because of an agreement that had been reached with the Government that the wage scale should not be increased during the war. You find the same situation existent in the coal mines, the railroads, and in various other fields of endeavor. Men with families trying to do their best to live on their present wages but who find it physically and humanly impossible to do so because the cost of living has soared, due to this excess buying power that is constantly hovering over us.

As you travel around the country you find in one section people are living in the lap of luxury because of the war effort, benefiting in

every way from this terrible catastrophe, while in other sections of the country you find people actually bent under the load of living on a low wage scale and trying to support their families with the cost of living constantly soaring.

I recently appeared before the Ways and Means Committee and urged them to throw out the entire proposed tax bill and adopt compulsory saving for financing the balance of this war. I am delighted to find that the revenue bill has been reduced to $2,000,000,000 from the proposed $10,000,000,000, and, gentlemen, even that is too high. I am sure that you will not be influenced by the efforts that are being made or will be made to increase the amount of taxes under this bill. I would recommend that there be no increase in the cost of postage and that the proposed increased tax on telephone calls, telegrams, and so forth be entirely eliminated from the bill.

This is necessary in order to avoid further burdens being imposed upon those people whose incomes have not been increased, and who, in many instances, have had their salaries decreased because they have had to change their employment due to the war.

In one city you find women who never worked before purchasing fur coats as high as $1,500, and alligator bags up to $150 and indulging in similar other luxuries, whereas in other cities where there are no defense plants you find families skimping and trying to get along on modest salaries, when fresh eggs are now costing 76 cents a dozen and other food is similarly high in cost, and their salaries have remained practically the same.

You won't solve this problem by trying to keep food prices down through the means of subsidies because that is only a palliative. You must get at the source of this trouble. The Secretary of the Treasury announces the national income for 1944 will be the unprecedent figure of $152,000,000,000. There is available now about $90,000,600,000 worth of consumer goods and services, which means that the gap is steadily getting wider.

There are only two solutions to this problem. One is to see to it that the Government stops pouring into the pockets of defense-work employees the unbelievably high salaries that are made possible through the cost-plus system of purchasing. Some of the salaries that they are making are ridiculous in the face of what other people are earning today. This will at least reduce, to some extent, the excess buying power that is constantly menacing us.

The other is to introduce a plan for compulsory saving which would make it mandatory for every individual to purchase War bonds up to 30 percent of the increase of their earnings over the year 1940. These bonds will bear interest as regular War bonds, but they cannot be cashed or used as collateral for loans for the duration of the war. They shall be subject to call by the Government after the war at such time as the Government would deem it advisable to do so. When making the income-tax return, the individual shall state what his or her earnings were in 1940 and show receipts for the purchase of these special War bonds for 30 percent of their increased earnings. The purchase of these bonds can be regulated by legislation so that the buying would be done monthly, and reports of the purchases could be made quarterly, preferably at the same time when income-tax payments are being made. This may sound somewhat complicated but after careful study, it will not appear so.

Any person failing to purchase these bonds will be penalized by having to pay that sum in taxes besides other penalties that should be imposed by the law that are usually made a part of such regulation. This would help to syphon off a sizable portion of the excess purchasing power that is plaguing us. The people would soon find that prices, instead of increasing, would at least remain stable and probably start decreasing.

So far as I am concerned, I think it is relatively unimportant if we did not have any new revenue act, because $2,000,000,000 will not make very much difference in the general picture. If, on the other hand, you adopt this compulsory-saving plan, it would immediately syphon off from 10 to 15 billion dollars of the excess purchasing power and help us to finance the war in a sound manner.

Under this compulsory saving plan, bonds would only be cashed at such strategic times, and only in such instances where the Government decides it would serve the interest of the country to do so. The Government would be in full control of the cashing of these bonds, which would help greatly to stabilize conditions, particularly during the post-war period.

The people will readily understand the benefits of saving money under a compulsory plan until after the war, particularly so if they are made to realize that unless this is done they will be wasting the money they would thus save by paying that much more for the things they need and want.

I do not intend to discuss the post-war period except to state that there inevitably must be a tremendous amount of unemployment immediately after the war ceases, and the cashing of these bonds will be a steadying influence upon the people besides giving them the added buying power to carry on until plants can be retooled and they can return to work again. It is difficult to get most of the people who are working in defense plants to save money. You will find that a great many of the people who are earning big salaries now are those who are out of employment during normal periods. To tax these people would mean to stifle their initiative. Remember, as I stated, the people who are making most money today are the ones who never had jobs before or who only worked intermittently. Such a person, when he is told that he is saving money through a plan that will permit him to spend the money later on, at least has the initiative to continue working at high speed. If you tax that same type of person to a greater degree than we are now taxing them, I am fearful you will destroy their desire to work, which would be dangerous to the war effort.

Gentlemen, with all my sincerity and with all the earnestness with which any human being can come before you, I plead that you give most serious consideration to the adoption of compulsory saving in order to stop the tidal wave of inflation that is engulfing us. The gentlemen of the Ways and Means Committee of the House of Representatives apparently were impressed by my request to reduce the tax bill but did not do anything about the adoption of compulsory saving, although they manifested a keen interest in it. I ask you gentlemen to give this matter the utmost consideration before we are so severely damaged by inflation that it will take years of suffering before we repair the damage.

This is no time for palliatives. A festering world needs radical treatment at the hands of a competent surgeon. To poultice such a wound is most always a dangerous treatment. A competent physician would advocate lancing it, no matter how painful the process may be. Inflation is a dangerous festering wound, menacing the welfare of our entire economy as well as our people, and needs radical treatment at the hands of competent men like yourselves.

I need not remind you that we are fighting for our security. On battlefields and waters the world over, our men and boys, in company with sons of other free nations, are facing and meeting death so that our security will not be taken away from us. What do we mean by security? Beyond those sacred principles inscribed in our Bill of Rights and the essence of the four freedoms, security means a job, a home, food, clothing, our entertainment, our savings accounts, our life insurance. In other words, to us, security means peace of mind. Will we have peace of mind and security after we have made armless and harmless the Nazi and the Jap? Unless we curtail inflation now, there will be no security and there will be no peace of mind after we have won the war. Unless we battle with determination against it now, we shall be reduced to economic slavery when inflation engulfs the United States.

Remember, above all, that our savings accounts and our life insurance, which every American family struggles to accumulate and protect, will practically become valueless if a run-away inflation should engulf us.

I wish to remind you that war always produces human vultures. This war has proven to be no exception. Given an opportunity, there are always some people who trade on patriotism, on misery, even on death to make a dollar. It is this latter group that is exploiting to the fullest the excess purchasing power by creating black markets that will leave a horrible stench long after the war is over. Many of our people still remember the experience that Germany had in 1923 when millions of marks were unable to purchase a loaf of bread.

Gentlemen, you cannot straddle the serious issue of inflation. It has got to be met now. You cannot keep millions of wage earners hemmed in by agreements that their wages must not be increased and with the patriotic urge in their hearts to do their best, are nevertheless unable to make both ends meet because of the rising cost of living, while on the other hand you have an army of spendthrifts—people who are getting swollen pay envelopes, way beyond what they have ever made before or ever expected to make because of the war effort.

Gentlemen, I have stated to you before and I repeat to you now that if it is not undemocratic to conscript the lives and services of our young men for the armed forces why should it be undemocratic to conscript the dollars or merely a loan of them from the people who are benefiting from this terrible catastrophe?

You surely realize that the millions who are working for fixed salaries, the savings banks, the insurance companies and the beneficiaries of their policies, the old-age pensionees, the dependents of our soldiers and sailors, the endowed institutions of religion, education, and philanthropy, are expecting action on your part to stop inflation.

Now that the United Mine Workers have received an increase in wages, the Little Steel formula is practically dead. The railroad and steel workers are all demanding higher wages. A new round of wages and price increases is now truly right around the corner. All organized labor groups who have been restrained from asking for wage increases will now come out in the open with their demands. The forces of inflation will soon be riding high. You cannot place the blame for this condition on organized labor, on the W. L. B., or on the O. P. A. It is the excess purchasing power of the consumers plus the unnecessary high wages that are being paid to many of the defense workers that is mainly responsible for it.

The situation, gentlemen, is in your hands. It is clearly up to you.

Competent economists will state that higher taxation and compulsory saving is needed to solve the problem. I contend that heavier taxation will upset our economic structure, menace the welfare of those whose salaries have not been increased, stifle the initiative of those defense workers who are being paid high wages, thus retarding the war effort. Compulsory saving is the only solution and our only salvation.

The CHAIRMAN. Thank you very much.

Senator DAVIS. How much did I understand you to say you would siphon off by compulsory savings?

Mr. GOLDMAN. From ten- to fifteen-odd.

Senator DAVIS. I mean the percentage.

Mr. GOLDMAN. Thirty percent of the increased savings over 1940.

Senator DAVIS. And 20 percent additional for taxes, that would be 50 percent, and you have 1 percent old age annuity, that would be 51 percent that would be taken out of the pay envelopes of the workers.

Mr. GOLDMAN. Only out of the envelopes of those who are getting the big salaries today.

Senator DAVIS. How are you going to differentiate between the fellows with the low salaries and those with the high salaries?

Mr. GOLDMAN, The fellows with the low salaries have not had any increase since 1940.

Senator DAVIS. But you take 20 percent out of most of them.

Mr. GOLDMAN. Yes, sir.

Senator DAVIS. If you are going to take another 30 percent——

Mr. GOLDMAN. It is not 30 percent of their salaries. It is 30 percent of the increased earnings over 1940.

Senator DAVIS. Oh, I didn't get that.

Mr. GOLDMAN. Thirty percent of the increased earnings over 1940, which represents the increase in the national income, which is now about $80,000,000,000 over 1940, and it would be 30 percent of that. We wouldn't get all of it.

Senator DAVIS. I understand.

The CHAIRMAN. Mr. Moore.

STATEMENT OF W. CLEMENT MOORE, REPRESENTING THE NATIONAL PAPER BOX MANUFACTURERS ASSOCIATION

Mr. MOORE. Mr. Chairman, I have been tax consultant for the association which I represent, the National Paper Box Manufacturers Association, for 19 years, and revenue agent, under the old excise-

profits regime. I have digested the matter to be presented here in nine separate proposals.

The CHAIRMAN. Proceed.

Mr. MOORE. The present economic condition of this country is such that certain fundamental principles must be kept in mind before any further increases in the tax burden are made and such increases as must be should be gaged to cause the least economic disturbance.

First. The ability of the great middle class, and the so-called white-collar workers, to exist, without confiscation of what little capital they have, should be carefully guarded. Their income-tax burden should not be greater than under the 1942 act.

Second. The recognition of earned income as compared with other forms of income should continue to be recognized and should not be eliminated as is proposed in House bill 3687.

Third. Capital gains are taxed so heavily that many legitimate and worthy business transactions are discouraged to the point of greatly impeding progress. The laws of Britain and Canada are much more liberal with excellent results.

Fourth. Corporations, partnerships, and individuals in business should be allowed to accumulate post-war reserves in order that funds may be available for post-war rehabilitation. The great assistance to the recovery program of this country afforded through the use of the accumulated surplus accounts of business generally in weathering the financial storms of 1930 and 1936 should not be forgotten.

Fifth. Double taxation of corporate profits is in reality a confiscation of capital and is discouraging to the formation of corporations to the great detriment of industrial progress in this country.

Sixth. Any increase in excise taxes should take into consideration the effect on the ordinary cost of living.

Seventh. There should be a form of taxation of general application promulgated at this time which would affect every individual to a slight degree yet sufficient to curb inflation to some extent and at the same time supply the loss of revenue caused by liberalizing some of the taxes proposed by the House bill or already in the law.

Eighth. There should be a provision in the new law for a definite credit against taxes or taxable income for investment in Government bonds deferred as to interest and negotiability until the end of the war—then immediately become interest bearing and negotiable for all purposes.

Ninth. Recognition should be given to the equitable application of depreciation which as administered under the Supreme Court decision in the *Virginia Hotels Corporation case* results in a great hardship to taxpayers in many cases and frequently falls heaviest on widows, trusts, estates, and creditors under liquidations, and so forth.

Methods of accomplishing the above objectives:

First and second. Leave the earned income credit as it is in section 25 (a) (3) and (4) and section 185 and section 47 (d) of the existing law. This would eliminate section 108 from H. R. 3687.

Third. Capital gains should be limited to a capital-gains tax or deductible benefit not to exceed 15 percent of the total net capital gain or loss.

The rate was 12½ percent for years and worked to good advantage. I believe careful analysis would show greater dollar results under those laws than at present in ratio to total taxes collected from all sources.

I might say that that section of the law is entirely too complicated and, as a matter of fact, rather silly when it is analyzed because 50 percent of 50 percent of the long-term capital gain in final analysis is really a 25-percent tax on the total gain. That is the way it works out, and it might just as well be written in simple form so that people in general might understand it.

Fourth and eighth. An allowance of a deduction up to 10 percent of net income without such provision should be allowed for 50 percent of all nonnegotiable, noninterest bearing bonds indicated in the eighth paragraph above purchased during the taxable year.

Thus, if $100,000 of such bonds were purchased during the year, a credit against income of $50,000 would be permitted, provided the total net income of the concern or individual amounted to $500,000.

Partnership credits to be distributed pro rata to the partners.

This would accomplish the purpose of both the fourth and eighth paragraphs and solve to a great extent the matter of selling your bonds.

Ninth. This inequity may be adjusted by permitting depreciation in loss years to be set back to capital to the extent of such losses or the depreciation deduction, whichever is less.

Fifth. Dividends should be returned to their original status in the early tax laws and subjected to surtax rates only.

This would greatly encourage more distributions of dividends and probably increase the taxes collected.

Sixth. Recommendations in House bill 3687 under section 1650 should be approved except the increased tax on toilet preparations and electric light bulbs and under section 1651 the additional tax on luggage, because they are all in a sense necessities, hence the tax should not exceed 15 percent.

Seventh. A 5-percent transaction tax on all transactions or sales including manufacturing, wholesale, and retail and certain other transactions to be later decided upon should be applied for the duration and 2 years thereafter. The tax would be added to every invoice, collected by the seller, and reported on the seller's annual income tax and administered by the Income Tax Division of the Bureau in order that there be practically no additional cost of collection.

This tax should produce approximately $3,000,000,000 in revenue without serious economic effect and will therefore more than offset the suggested liberalizing of the Revenue Act as already suggested.

In other words, H. R. 3687 with these suggested amendments should produce at least $4,000,000,000 of additional revenue over the act of 1942, and with the least possible economic or industrial disturbance.

In spite of public statements to the contrary it is believed that a fair, unbiased survey of the entire country would find the people in favor of a reasonable pay-as-you-go sales tax rather than further increases in income and corporation taxes.

Finally, a thorough system of national economy as to all kinds and types of Government expenditures is of vital necessity and if accomplished should result in a saving of another 10 to 12 billion dollars.

The CHAIRMAN. Thank you very much, Mr. Moore.

We have now reached some six witnesses who are listed on postal rates. Has there been some consolidation by these witnesses of their statements? I will call the first witness and express the hope that we may be able to put briefs in where the same ground has been cov-

ered. Of course, if there is anything different in the picture, we would be glad to have you direct our attention to it.

Mr. Wood.

STATEMENT OF WILLIAM C. WOOD, WASHINGTON, D. C., REPRESENTING MEMBERS OF THE NATIONAL BUSINESS PAPERS ASSOCIATION

Mr. Wood. Mr. Chairman and gentlemen of the committee, my name is William C. Wood. I am a lawyer, address 2308 Ashmead Place NW., Washington, D. C. I am appearing on behalf of the members of the National Business Papers Association, whose publications, copies of which weigh not over 8 ounces, are embraced in mail of the third class, on which bill H. R. 3687 proposes to double the rate.

The publications of the members comprising the National Business Papers Association are in the main trade publications pertaining to a particular industry or business and whose circulation is controlled by being limited to persons interested in the particular field to which the respective publications pertain. Their character is similar to that of publications entered as second-class matter. They are mailed at the bulk third-class rate.

For more than 23 years I was Superintendent of the Division of Classification of the Post Office Department, having to do with postage rates, and from my experience and knowledge with respect to the effect of increases in postage rates, I am clearly of the opinion that doubling the rates for third-class matter will be more than the traffic can reasonably bear and will drive large quantities of third-class matter out of the mails, thus adversely affecting the revenue derived therefrom. This is particularly the case regarding the publications I am referring to.

As instancing the effect of increasing postage rates beyond what the traffic can reasonably bear, I cite the increased rates on second-class matter made by the Revenue Act of 1932. The postage from second-class matter for the year 1932 was $21,761,000. Even with the increase in rates the postage from second-class matter for 1933 was only $18,761,000, a decline of 13.8 percent. While some of this loss of $3,000,000 was no doubt due to the decline in business, it is reasonable to suppose that a very considerable part of it was due to the increased postage rates.

Another instance is the increase in the rate on private mailing cards from 1 cent to 2 cents each by the act of February 28, 1925. This increase had such a disastrous effect on the use of private mailing cards that the 1-cent rate was restored by the act of May 29, 1928.

These are instances of the truism that the law of diminishing returns as rates advance operates adversely on the revenue derived from increased rates.

Doubling the postage rates on third-class matter as proposed will drive out of the mails some of the publications I am referring to, and will also drive large quantities of other kinds of third-class matter out of the mails, and thus put out of business many small and medium sized business concerns whose existence would be particularly helpful in the post-war period.

If there is to be an increase in the rates on third-class matter, and I question the advisability of making any increase at all in the rate on third-class matter, but if there is to be one, I suggest that in order for the increase to be not more than the traffic can reasonably bear, and so as not adversely to affect the revenue derived from the increased rates, that the incfese be not more than from 25 to 50 percent, so as to change the rates under existing law to not more than the following: 2 cents for each 2 ounces or fraction thereof (33⅓ percent increase), except that the rate on books, catalogs, seeds, cuttings, bulbs, roots, scions, and plants shall be 1½ cents for each two ounces or fraction thereof (50 percent increase). On library books described by the act of May 29, 1928, 45 Stat. 940, and on books described by the act of June 30, 1942, 56 Stat. 462, in parcels not exceeding 8 ounces, 4 cents a pound or fraction thereof (33⅓ percent increase): *Provided*, That the rate of postage on third-class matter mailed in bulk shall be 16 cents for each pound or fraction thereof (33⅓ percent increase), except that the rate on books, catalogs, seeds, cuttings, bulbs, roots, scions, and plants, shall be 10 cents for each pound or fraction thereof (25 percent increase); the increase in the bulk minimum rate, now 1 cent per piece, be to not more than 1½ cents per piece (50 percent increase); for other than local matter, the local minimum bulk rate to remain at 1 cent per piece.

I should like to submit an amendment of section 403 of the bill regarding rates of postage on third-class matter embodying the rates I have suggested if there is to be an increase. This amendment follows the language of the existing law, the rates only being changed.

AMENDMENT OF SECTION 403 OF BILL H. R. 3687 REGARDING RATE OF POSTAGE ON THIRD-CLASS MAIL

SEC. 403. THIRD-CLASS MAIL.

The rate of postage on third-class matter shall be 2 cents for each 2 ounces or fraction thereof, up to and including 8 ounces in weight, except that the rate of postage on books, catalogs, seeds, cuttings, bulbs, roots, scions, and plants, not exceeding 8 ounces in weight shall be 1½ cents for each 2 ounces or fraction thereof, except that on library books described by the Act of May 29, 1928, 45 Stat. 940, and on books described by the Act of June 30, 1942, 56 Stat. 462, in parcels not exceeding 8 ounces in weight the rate shall be 4 cents a pound or fraction thereof: *Provided*, That the rate of postage on third-class matter mailed in bulk under the provisions of the Act of May 29, 1928, 45 Stat. 940, shall be 16 cents for each pound or fraction thereof, except that in the case of books, catalogs, seeds, cuttings, bulbs, roots, scions, and plants, the rate shall be 10 cents for each pound or fraction thereof: *Provided, however*, That the rate of postage on third-class matter mailed in bulk under the provisions aforesaid shall be not less than 1½ cents per piece for other than local matter and not less than 1 cent per piece for local matter.

Senator DAVIS. You were formerly connected with the Post Office Department, were you not?

Mr. WOOD. I was, Senator.

Senator DAVIS. I recall you about 23 years ago——

Mr. WOOD. For more than 23 year I was Superintendent of the Classification Division.

The CHAIRMAN. We thank you.

Mr. Beesley.

STATEMENT OF T. Q. BEESLEY, REPRESENTING THE NATIONAL COUNCIL ON BUSINESS MAIL

Mr. BEESLEY. By way of preface, Senators, it is my understanding you desire us to consolidate statements.

The CHAIRMAN. As much as possible, on the basis of time.

Mr. BEESLEY. I shall do my best to comply with the committee's wishes, and so far as I can speak for other witnesses present, that will be done.

I would like, first, the permission of the Chair and the committee to have leave to revise and extend my remarks to include material which I will not detain the committee by reading, excerpts from the testimony of the Postmaster General before the House Appropriations Committee, and his letter to the Ways and Means Committee on July 7, 1942, in which he states his views about the postal rate structure and the methods for revising it, which the House appropriated money to carry forward beginning with the current fiscal year.

The CHAIRMAN. You may insert the documents to which you refer.

Mr. BEESLEY. And I have also in this brief case something like 200 letters and telegrams from businessmen from Maine to California testifying as to the effect of the proposed increase in postal rates on their businesses, in about 40 different lines of industry. I shall not impose that on the record, but with the chairman's permission I should like to summarize those in detail, in my subsequent remarks.

The CHAIRMAN. That is quite agreeable.

For the record, my name in Thomas Quinn Beesley, Washington representative of the National Council on Business Mail. My Washington address is Second National Bank Building. The business headquarters of the National Council on Business Mail are at 105 West Monroe Street, Chicago.

As the name indicates, it is not a trade association, it is a clearing-house in Washington on postal information and on postal affairs for 14 nationally known trade associations and business and professional organizations. It works very closely with the Post Office Department. It is a nonprofit, voluntary organization, and as its Washington representative it is my duty to appear on occasions like this to present to the committee the views of some thousands of individual businesses across the country, large and small, mostly small, as to the effect of proposed postal legislation.

My appearing here this afternoon, Mr. Chairman and members of the committee, is in opposition to the postal rates as contained in sections 401 to 410 of this bill, on several grounds.

I will file with the committee a longer brief, and this afternoon, with the committee's permission, I will confine myself just to the main points or high lights, as you please, of the effect of these rates on business in the United States, an effect which, in many instances, comes very close to disaster.

I would like to begin, with the committee's permission, by bringing to their attention a very disturbing situation which occurred in the House, and I wish to have it thoroughly understood, both for the record and by the Chair and the committee, that what I say is not in

any criticism. As an old newspaper man, I am merely reporting to the committee a state of facts, and the facts are these: That in this bill something is proposed which is objectionable on so many grounds that it should be put out of the bill in toto, on those grounds, and in the next place, the procedure in the House, and I realize the delicacy of mentioning before this committee of the Senate anything that reflects on the other body of Congress, but the fact is there was no hearing in the House on these rates. There was no prior knowledge given by the Ways and Means Committee either to the Postmaster General, to the chairman of the House Post Office and Post Roads Committee, or to us, the public. The first any one of the three of us knew about it, and I include the Postmaster General and the chairman of the House Post Office and Post Roads Committee, was when we read it in the final edition of the Washington evening newspapers, too late for circulation by the wire services, and its circulation the next morning throughout the country was in the morning newspapers.

Believe it, the Postmaster General, the chairman of the House Post Office and Post Roads Committee and the patrons of the service, had to learn of it through the press.

I shall not comment on that fact beyond stating it. I will leave it to the committee to draw its own conclusions. There was a time when that was called taxation without representation.

In the next place, and this is a delicate matter to mention, the procedure of the House violated all parliamentary procedure. I do not claim to be the expert in parliamentary procedure that you gentlemen at the bench are, but I have been here for a good many years, an old State Department official, among other things, and I have never seen that done before when a committee went outside its jurisdiction and trampled on the rights and prerogatives of another committee. It happened. I merely note that.

The third thing that is far more disturbing than those details is the procedure involved in fixing postage. That is a violation of every historical fact, to say nothing of other considerations in our Government. Most of you gentlemen knew the late Clyde Kelly, when he was chairman of the House committee. He was from your State, Senator Davis. I wonder, lying out there in his grave in the wind-swept hillside cemetery, which was unmarked, incidentally, until post-office organizations took up a collection to raise a tombstone for him, what he might be thinking, because in his book, Postal Policy, a standard work on the subject, he wrote:

> The essence of the enmity of the colonists to the mother country was the feeling that Great Britain through her profit-making motive was attemping to tax the colonists by means of the postal system * * * (p. 12).
>
> Benjamin Franklin faced that question squarely when he was called before a parliamentary committee in London, when the revolt over the stamp tax had almost reached the point of revolution. In truth, he had done more than any other person to prevent the issue of taxation being raised against postage rates. He had administered the post office efficiently and he took pride in the fact that he had sent substantial sums to Great Britain as profits from the institution * * * (p. 12).
>
> Before the parliamentary committee, he declared that postage rates are not in the nature of a tax but rather are fees for service (p. 12).
>
> Franklin was summarily dismissed from office. Five days after the action an American in London wrote to Lord North, voicing the common opinion * * *

"His dismissal will happily end your boasted post office, so often given as a precedent for taxing Americans" (pp. 14–15).

On Christmas Day, 1775, the postmaster at New York gave public notice that all inland postal service would cease from that date. Thus shut the door on the Royal post office in the American Colonies. Thus opened the door into the United States post office, one of the most beneficent institutions in the Republic.

The policy is the thing. It is that which determines methods and results. The policy of postal profits for the King led to the downfall of the system and the establishment of an institution with an entirely different policy—that of service to the people. One thing was permanently settled by the record made under the original policy. Since Christmas Day, 1775, American public sentiment had steadily rejected any suggestion that the post office should be a source of revenue to the Government, through profits from its operations (pp. 18–19).

Washington, writing to Lafayette in 1783, struggling to bind the new Government together by means of communications such as post roads and canals, emphasized the prime importance of a free, cheap and universal postal service when he said: "These settlers [in the West] are on a pivot and the touch of a feather would turn them away" (p. 33).

The question as to whether the post office should be a money-making enterprise did not long detain them [the makers of the Constitution]. The Pinckney plan provided that Congress should have power to "establish post offices and raise a revenue from them." It received no serious consideration. Mr. Patterson of New Jersey, a vigorous advocate of the smaller States, suggested a provision that Congress be empowered to raise revenues "by a postage on all letters and packages passing through the general post office, to be applied to such Federal purposes as they shall deem proper and expedient." This suggestion was decisively rejected, as was also the theory behind it.

These Nation builders had had experience in postal affairs. They knew the effect of the profit-making policy on the Colonial service under Great Britain. They did not propose to make the same mistake and thus mar and cripple the service which they realized was of vital importance in achieving national unity. The Post Office Establishment was to be a service institution for the promotion of the general welfare. They desired the widest possible circulation of letters and news so that separate communities might act together on the same version of facts. Out of their experience and in accordance with their purpose, these builders of the Constitution accepted as a matter of course that the post office should be under the exclusive control of the National Government and that it should not be used as a revenue-producing agency (pp. 35–36).

For 25 years, gentlemen, the career men in the Postal Service and the patrons of the Service have been fighting for the establishment of an accurate cost-finding system and a scientific determination of rates. We have just reached, at the end of that 25 years' struggle, a point where this Congress has financed the engagement of experts to make that study. They are now at work.

Under the terms of the grant from the Appropriations Committees, their report must be rendered to the Congress this coming month, January. Their findings as to the establishment of an accurate cost system will be before you for discussion and analysis. The thing the House Ways and Means Committee could have waited for is just around the corner, 5 weeks away. Why all the haste, I don't know.

As a matter of fact, one of the most amazing things I have read in the committee report, in a great many years of reading, is contained on page 30 of the report on the revenue bill, 1943, Report 871, House of Representatives, Seventy-eighth Congress, first session: Postage rates.

I will read the whole paragraph, to be fair:

Were it not for the great lack of sources to which the committee can turn for additional revenue, it would not recommend increases in postage rates, especially in view of the fact that the Committee on Post Offices and Post Roads

expect at an early date to consider the desirability of making adjustments in postage rates. The committee thought it was desirable to provide for this additional revenue at this time and adjust the rates later, especially since the Post Office Department continues to operate most of its service at a loss under present rates, despite the heavy volume of wartime mailings. The cost ascertainment report for 1942 of the Post Office Department shows that while first-class mail service was operated at a profit of $163,000,000 during the fiscal year 1942, all other classes of mail services operated, in the aggregate, at a loss of $172,000,000. A similar over-all situation has existed with respect to the Postal Service for 42 years.

That in the face of the statement of the Postmaster General to the House Appropriations Committee that for many years before that he did not know his costs, that his cost ascertainment system was not a reliable guide, and he asked for money from the Congress to find out the facts.

I leave you to draw your own conclusions.

Now, the experience of the Post Office Department, gentlemen, in connection with increases in rates, has invariably been costly. You will recall when the post-card rate was increased to 2 cents—I will not detain you with the figures; I will put them in the record—but the net result was that on the 2-cent rate for post cards they lost half the revenue they had at 1 cent, and it took 3 years and a reduction of the rate back to 1 cent to recover the loss. When local first-class mail was advanced from 2 cents to 3 cents, they promptly lost a substantial portion of the volume they had at 2 cents, and it took 10 years to recover it.

I will put the statistical details in the record, with your permission, Mr. Chairman.

The CHAIRMAN. You may do so.

Mr. BEESLEY. Now, there are collateral effects of increases in rates, curiously enough, gentlemen, starting with the post office, then working out to the public. Third-class mail, fourth-class mail, some of the special services, are fill-in types for temporary employees and the like, and an efficiently operated post office cannot be conducted without that fill-in business. Perhaps on a dollar basis, according to the so-called cost ascertainment system, it may be operating at a loss, but the fact is that without that there would be an overhead for the Post Office Department that would be a very substantial loss in idle time.

There is probably going through your minds the question of manpower. That does not enter into this picture, curiously. It is to keep the available manpower employed that this other class of mail, so heavily taxed in this bill, is held back for some time, so that there will be no lost manpower time in any post office, no matter how small. There is the real truth of the matter.

In the next place, increases in postal rates invariably drive business in which the post office is competing in the public market to other agencies of transportation. I would like to introduce for the record a very enterprising advertisement from a newspaper in Kansas City, Mo., published last week, in which a bank in Kansas City is already advertising "Special checking account checks cost less than money orders," especially under the new proposed rates. They are not waiting.

I will introduce the advertisement for the record.

The CHAIRMAN. You may do so.

(The advertisement in question is as follows:)

"SPECIAL CHECKING ACCOUNT" CHECKS COST LESS THAN MONEY ORDERS

A "Special Checking Account" is a most economical method of transferring money and paying bills. There is only one cost—just $2 for a book of 20 checks. Compare the cost with that of Money Orders.

Amount of money order:	Cost of money order
$2.51 to $5	8c
$5.01 to $10	11c
$10.01 to $20	13c
$20.01 to $40	15c
$40.01 to $60	18c
$60.01 to $80	20c
$80.01 to $100	22c

Cost of checks on "Special Checking Account" 10 cents each regardless of amount.

Save time, tiresome trips to the post office, car fare, and standing in line. Save money, too, by paying your bills with checks on the new "Special Checking Account" available at the Union National Bank.

A "Special Checking Account" provides you with a permanent record of all your expenses and is very helpful in figuring income tax deductions. Statements, including your canceled vouchers, are available every three months.

UNION NATIONAL BANK

Ninth and Walnut Streets

MEMBER FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. BEESLEY. It will drive the c. o. d. services and the money remittance services to a certain extent directly into the arms of the Railway Express Co., which already is hotly competing with the Post Office Department, because it gives service not rendered by the Post Office Department, such as receipts, several tries at delivery, and so forth.

That will be the effect, the inevitable effect, because it has been the effect in the past, especially in these days with increased taxation on business, with business caught between the upper and nether millstones of O. P. A. price regulations and price ceilings, shortage of materials, shortage of manpower, tremendously increased operating costs, and the like.

If, on top of that, gentlemen, you pile taxation on postage, you are simply asking business to fold up and disappear for the duration, a large part of it at least.

You may remember, gentlemen, the Post Office Department and the Postal Service is a penny, nickel, and dime service. That is all it is. It is dependent wholly on volume, like any other penny, nickel, and dime business, and anything that is done to interfere with the increase in volume of the Post Office Department is simply cutting the throat of the Post Office Department.

Not only in loss of revenue, but in increase of overhead, because you must remember, gentlemen, the Post Office Department has a monopoly only on one class of mail, that is, first-class mail. That was estab-

lished in the famous case of *United States* v. *Wells Fargo*, which set Mr. Wells and Mr. Fargo up in business. They were a couple of enterprising gentlemen, running a canal-boat system. They had a lot of empty space sometimes in their canal boats and they figured out that for 6 cents they could carry all the mail the United States was charging 25 cents for, but the Supreme Court ruled that Uncle Sam had a monopoly on first-class mail and nothing else, and for the rest he was in competition; and if you want to take the Post Office Department out of the competitive field, and maintain this overhead strictly for first-class mail, because that will go on, and you will have to have 43,000 post offices whether there is nothing but letter mail and post cards or not, all right.

Another thing, the language of this law, as you will recall, sets a termination date, as it must. It is for the duration and 6 months thereafter, whether determined by the President or Congress in joint session of the two Houses.

Now, there is a significant thing in that. I would like to direct your attention to the fact that last June the House adopted a continuance of the 3-cent and 2-cent rate as an amendment to the Revenue Act, section 1001 (b), as I remember, of 1933.

If that was a going rate that was paying dividends, and now you put a tax on it, I can't follow the logic of it, gentlemen. I simply cannot.

Yesterday the committee asked some rather searching questions about fixed income, the effect of taxation on people with fixed income. Does it occur to you that business operating on postal budgets are fixed income people? If you can afford to spend for your client or for yourself only $10,000 a year on postage, you cannot spend $20,000, if the rate is doubled, so you simply have to make your $10,000 go as far as it will and cut your business in half. It is not rubber; you cannot expand it. There is no substitute for it.

Postage is spent for what it produces in the way of business and spent for no other reason outside, of course, of personal correspondence.

The Chairman spoke this morning, to give you a very vivid illustration, of the interest of the Senator from Nebraska in the filing of a brief from Father Flanagan of Boys Town.

Father Flanagan is quite competent to speak for himself. By a curious coincidence, when I went back to my office during the noon recess, on my desk was a letter—Father Flanagan's Boys' Home, Boys Town, Nebr., third-class mail.

This is a Christmas letter, dated November 29, 1943—as a prisoner of the Imperial Japanese Army there is a boy named Paradise, an amazing coincidence. There is a business reply envelope enclosed and a very interesting autographed letter from Father Flanagan—

> Any contribution you care to send will be of great assistance, because, as you know, every penny must come from our friends, for we receive no other support.

And those pennies, gentlemen, come from third-class mail. If you want to put Father Flanagan and Boys Town out of business, pass this bill with the tax in it.

There was also on my desk a long telegram, which with the Chair's permission, I will introduce into the record. It is practically a summation of the hundreds of telegrams to which I have referred. The

significant thing is the signatures at the end of it: Adcraft Club, Detroit; Retail Merchants' Association, Detroit; Typothetae Franklin Association, Detroit; the Employing Printers; the Photoengravers' Association; the Employing Lithographers' Association, the Master Bookbinders' Association.

I spoke of the collateral effect of this tax. The whole thing just falls over, in sequence, right down to and including organized labor, because organized labor is paying the tax, especially in the graphic arts unions, whose books have always been open to public examination, always audited by certified accountants. They are supporting our stand as employers, businessmen, and professional people, in opposition to this bill, and supporting it wholeheartedly.

There is a person in this room also, a gentleman from the Railway Mail Association, Mr. J. F. Bennett, formerly their president for several terms, now their industrial secretary and representative, who can tell you, if time permitted, and I am sure he will allow me to speak for him for a minute or so, of the effect of this bill on the postal employees.

During the noon recess I had a call also from the Washington representative of the District Postmasters' Association, which represents practically all of the postmasters in the small communities throughout the United States.

You may have seen our advertisement in this morning's Washington Post, which I ask permission to file with the record. He called up to say he had read it and it was exactly their opinion, because it represented the problems that he had to face as a small postmaster, and he knew all the small postmasters would have to face under the increase in rates proposed in this bill.

There is no escape from it, gentlemen. Everybody is caught and everybody is hurt and nobody is helped. It means less revenue for the United States and headaches for everybody else concerned.

Let me give you an example of these headaches, gentlemen, from the point of view of business. Do you realize the utter confusion in which business is at the present time with this bill before your committee? You know it was brought in under a 5-minute rule in the House and there was no chance for debate. If there had been any chance, I can assure you, gentlemen, the House would have enthusiastically voted the postal rate tax out of the bill unanimously, or very close to it.

Senator WALSH. Did you appear before the Ways and Means Committee?

Mr. BEESLEY. No, sir; we had no opportunity. Neither did the Postmaster General.

Senator WALSH. The first thing you knew of it was when you read of it in the newspapers?

Mr. BEESLEY. Yes, sir. As a matter of fact, Senator Walsh, there was nothing in the schedule of the hearing that even gave a hint that the matter was under consideration by that committee.

(Discussion off the record.)

Mr. BEESLEY. I was speaking of the confusion in business. Plans for advertising, leading to the distribution of merchandise, have to be laid many months in advance. It is a question of obtaining in-

ventory, a question of advertising to distribute that inventory at the lowest possible cost, both to the consumer and to the merchant. How, under the present circumstances, can any businessman make any plans? Have you any idea how much press time is tied up, how much paper is tied up, how much planning is tied up, just the way the matter stands at this moment?

Then suppose we take the statement of the Ways and Means Committee that they will adopt this tax now and adjust the rates later. That printed material may be out for several months and then a new set of rates comes out. Have you any idea what that involves? Of course you have. You are experienced men—to say nothing of the effect on the services related to direct advertising.

A remark was made on the floor of the House by the Chairman of the Ways and Means Committee in response to interrogation from the senior Representative from Ohio, that third-class mail was just advertising. Just advertising—but, gentlemen, just as a quick illustration of what it produces in collateral business for the Post Office Department, I have consolidated three typical mail-order houses.

Their consolidated expenditures for third-class postage annually is $1,672,000, and they mail 88,428,000 pieces, ranging all the way from small catalogs and fliers to the typical piece of letter mail.

Now, here is a record of what they produce for the Post Office Department in cash:

In first-class mail alone, that $1,672,000 produces $788,391. Almost half of it comes back immediately in first-class mail, which is the "gravy train" of the Postal Service.

In fourth-class mail Postal Service, which on a dollar basis pays of profit, $4,411,000.

In money order fees, $906,164.

In c. o. d. fees, $300,922.

For a gross total cash postal income from an original expenditure, gentlemen, of $1,672,000, of $6,436,477.

In other words, $3.85 collateral postage for each $1 spent in third-class mail.

Double the rate, gentlemen, and all you do is kill the goose that laid the golden egg.

I shall not detain the committee longer. I thank the committee for its attention. There are facts which could be introduced in this record which will be brought out in the reports of Mr. Heiss and Mr. Crunden, the retired comptroller and deputy comptroller of the American Telephone & Telegraph Co., which will be before you very shortly.

I would like to ask the committee to consider very carefully this coming week, in its executive deliberations, whether this is the time, if ever there would be a time, to reverse the American policy established by the gentlemen who wrote the Constitution, whether this is the time to establish a new precedent of committee action in this Congress, to repudiate the Postmaster General and his career staff, because, gentlemen, to say nothing of the curtailing effect on business, to say nothing of the loss of revenue to the Postal Service at a time when it has just reached its peak, you will do all these things if you adopt postal taxation.

I thank you.

The CHAIRMAN. Thank you very much, Mr. Beesley.

(The following data were submitted for the record by Mr. Beesley:)

EXCERPTS FROM TESTIMONY OF HON. FRANK C. WALKER, POSTMASTER GENERAL, BEFORE SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS, HOUSE OF REPRESENTATIVES, SEVENTY-EIGHTH CONGRESS; FIRST SESSION, ON THE POST OFFICE DEPARTMENT APPROPRIATION BILL FOR 1944, TUESDAY, JANUARY 12, 1943.

ADVISABILITY OF RAISING POSTAGE RATES

Mr. LUDLOW. As I understand it, the 3-cent postage rate provision will expire on June 30.

Mr. WALKER. Yes, sir.

Mr. LUDLOW. Have you made any studies or given any thought to the advisability of the revision of postal rates for the different categories of mail matter? Will you state what you are thinking along that line?

Mr. WALKER. I have been giving thought to that for approximately a year. Sometimes since, Chairman Doughton, of the Ways and Means Committee, asked for a meeting, and I talked with him about postage rates. He was viewing it from the revenue standpoint, as well as some other members of the committee. It was thought that out of second-class mail they could obtain $100,000,000. Prior to that we had been giving some thought to it. In fact, ever since I have been in the Department I have been giving it considerable thought, together with the Bureau heads.

That involves the matter of cost ascertainment, and it was thought that before we went into the matter of the rate structure at all we should definitely ascertain what the costs were. At that time I reported to Congressman Doughton that in our judgment it would be impossible to raise that amount of revenue out of second-class mail matter, and I stated, also, that we did not know what second-class mail costs, of what was the cost of handling it. I told him that we could try to get a considerable amount, or a larger amount of revenue out of our second-class mail, but that if it were done we might drive a considerable amount of second-class matter out of that classification.

Mr. KEEFE. Will you state at this point what you mean by second-class material?

Mr. WALKER. That means usually permits to newspapers, including newspapers in small country towns and newspapers generally, together with magazines of all kinds. As I remember the history of it, the first statutory regulation was made by Benjamin Franklin, and it contemplated carrying current information and, broadly, matter of a scientific and cultural character. The purpose was to give such matter a preferential classification. Over the years that has developed to the point where we deliver within-county newspapers gratis, and a preferential rate is given magazines and newspapers. They are given the second-class mailing privilege.

Mr. LUDLOW. General Walker has given much thought to this question of the advisability of revising the rates, and I wish you would go ahead, General, and tell us fully what you have in mind on that subject.

Mr. WALKER. Pursuing further the conference with Chairman Doughton, I told him that we realized from second-class mail in 1941 over $25,000,000 and in 1942, $26,000,000 plus, and that I did not think that we could increase second-class rates and get that amount, or nearly as much money as was suggested by them for revenue purposes. We feel down in the Department that before we reach any definite conclusion as to what we should do about rates, we should have more definite information about what our costs are in all classifications of mail—first, second, third, and fourth classes. In other words, an examination of it over the last 2 years that I have been there has convinced me that we just do not know what it costs us to handle the various types or kinds of mail. That is not any reflection on the Cost Ascertainment Department, because that Department is very limited.

Mr. TABER. Have you made any check-up of this at all as to the number of pieces or volume handled, or anything of that kind? Have you made any experimental count, or done anything of that sort?

Mr. WALKER. Yes, sir; but I am not satisfied with it.

Mr. TABER. What do the counts show?

Mr. WALKER. For instance, we show that we have distributed over 80,000,000,000 pieces of mail. Of first-class mail we have handled 16,817,435,320 pieces, exclusive of free and air mail, which is 55 percent of all the mail handled. Of second-class matter, including newspapers, dailies, other than dailies, and other publications, we have handled 4,522,391,294.

Mr. TABER. That is about 15 percent?

Mr. WALKER. Yes, sir.

Mr. KEEFE. And it yields about 3 percent of the revenue.

Mr. TABER. That includes the free distribution of papers in the counties.

Mr. WALKER. Yes, sir. Of third-class matter we have handled 5,434,559,390 pieces.

Mr. KEEFE. For the purposes of the record, state what that classification includes.

Mr. WALKER. On that you have regular zone rates, covering circulars and other miscellaneous printed matter; merchandise, books, and so forth. We have a special book rate. We also will mail a bulk of not less than 20 pounds or 200 pieces at a special rate.

Mr. TABER. That covers 5 000,000 000 pieces?

Mr. WALKER. That covers 5,434,000,000 pieces.

In the third class, we have in addition various other classifications. They are broken down. We want to have a real survey made, to determine what all the classifications of mail are. It is a very difficult matter because there have been so many special classifications made for special situations. For that reason, it is difficult to determine the classifications. We have attempted to determine what all the rates are, and I think that a survey should be made of the classifications so as to make the classifications more definite.

Mr. LUDLOW. Do you have the facilities to make that survey?

Mr. WALKER. Yes, sir; what I would like to do would be to get some cost men who have had considerable experience to aid and guide us in that survey. In my opinion, it is unusual to find that the overhead in what we call the home office, or the Department, as distinguished from the field is only 6 mills of each dollar of expenditures. That includes all Department services, with approximately 1,300 or 1,400 employees. With the inspectors in the field and in the home office there would be about 2,200 employees. For an organization of this kind I think that is an unusual record. We do not have the personnel to do the job. Our force does not have the time to do the requisite planning. Men like Mr. Donaldson, in the office of the First Assistant; Mr. Purdum, the Second Assistant; Mr. North; and Mr. Meyers cannot find time for this. They have so much detail and routine work to handle that they do not have time to do this planning, and we have no one to do the job. These other men just cannot take time from the work they have on hand, most of it routine work, to do this job.

Mr. LUDLOW. Is money carried in this estimate for that personnel?

Mr. WALKER. Yes, sir.

Mr. TABER. Who does the cost-accounting work now?

Mr. WALKER. It has been under the Third Assistant, in the Accounting Division, and is now in the Bureau of Accounts.

Mr. TABER. What is the appropriation for that?

Mr. WALKER. The appropriation was $35,000 for the Cost Ascertainment Division. We asked for $323,000, and, as that is broken down, the Bureau of Accounts would have $133,000. Cost Ascertainment $35,000, or a total of $168,000. Our increase there is $159,500, and $50,000 of that would be for temporary consultants. The thing I have in mind, if it meets the approval of the committee, is to get experienced cost men. The Telephone Co. has done a grand job in ascertaining what its costs are, and we have a capacity load like that of the Telephone Co. The big mail-order houses have their costs very scientifically figured. When the load gets too heavy they know whether to put it in the Postal Service. We cannot tell when we begin to make money, or when the load gets too heavy for us. That is true of the zoning regulations and special services, including the money-order service, insured-mail service, registered-mail service, and so forth.

We have a vast discrepancy in our cost ascertainment that comes by reason of the character of the surveys and estimates made. I might direct your attention to some instances to show the vast discrepancies in the conclusions reached when the estimates are made. An analysis of the reports shows many variations in the cost. For example, the cost ascertainment in the matter of third-class mail shows that the cost of handling such mail in Atlanta is 8 cents per pound; at Salt Lake City, 30 cents per pound; at Chicago, 5 cents per pound; while the cost at Brooklyn is 40 cents per pound. In the case of second-class matter, the cost of handling mail at Chicago is .8 cent per pound; at Brooklyn, 20 cents per pound; and at New Haven, 6.5 cents per pound. In the handling of franked mail, the cost is 49 cents per pound at Pittsburgh, 7.3 cents per pound at Minneapolis, and at Salt Lake City 9 cents.

Mr. LUDLOW. Do you think that with the personnel you are requesting you will be able to effect a set-up that will give you a more accurate cost ascertainment?

Mr. WALKER. I think we should set up a cost-ascertainment with a cost-accounting system with the aid and advice of students of such systems.

Mr. LUDLOW. The head of a great business establishment like yours is pretty much at a loss if he does not have the facilities for making accurate cost ascertainments, is he not?

Mr. WALKER. Yes, sir. I do not like to recommend fixing postage rates, until we know what the costs are. We do not have much information on which a conclusion could be reached. I do not think that our Cost Ascertainment Division is to blame for that. The office is as it was a number of years ago, and the force of personnel we have is so limited that we cannot do a good job. When you go into an ordinary post office, according to my observation, they have quite a load of work on hand. The people are very busy, and they do not like to have men in there checking up on them in this cost-ascertainment work. Consequently, they simply have to guess as to how much is going over the road at a certain time, or how much mail is handled at a given point. In the matter of penalty mail, Senator O'Mahoney's resolution provided for reports twice a year, but they were not satisfactory. I do not say that it was so designed, but they simply hazarded guesses. Even if we had the people to work on it, it would be a great task.

Mr. LUDLOW. The first-class postage continues to be the backbone of the postal revenue?

Mr. WALKER. Yes, sir.

RECEIPTS FROM FIRST-CLASS MAIL

Mr. LUDLOW. That is paying how much?

Mr. WALKER. $492,000,000.

Mr. LUDLOW. For what period?

Mr. WALKER. For the fiscal year 1942.

Mr. LUDLOW. How is it holding up for the fiscal year 1943?

Mr. WALKER. It is higher in 1943.

REVENUE FROM SECOND-CLASS MATTER

Mr. LUDLOW. How about second-class matter?

Mr. WALKER. From second-class matter our revenue was $26,793,000 in 1942, and it was $25,724,000 in 1941.

REVENUE FROM THIRD-CLASS MATTER

Mr. LUDLOW. What about third-class matter?

Mr. WALKER. From third-class matter the receipts were $82,000,000 in 1941 and $74,000,000 in 1942. That is one of the few cases where mail has dropped off. I think that is due to the dropping off of advertising by large mail-order firms. They do not send out the same number of catalogs and circulars. That is the only type of mail in which there has been a falling off.

REVENUE FROM FOURTH-CLASS MATTER

Mr. LUDLOW. What about the receipts from fourth-class matter?

Mr. WALKER. From fourth-class matter the revenue in 1941 was $141,000,000, and in 1942 the receipts were $150,736,000.

RECEIPTS FROM AIR MAIL

Mr. LUDLOW. What about air mail?

Mr. WALKER. That is broken down under first-class matter. Of the $456,000,000 in 1941, $23,000,000 was from domestic air mail. In 1942 the revenues from domestic air mail were $33,417,000.

INCREASE OF AIR-MAIL POSTAGE

Mr. LUDLOW. Is there any plan for increasing air-mail postage?

Mr. WALKER. I do not like to come before the committee with any particular suggestion or plan. What I would like to do would be in a cooperative way to give you an idea of what I think should be done. We have made a study of this air-transport problem, and we have tried to figure out a plan to meet it temporarily. May I suggest to you that the only reason why I would not want to increase the rates for second-, third-, and fourth-class mail is because I do not know exactly what the effect of it would be on the mail, not knowing the cost

of handling the mail or the cost of the special services. In view of that, I feel that the best way to approach it would be to increase our first-class mail rates and possibly special services temporarily, and then give us an opportunity during the current year to ascertain what the costs are. After ascertaining the costs, we can come with a recommendation to the committee and get your advice on it, and distribute the cost where it should be distributed.

Mr. LUDLOW. In reference to the first-class postage rate, the rate is 3 cents nationally and 2 cents for local mail?

Mr. WALKER. Yes, sir.

Mr. LUDLOW. If we increased that rate by 1 cent, what would be your judgment as to the additional revenue to be derived?

Mr. WALKER. If we increased the postage on postal cards from 1 to 2 cents, local letters from 2 to 3 cents, and other than local letters from 3 to 4 cents, we would get $172,000,000.

Mr. LUDLOW. That is based, however, on the existing volume of mail?

Mr. WALKER. Yes, sir; and that would be per piece. That would not increase the rate per ounce; it would increase it 1 cent per piece.

Mr. LUDLOW. Does that take into consideration the possibility of nonuse of mail by a good many people who now use mail?

Mr. WALKER. No, sir.

Mr. LUDLOW. In other words, a falling off of volume?

Mr. WALKER. No; it does not.

Mr. LUDLOW. Is not that likely to be a considerable factor?

Mr. WALKER. I am told that that was not the experience that was had when the mail rates were changed previously. Does not your research show that?

Mr. HAGGERTY. Yes.

Mr. LUDLOW. In case you were to increase the rate of postage or reduce it, as has been urged by a good many businessmen, how much loss of revenue would that involve?

Mr. WALKER. The experience has taught my predecessors and those in my Department for a number of years that when decreases were made it just meant a decrease in actual money, and did not increase the volume of mail. So it would decrease it as 1 is to 2, or 2 is to 3.

Mr. LUDLOW. I think the general estimate of the Department has been that the 1-cent differential there would mean a loss of about $125,000,000 in revenue.

Mr. WALKER. On the basis of present volume.

I do not make this as a recommendation at this time.

Mr. LUDLOW. If you want to elaborate your testimony, General, of course you are at liberty to do so.

Mr. WALKER. I do have some ideas on this that I would like to discuss. I think, perhaps, instead of increasing a cent on each of those three classifications of first-class mail, if we would increase it half a cent per piece in each of those, it would about balance our budget for the coming year, or come very close to balancing it.

Mr. LUDLOW. For the fiscal year of 1944?

Mr. WALKER. Yes. I think is is a good thing to pay as you go and, in addition to that, it will give us an opportunity to improve our cost-ascertainment system, so that some time during the current year we could submit to Congress our recommendations for them to do as they see fit with reference to the various classifications—all the classifications of mail. I do not think eventually this burden should remain on first-class mail at all. For the duration of the war, or this intermediate period, I think it might be well.

INCREASE IN RATES FOR FOURTH-CLASS MAIL

Mr. O'NEAL. Mr. Chairman, I would like to make one comment. I know very little about the subject, but it appears to me that the fourth-class mail ought to be subject more to change than almost any other class. You take the cost of sending a telegram, which merely goes over a wire, or the cost of railway express, or anything else, and the postage rates on fourth-class mail are ridiculously low as compared to the service rendered by the Post Office Department in contrast to the services rendered and the cost charged by other types of service. I usually send a box—I do not know what the weight is, but say a pound—from Philadelphia to New York. What would be the cost of your postage there—fourth class, the lowest type of postage?

Mr. WALKER. Parcel post?

Mr. O'NEAL. Parcel post.

Mr. NORTH. About 9 cents a pound.

Mr. O'NEAL. Well, think of the service required on that as compared to the service of sending a telegram, which would be 25 or 30 cents for that same thing. It seems to me the postal rates on fourth-class mail are all out of line as to the service rendered compared to similar services rendered by other types of work.

Mr. WALKER. I think that is right, Mr. O'Neal, but I cannot prove it. I do not have the figures. I might say we ought to do this or that, and some express official would come up here and make a fool out of me. I have not the figures to prove I am right.

Mr. O'NEAL. The cost of sending a telegram from New York to Philadelphia is 85 cents, and you send a box weighing a pound for 9 cents. I do not think you need much of a cost ascertainment to see that you are too low or he is too high; and it seems to me that runs all along the line.

INCREASE OF REVENUES, FIRST 6 MONTHS OF FISCAL YEAR 1943, AS COMPARED WITH FIRST 6 MONTHS OF FISCAL YEAR 1942

Mr. LUDLOW. Can you tell us from the unaudited cash basic figures for the first 6 months of the fiscal year 1943, what percent the revenues increased over the same months of the fiscal year 1942, and by what percentage expenditures increased during that period?

Mr. WALKER. A little over 6 percent.

Mr. HAGGERTY. 6.3 percent increase in revenues.

Mr. LUDLOW. How about expenditures?

Mr. HAGGERTY. I am making up that statement of obligations. We have not got the figures yet. We will have that out in time to put it in the record. The increase will be over 5 percent in expenditures.

Mr. O'NEAL. Do you suppose we could have figures submitted showing comparable rates by express and parcel post?

Mr. LUDLOW. Yes. We have had that before; and you can bring that down to date?

Mr. HAGGERTY. Yes, sir.

(The matter requested is as follows:)

	Express scale	Parcel-post zone	1 pound		5 pounds		10 pounds		50 pounds		70 pounds	
			Express	Parcel post	Express	Parcel post	Express	Parcel post	Express	Parcel post	Express	Parcel post
From New York, N. Y., to—												
Philadelphia, Pa	20	1, 2	$0.36	$0.08	$0.36	$0.13	$0.41	$0.18	$0.67	$0.62	$0.78	$0.84
Baltimore, Md	24	1, 2	.36	.08	.36	.13	.41	.18	1.14	.62	1.52	.84
Boston, Mass	28	1, 2	.36	.08	.36	.13	.42	.18	1.26	.62	1.66	.84
Washington, D. C	28	3	.36	.09	.36	.17	.42	.27	1.26	1.07	1.66	1.47
Richmond, Va	36	3	.36	.09	.41	.17	.52	.27	1.41	1.07	2.00	1.47
Rochester, N. Y	36	3	.36	.09	.41	.17	.52	.27	1.41	1.07	2.00	1.47
Buffalo, N. Y	40	3	.36	.09	.41	.17	.52	.27	1.60	1.07	2.15	1.47
Pittsburgh, Pa	40	4	.36	.10	.41	.24	.52	.42	1.60	1.82	2.15	2.52
Cleveland, Ohio	53	4	.36	.10	.46	.24	.62	.42	1.97	1.82	2.67	2.52
Cincinnati, Ohio	61	4	.36	.10	.46	.24	.62	.42	2.19	1.82	2.99	2.52
Detroit, Mich	61	4	.36	.10	.46	.24	.62	.42	2.19	1.82	2.99	2.52
Fort Wayne, Ind	63	4	.36	.10	.46	.24	.62	.42	2.25	1.82	3.07	2.52
Indianapolis, Ind	65	5	.36	.11	.57	.33	.77	.60	2.31	2.71	3.14	3.77
Chicago, Ill	67	5	.36	.11	.57	.33	.77	.60	2.35	2.71	3.22	3.77
Madison, Wis	71	5	.36	.11	.57	.33	.77	.60	2.47	2.71	3.38	4.77
Duluth, Minn	101	5	.36	.11	.62	.33	.83	.60	3.33	2.71	4.57	3.77
Des Moines, Iowa	87	6	.36	.12	.62	.40	.82	.75	2.93	3.55	4.02	4.95
St. Paul, Minn	96	6	.36	.12	.62	.40	.82	.75	3.18	3.55	4.33	4.95
New Orleans, La	99	6	.36	.12	.62	.40	.82	.75	3.27	3.55	4.43	4.95
Fargo, N. Dak	111	6	.36	.12	.62	.40	.89	.75	3.61	3.55	4.96	4.95
Dallas, Tex	126	6	.36	.12	.62	.40	.98	.75	4.04	3.55	5.57	4.95
Cheyenne, Wyo	142	7	.36	.14	.72	.60	1.07	.95	4.49	4.55	6.20	6.35
Denver, Colo	146	7	.36	.14	.72	.60	1.09	.95	4.60	4.55	6.37	6.35
Billings, Mont	162	7	.36	.14	.72	.60	1.15	.95	5.06	4.55	6.99	6.35
Butte, Mont	183	8	.41	.15	.77	.89	1.25	1.14	5.40	5.54	7.48	7.74
Boise, Idaho	200	8	.41	.15	.80	.89	1.30	1.14	5.11	5.54	7.47	7.74
Spokane, Wash	212	8	.41	.15	.81	.89	1.41	1.14	6.19	5.54	8.54	7.74
Seattle, Wash	227	8	.41	.15	.88	.89	1.55	1.14	6.86	5.54	9.53	7.74
San Francisco, Calif	248	8	.41	.15	.91	.89	1.60	1.14	7.16	5.54	9.94	7.74

There has been no change in the express rate tariffs since Apr. 15, 1939. However, there is included in the above rates a 10 cents per piece emergency charge granted as of Jan. 20, 1942, to offset wage increases. There is also included in the above a 3-percent tax which became effective on Dec. 1, 1942.

CORRESPONDENCE BETWEEN POSTMASTER GENERAL FRANK C. WALKER AND R. L. DOUGHTON, CHAIRMAN, WAYS AND MEANS COMMITTEE, HOUSE OF REPRESENTATIVES, JULY 7 AND 8, 1942

OFFICE OF THE POSTMASTER GENERAL,
Washington, D. C., July 7, 1942.

Hon. ROBERT L. DOUGHTON,
Chairman, Committee on Ways and Means, House of Representatives,
Washington, D. C.

DEAR MR. CHAIRMAN: I have your letter of June 25, 1942, which suggests certain action on the part of the Post Office Department in respect of postage rates on second and third class mail matter. Careful consideration has been given to this letter, which informs me of a motion of the Committee on Ways and Means, and the request of the committee that the language of the motion be studied, and that I report as to the feasibility of the proposition therein expressed, and make such recommendations as may seem appropriate.

This proposition of the Committee on Ways and Means is as follows:

"SEC. —. The Postmaster General is hereby authorized and directed to prescribe after notice and hearings, but not later than 90 days after the date of enactment of this act, regulations providing for such increases in the rates of postage applicable to mail matter of the second class (except free county matter) and mail matter of the third class as may be necessary in order that the revenues in the case of each such class and in the case of reasonable classifications within each such class will fairly approximate the costs and expenditures attributable thereto, and to amend such regulations, from time to time, to the extent necessary to carry out the purpose of this act. The rates of postage provided for in such regulations shall become effective, in lieu of the rates now provided by law, within such reasonable time after the promulgation of such regulations as the Postmaster General may provide therein. The regulations prescribed pursuant to the provisions of this act shall be published in the Federal Register."

May I at the outset say that I heartily approve your proposal that the Postmaster General be authorized and directed to conduct public hearings for the purpose of examining and studying postal rates and making recommendations to Congress with reference thereto. The proposal is the most important made in modern postal history. The need for this study is most urgent. I feel it is highly desirable that the hearings be conducted publicly. This is in the best interests of the Postal Establishment and the host of mail users as well. It should serve also to bring to the public a better understanding of the affairs of the Postal Service and should lead to a more clearly defined public policy.

I beg leave, however, to make the following recommendations to your committee:

1. That the proposed legislation direct that the study, hearings, and authority embrace all postage rates and rates for all services performed by the Postal Establishment;

2. That no time limit be prescribed for the fixing of rates but that the proposed legislation direct that the studies and hearings be begun promptly;

3. That the language of the proposed legislation be amended to require that postage rates and rates for postal services in cases, classes, and classifications within classes, wherein the Government has the monopoly, be fixed so as to fairly approximate the costs and expenditures respectively attributable thereto;

4. That the proposed legislation be amended to require that costs and expenditures be determined respectively attributable to all other cases, classes, and classifications within classes, wherein the Government does not have the monopoly, and that the rates therefor be fixed in the light of the general welfare and the public interest; and

5. That the legislation be amended so that regulations of the Postmaster General establishing a rate of postage or a rate for service be not effective until 60 days after the regulation fixing the rate is reported to both Houses of Congress.

At my first appearance before the Bureau of the Budget and the subcommittee of the Appropriations Committee last year, I indicated that in my opinion there was a real necessity for a scientific study of costs and revenues, and an intelligent application of the results of the study to the postal business.

Few appreciate the magnitude or the vastness of the Postal Establishment. Few realize what an immense and involved business structure and service agency it has come to be. It is a business operated through more than 44,000 post offices.

It employs more than 336,000 persons. It handles each year accountable cash, property, and stock of the value of more than $8,000,000,000. It is an intricate, involved, and complicated enterprise of immense detail and tremendous day-to-day operation. Its work is most exacting and requires the best in efficiency. This huge enterprise is operated with a main or headquarters office personnel of 1,317 persons. It is inspected, audited, and instructed in its workings by an inspection force of 750 men.

It is obvious that the important and exacting work of cost and revenue studies cannot be carried forward adequately with the limited departmental and inspection force available, for even now the staff is overburdened with the tremendous task of day-to-day operations.

These views, as I have said, were presented to the Bureau of the Budget and to the subcommittee of the Appropriations Committee last year in connection with the 1943 estimates for the Postal Establishment, and again in the past few months in connection with the deficiency appropriation for 1942. The Congress sympathetically considered our management problems, and we were allowed, effective July 1, 1942, for the fiscal year 1943, $25,000 for budget and administrative planning, 4 minor executive places, and 27 minor clerical places for the departmental service, and 100 additional post-office inspectors. Our estimates for these requirements were substantially larger, and were based upon a peacetime postal service. Subsequently, the Congress allowed the recruitment of the additional post-office inspectors to begin April 1, and several weeks ago these inspectors completed their preliminary training, which starts them on their 3½-year course to become qualified post-office inspectors.

These recommendations to the Budget and the Appropriations Committee were made to care for a condition existing in the Department a year since. Before relief was granted, the war was upon us, and its coming brought new and greater problems to the establishment. Wartime postal security and conservation procedures had to be planned and placed in operation. Not only was it necessary to instruct and train the entire postal personnel in the application of these procedures but we have the continual task of seeing to it that these procedures are followed and made more effective throughout the entire Postal Establishment.

In addition, the rubber shortage caused by the war has brought us the altogether new problem of finding ways and means and formulating plans for moving the mails over 3,236,000,000 tire-miles per year, notwithstanding curtailments of rubber supplies. Unless an adequate supply of rubber is made available, this will be a problem of readjustment of the first magnitude necessarily involving vast changes in routes, schedules, and mail-handling operations, not only during the war period but requiring readjustments of comparable complexity after the war.

In addition to all this there have come tremendous demands for additional postal work and services from other departments and agencies of the Government to assist in the war effort.

For these reasons the Department cannot study and plan adequately for improvement and simplification of operation and management procedures, nor can it make the continuous and essentially scientific cost and revenue studies that must be made, nor can it plan sufficiently for the readjustments so necessary to meet the present daily changes in the postal business, in general business, and in the national economy during the wartime and in the time of peace to come.

Departmental hours have been increased; officials and the inspection force have extended their own hours to the utmost. But we have not been able thereby to obtain the management manpower necessary to perform even our daily tasks in the manner and with the thoughtful and deliberate consideration that all of us in the Postal Service recognize as absolutely essential.

With the encouragement we have received from Congress in recent months, and realizing the desire of Congress to see to it that the Postal Service is implemented sufficiently to conduct its affairs on a businesslike basis, I have in the meantime attempted, within the limits of available personnel, to make a start on certain phases of postal operations which are directly related to costs, revenues, and rates.

Postal business has been managed upon revenue and expenditure figures. It has seemed to me that the real guide for management is to be found in the volume and costs. I have felt for some time, as I indicated in the hearings before the Appropriations Committee last year and again in my annual report for the fiscal year 1941, that the peak of postal revenues would soon be reached and that postal work volume and costs would increase. In discussing general postal business with the Appropriations subcommittee last year before the inception of the war,

I stated that I was very dubious of the general financial position of the Postal Establishment as then estimated for the fiscal year 1943, because costs were steadily mounting. I felt then, as I do now, that we should have more complete operation and cost data in order that significant changes in the trend of postal affairs might be brought promptly to the attention of the executive and legislative branches of the Government for necessary action.

In order to keep informed currently of the situation, in February of this year I instituted a system of monthly reports from 172 of the largest post offices to reflect promptly trends in postal business. While the reports are not conclusive and as yet do not contain the detail which I believe the Department should have continuously before it, I feel that these reports are accurately representative of the trends. On the basis of this information, the fiscal year 1942 as a whole will show an increase in revenues over the fiscal year 1941, and the actual postal deficit will be the smallest since 1926. The Department has definitely passed the peak of revenues, yet the work-load volume is steadily increasing and will continue to do so. In my opinion, there will be a substantial decline in postal revenues for the fiscal year 1943 and a substantial increase in work-load volume. This will cause expenditures to greatly exceed revenues and result in a substantial postal deficit.

To what extent and to what amount in money this will be reflected, I am not yet in a position to approximate since this is an entirely new phase in postal history. Heretofore when there has been a decline in postal revenues there has also been a decline in postal work-load volume, not actually corresponding but nevertheless rather parallel. The Department, therefore, more than ever before, needs to equip itself with operating, volume, and cost data.

To obtain and analyze these essential data and to begin promptly the necessary budget and administrative planning work on the effective date of the 1943 appropriation, I had in readiness certain plans which were put in effect July 1, 1942. I have established the Office of Budget and Administrative Planning and laid down a program of work for it. I have brought together under the Bureau of Accounts all the work of the Department in connection with reports and accounts affecting over-all operations and the ascertainment of costs.

Last year I started the work of surveying all mail handling and financial operations in the field in order that there might be available for the first time complete and factually accurate bases for the continuous improvement and simplification of postal operations, and for use in the analyses of factors of cost. The preliminary gathering of these data has been completed and graphic charts showing these field operations in detail have been furnished to departmental officials and the inspection force for study.

As a result of information obtained during this preliminary survey the Department has been able to eliminate and consolidate more reports and forms than in any like period in modern postal history. This has been possible without detracting in any way from the efficiency of operations and without dispensing with necessary financial and management data. By the discontinuance of one report form, the Postal Service has been saved each year the necessity of preparing and submitting 229,000 individual reports. By dispensing with one group of 22 reports, the work of preparing and verifying more than 47,000,000 entries in the field and reviewing them in the Department each year has been eliminated. By the abolition of one group of 8 reports, the Postal Establishment has not only saved the actual cost of 444,000 envelopes but, what is more important, it has eliminated the work of preparing the reports involved and the cost of addressing, handling, and distributing them each year.

In order that instructions for the guidance of the 44,000 post offices and the postal personnel be simplified, made uniform, and consistent, and so that instructions might be more economically and efficiently placed in effect by the postal personnel, I made certain changes in the Postal Bulletin effective March 15, 1942. It has been found possible not only to curtail the publication of the daily Postal Bulletin to 3 issues a week, but also to reduce the average number of pages published each month from 62 to 20. The cost of printing the Postal Bulletin during the months of April and May 1940 and 1941 averaged $8,500, whereas during April and May 1942 costs have been reduced to $4,450. This saving has been made notwithstanding the increase in per page printing cost of over 20 percent. By this curtailment and reduction of the Postal Bulletin, not only does the field continue to be as well informed, but there will be a saving of over 1,000,000 envelopes each year.

I cite these few examples merely for the purpose of demonstrating the possibilities of benefits and savings that may be had if and when sufficient manpower is available to scrutinize constantly procedures, reports, and forms from the standpoint of efficiency and economy of operations. The Postal Establishment must constantly seek to simplify and improve its operations and methods so that greater efficiency and intelligent economy may result. Savings due to these efforts should be important and substantial in dollar amount.

However, these savings, in terms of percentage of total postal expenditures, are necessarily small. Economies in the Postal Establishment are confined to a narrow field. Of total annual postal expenditures of more than $800,000,000, approximately 75 cents of each dollar expended is paid out for the services of personnel in the field and 20 cents of each dollar is paid out for transportation of the mails. By reason of statutory limitations, requirements, and directions made over the years, permanent charges have been placed upon the Postal Establishment in these two classes of expenditures. These charges make it virtually impossible to flatly or arbitrarily cut expenditures—if the mail is to be moved with dispatch—if the facilities of the Postal Service are to remain available to the public, and if the postal organization is to be used by the Government to carry out national-policy programs. Thus the field of opportunity for working out economies is limited to the remaining 5 cents of the dollar expended.

There remains but one alternative in the field of economy and that is to restrict the type and kind of service that is in the very tradition of the United States Postal Service. A step in this direction would, of necessity, have as its effect the curtailment of deliveries and dispatches, would reduce the facilities of the Postal Service available for hire by the public, and would limit substantially the use of the postal organization by the Government in carrying out national-policy activities. Such a radical step would be contrary to the tradition of the Department and a drastic departure from the national policy pursued by our Government since the creation of the Postal Establishment.

Another and even larger factor in this relationship between revenues and expenditures is the work and service performed by the Postal Establishment for other governmental agencies. Other branches and agencies of the Government continue to rely more and more upon the postal organization to assist and implement their work. The free mail privilege for governmental agencies, and the provision for custodial and maintenance equipment and services for quarters located in post-office buildings and used by other Government agencies, are important and well-known services furnished by the establishment.

However, at no time in its modern-day history have so many services in such tremendous volume been expected of and required to be furnished by the Postal Establishment. Registration of aliens, reregistration of enemy aliens, rehandling of mail for censorship, establishment of postal facilities for more than 700 military units, free mail privilege for our armed forces, selling and accounting for 58,000 000 motor use tax stamps valued at $206,000,000, selling and accounting for 19,000,000 Defense-War Savings bonds valued at $358,000 000,[1] selling and accounting for 1,517,000 000 Defense-War Savings stamps valued at $310,000,000,[1] and dozens of other services added substantially to the postal work-load during the past year.

For the past year a serious effort has been made to obtain reimbursement from other agencies of the Government for this work. While the Department has had more success in obtaining reimbursement than heretofore, yet statutory restrictions and directions prevent reimbursement for many of these services. On the whole, the Postal Establishment is being reimbursed only a minor fraction

[1] During the last war the Postal Establishment was also utilized to sell Government securities of two kinds, 25-cent Thrift stamps and $5 War stamps. While the volume and amount of these sales were tremendous, they were, in a recent comparable period of this war, greatly exceeded.

Postal Establishment sale of Government securities

Securities sold	Dec. 1, 1917, to June 30, 1918	Dec. 1, 1941, to June 30, 1942	Percentage increase
Savings and War stamps	$336, 920, 504. 03	$284, 053, 000	
Savings bonds		744, 329, 000	
Total	336, 920, 504. 03	1, 028, 382. 000	165. 52
Total number of individual securities sold	283, 255, 239	1, 520, 244, 000	436. 70

of the expense incurred for these services. The performance of these services likewise has a distinct bearing upon the relationship of revenues and expenditures of the Postal Establishment, and upon the revenues derived from the various classes of mail and special services and the costs and expenditures attributable thereto.

Another and vital factor in these relationships has been the enormous changes occurring in our national economy due to the war effort. In modern postal history there have been no such great shifts of population and no great conversions of industry. Thus plans for field personnel, buildings, equipment, and transportation could be based upon the expectation of a rather predictable growth in population and business. True, business cycles had their effect upon the postal business, but this effect was almost solely limited to declining or increasing postal value and postal receipts. Postal expenditures, to some extent, paralleled postal revenues, and it has been axiomatic in the Postal Service that declining revenues meant declining work volume.

In a period of business depression the adjustment of postal expenditures to revenues has never been easily managed. Beginning in the early thirties, the Postal Establishment had the experience and felt the effect of decreased postal income and volume, which dropped sharply with the decline in general business activity. The public curtailed the use of postal services and facilities; that meant less postal work load and volume, and obviously less expenditures for personnel and transportation were required to move the mails and provide the services. Executive and legislative action, though distasteful, became imperative. This adjustment between revenues and expenditures took many months and was climaxed by the payless furlough, affecting every employee in the Postal Service.

At this time the Postal Establishment has encountered no mere change in the business cycle. It is confronted by great, and at this time unpredictable, changes in the national economy, great shifts in population, great mobilization of military forces, and complete conversion of business to war industry. All previous gages, principles, and factors which have been useful in charting and forecasting the future of the operations of the Postal Establishment have become virtually valueless and meaningless.

To illustrate this, it now appears that during May 1942, at the 172 largest post offices which have usually accounted for 71 percent of total postal revenues, there was a decrease of $2,351,450, or 5.62 percent, in postal revenues and a decrease of 529,139, or 9.36 percent, in the number of sacks of parcel post dispatched, compared with May 1941.

In the same period the number of domestic money orders issued increased 896,910, or 13.39 percent; the number of savings bonds sold increased 1,031,640, or 394 percent; the number of paid domestic registered articles increased 1,458,434, or 61.48 percent; the number of free domestic registered articles increased 425,547, or 61.88 percent; the number of special delivery articles delivered increased 577,523, or 9.4 percent; and the number of pouches of mail other than parcel post received and dispatched increased 196,909, or 7.5 percent. Thus, notwithstanding the sharp decline in postal revenues shown in these few offices, there was an increase of more than 4,500,000 in the number of transactions in the various postal services.

The expenditures at these 172 largest post offices for the month of May 1941 totaled $35,616,771.55 and for the month of May 1942 the expenditures of these offices were $37,149,672.83, an increase of $1,532,901.28, or 4.3 percent.

Business at the smaller offices differed substantially. During May 1942 stamp sales to the 28,000 fourth-class offices increased 6.15 percent over May 1941, and stamp sales to the 10,000 third-class offices increased 4.77 percent. During the same month the number of money orders paid at the 38,000 third- and fourth-class post offices increased 23.93 percent.

The usual relationships and trends between postal revenues, volume, and transactions, and as between classes of post offices, no longer exist.

The present dynamics of the national economy have and will continue to have a most important bearing upon the relation of the revenues derived from the various classes of mail and the special services, and the costs and expenditures attributable thereto.

The largest factor in this relationship between postal revenues and expenditures, as the proposal of your committee indicates, is postal rates—rates for service as well as for mail. My studies have brought me definitely to the conclusion that too little attention has been paid to the relationship that exists between postal rates on he one hand, and financial considerations and the public wel-

fare on the other. Notwithstanding that postal rates and costs are involved and complex it is in the public interest that they be understood more widely and more often subjected to public scrutiny.

In private business, costs have always been the principal consideration in fixing the rates or charges for the product. In postal business, public welfare has received serious consideration in the fixing of rates. It is proper that this policy should be continued in some measure. However, in fixing the postal rate structure consideration should be given to the factor of actual cost as well as to the public welfare. It seems to me that these considerations and factors have never been adequately integrated in postal rates.

It has been said that revenues from few classes of mail or postal services approximate the costs and expenditures attributable thereto—for instance, special delivery. A special delivery fee of 10 cents for a letter is fixed by statute. Another statute fixes a fee of 9 cents to be paid the special delivery messenger. The cost of the extra work involved in this transaction is not at all commensurate with the 1 cent which remains available to meet postal operating expense. If the special delivery message is to bear the costs and expenditures attributable to it, it should bear the cost of (1) printing the special delivery stamp; (2) sending the stamp to the post office for sale; (3) charging the stamp out to the window clerk for sale; (4) clerical time in selling the stamp and accounting for its purchase; (5) clerical time attributable to the handling of the stamp in and on the necessary accounting forms, records, and reports concerning the disposition of the stamp and its proceeds, and the attributable share of the cost of the yearly audit of the post office selling the stamp; (6) preferential handling of the special delivery letter from the place of collection through the post offices of dispatch, through the post office of receipt of the place of delivery; (7) clerical time attributable to the handling of the letter and recording it on forms, records, and reports at the post office of delivery, and the attributable share of the cost of the yearly inspection of the post office and facilities handling the special delivery letter; and (8) attributable share of the cost of supervision of the special delivery system. Last year more than 103,000,000 special deliveries were made and the volume is increasing.

An examination of the money-order system may cause one to reach the same conclusion, as the minimum fee of 6 cents fixed by the statute is said not to be commensurate with the cost of the extra work involved in money-order transactions. Handling of a money order involves substantially more postal work than a special-delivery message. In the issuance of a money order more than 15 separate entries must be made by the issuing clerk. Much special office equipment must be utilized. Last year more than 275,000,000 money orders were issued and paid. This makes 550,000,000 separate accounting and auditing transactions. Money-order volume is increasing.

Likewise it may be said that third-class mail does not approximate the costs and expenditures attributable thereto. The basic statutory rate of postage on third-class matter is 1½ cents for each 2 ounces or fraction thereof (first-class nonlocal mails is 3 cents per ounce, or fraction thereof). For the 1½ cents the Postal Service will deliver a 2-ounce item of printed matter to any postal patron anywhere in the United States. In the main there is little difference in the expense involved in the transmission and delivery of a 2-ounce first-class letter, for which the Postal Service would receive 6 cents, and the 2-ounce piece of third-class matter for which the Postal Service receives 1½ cents, except that the third-class matter does not receive the same priority in handling. It does require a comparable amount of clerical work in connection with its collection, distribution, transportation, and delivery.

Thus it may appear by these illustrations that the postal fees or rates charged do not meet the expense attributable to the service.

Many say that these services are in the public interest. The public must have an inexpensive method of quick communication—thus special delivery; others contend that business and private affairs require an economical means of security for the transmission of small sums of money—thus money orders; still others say that industry, in order to develop and increase employment, must have a means of bringing its products directly to the attention of prospective purchasers at nominal rates—thus low third-class postage rates.

Surmounting these considerations is the actual but seemingly intangible contribution that the Postal Establishment by its service has made to the unity of the Nation through the dissemination of information and knowledge, and the

more obvious aid it has been to the progress and growth of business and industry through its Nation-wide facilities for the transmission and safeguarding of communications and valuables at nominal cost to its patrons.

Services performed in the public welfare should not be rendered, however, with entire disregard of public cost.

It seems that postal costs have not as yet been measured scientifically. In the last 20 years great strides have been made in the techniques of time and cost studies and in the methods of cost accounting, but the Postal Service has not been equipped to keep its cost studies progressing in the light of improvements and gains in techniques. This tedious, exacting, and painstaking work is not to be accomplished without the expenditure of funds. Insufficient funds to properly carry out such work may be far worse than not doing the work at all, because fragmentary and indefinite figures which may result from insufficient analysis and study may be responsible for the drawing of factually incorrect conclusions. While the sample drawn for cost study may be appropriate, the lack of scientific and professional personnel to see to it that the sample is adequately controlled, tested, analyzed, and checked may result in wholly unjustified inferences and determinations being drawn from the data. Notwithstanding the inadequacy of funds for analytical work, the Department has made every effort to be as scientific as possible in its work of ascertaining costs. I believe, however, that the Postal Establishment has suffered and will now suffer even more because of its continued lack of facilities to establish, maintain, and improve its time and cost studies and analyses.

Expenditures from management personnel, which include departmental officials and employees and the inspection service, amount to but $0.006 of each dollar of postal expenditures. Included in that amount are the funds made available for all the departmental general administrative examination of accounts and reports of day-to-day operations as well as the amounts made available for departmental study and analysis of cost ascertainment data. These funds amount to $125,000 for the Bureau of Accounts and $35,000 for personnel services in the District of Columbia for cost ascertainment; a total of $160,000, or $0.00019 of each dollar of postal expenditures. The factual statement that the average yearly salary of the 81 officials and employees engaged in this work is $1,975 is a sufficient comment on the lack of importance that has been attached to this vital, exacting, scientific, and professional work.

Encouraged by the sympathetic interest displayed by the Congress in our management problems, I have combined all the over-all accounting, reports, and cost work in one bureau, effective July 1, and have laid down a plan of operations. By these means I have hope of improving this work. But it goes almost without saying that these preliminary steps will not alone solve the problem of insufficient manpower to do the job as it should be done.

The desirability of some method of cost accounting has been recognized for many years. In the fiscal year 1907-8 statistics were gathered and used to show comparisons of revenues and expenditures by classes of mail and special services, and the results of that study were published in the Annual Report of the Postmaster General for 1909. This was analyzed and carried forward with certain modifications by the Hughes Commission in 1911-12, but the conclusions were thrown into disarray almost immediately thereafter with the inauguration of the parcel post system on January 1, 1913.

The matter then remained in suspense until 1921, when the Joint Commission of Congress on Postal Service agreed that the Department undertake the work of obtaining more adequate information with respect to the cost of carrying and handling the several classes of mail matter and performing the special services. A comprehensive plan, embracing special instructions and forms, for gathering the data was then prepared with the collaboration of expert accountants employed by the Joint Commission and postal experts from the departmental and field services, but due to lack of funds the work was delayed.

The basic data were finally gathered during the period from September 21 to October 20, 1923, at 560 designated post offices of all classes and in representative lines and terminals in each division of the Railway Mail Service. The statistics thus obtained were applied to the audited revenues and expenditures of and for the fiscal year 1923, and the results were submitted to the Sixty-eighth Congress on December 2, 1924, as "a fair and reasonably accurate approximation

of the relative revenues and expenditures applicable to the several classes of mail and special services."

As a consequence, the Congress passed the act of February 28, 1925, authorizing the continuance of the cost ascertainment, under which authority the statistical results have been reported each fiscal year beginning with 1923.

It is impossible for the Post Office Department and the General Accounting Office to maintain records of each individual item of revenue and expenditure according to every single class of mail and each special service by each particular rate. Therefore, the break-up of the audited revenues from the general sources and the audited expenditures from the various appropriations must depend in the main upon apportionments based upon as representative and as reliable data as possible. This cost ascertainment has sought to accomplish by means of the procedure approved in 1924, on the basis of statistics and tests in a limited number of post offices at selected points during four 7-day statistical periods in the year, on the theory that the sample thus procured would be a cross-section of the postal business for the fiscal year.

The original 1924 cost ascertainment plan has been retained but so far as possible details have been modified from year to year to keep abreast of changes in classification, postal rates, and services. The scope of cost ascertainment has been broadened to embrace the comparison for certain subclasses and divisions of classes and also to show the number of pieces, weight, volume, and average haul of mail by classes, as well as the number of transactions in the special services. The purpose of the cost ascertainment is to credit as accurately as possible to each class of mail and each special service the revenue earned by it, and to charge each class of mail and each special service with its proper share of the expenditures.

No attempt is made to reflect such intangible factors as the relative priority of service, the relative intrinsic and economic values of the mails of the several classes, and the degrees of preferment in handling. For example, first-class mails are afforded safeguards in handling that are not accorded mails of the second and third classes, such as lock pouches in transportation and checking of receipt and dispatch of such pouches. They are also afforded the most expeditious handling in both offices of mailing and delivery and in transportation. Perishable and fragile matter are afforded special treatment in handling and transportation. Special delivery parcels and newspapers are afforded expeditious handling in transit over and above that accorded regular mails of the fourth and second classes. The cost of these priorities and preferments and the value of them to mailers are not reflected in cost ascertainment figures.

It is obvious that the present cost ascertainment methods and techniques are predicated upon the existence of reasonable uniformity in postal activity throughout the year. But we know that the usual static position in postal affairs is now a thing of the past. The great changes in our national economy, shifts in population, conversion of American business as we have known it to war industry, are producing and will continue to produce during the wartime and after the wartime such a dislocation of postal operations that determinations of costs on the existing bases will lead to factually incorrect conclusions.

The Postal Establishment looks forward to profound changes in the transportation of the mails as a direct result of the war. Even before the war new horizons came in view. The great growth in transportation of the mails by air, the successful experiments with air-mail pick-up service (wherein mail is picked up and discharged by planes traveling at high speeds, an operation recently adapted to military use) and the advancement in the technique of transportation by towed gliders have forecast the shape of things to come. After the war, the Nation will have vast numbers of highly trained and experienced pilots, navigators, and technicians, as well as an enormous supply of large and powerful transport planes. The Postal Establishment must be in a position, on behalf of the public, to take immediate advantage of these opportunities for better and more economical postal service which will be available almost immediately at the war's end. Mail handling equipment and facilities for distribution and dispatch of mail, the location of terminals, and mail-handling operating methods must be planned so that these resources available to the Nation may be intelligently integrated in the Nation's Postal Service. There will be produced changes as revolutionary in the transportation and handling of mails as came with the railroads. This

is not a visionary prophecy, but it is the considered judgment of many thoughtful men of sound technical training and business experience.

Yet this is all the more reason why our cost and planning studies must be continued, improved, and made more scientific.

The proposal of your honorable committee not only requires adequate, dependable, and comprehensible cost figures, but it demands also a proper forecast of the effect of new rates upon the volume of postal business, as well as an appropriate evaluation of the large considerations of public policy and public welfare.

There has long been a historic policy of encouraging by low postal rates the dissemination of news and information, and the extent to which this policy has proved successful must not be minimized. Most careful consideration should be given to any change in rates which would seriously hamper the circulation of useful information or which would tend to dislocate business and industry. The public has been afforded low postal service rates for the general benefit of the Nation, and the extent to which these rates for the classes of mail and the special postal services and special facilities such as registry, money order, and the like have contributed to the growth and comfort, the culture and influence of the Nation and its democratic processes, must not be overlooked.

If rates for mail and postal services were fixed immediately on a basis commensurate with the existing estimates of cost, not only would such rates be established on a factually faulty basis, but they would dislocate the service and produce such entirely new conditions that new cost computations would be required to determine whether the new rates, under the new conditions, were approximating fairly the costs and expenditures attributable to the services rendered.

For example, the cost ascertainment report for the fiscal year 1941 indicates there was an excess of apportioned expenditures over revenues on second-class matter of about $84,000,000, based on revenues of $24,000,000 and apportioned expenditures of $108,000,000. It does not necessarily follow that by increasing second-class rates four and a half times that the total expenditure figure will be met, because it would be pure conjecture to assume that the volume of second-class matter that was in the mails in 1941 would find its way into the mails in 1943 at these increased rates. The probable effect would be to drive second-class matter out of the mails. It by no means follows that the elimination of second-class mail would work a saving of $108,000,000 in expenditures. This item might be eliminated in a statistical table, but the Postal Establishment's financial statement might then very well indicate that the $108,000,000 had been apportioned to the other classes remaining in the mails, leading to larger amounts in the statistical statement of the excess of apportioned expenditures over revenues, as well as reducing the actual postal revenues by $24,000,000.

The postal system established by the Constitution and under the laws of Congress must of necessity operate as a going concern. If no second-class matter were in the mails, it would not thereby eliminate a proportionate share of the departmental personnel, the inspection force, the clerks, the carriers, the laborers, the Railway Mail clerks, the rural carriers, rent, light, and fuel because it is not possible to eliminate that portion of the personnel, the equipment, the buildings, the mail cars, and the trucks of the Postal Establishment that are handling the work load of second-class matter. We have no post offices or parts of post offices designed, equipped, and maintained to handle second-class mail exclusively. We have no Railway Mail cars or motor vehicles exclusively devoted to second-class mail. We have no post-office clerks or carriers, village delivery carriers, star-route carriers, or mail messengers recruited, trained, and employed to handle nothing but second-class matter. The Postal System is not composed of mail and service expense compartments which can be automatically eliminated or flatly reduced by the curtailment of expenditures when losses of mail or services occur in a particular category or classification. This elimination might lighten the burden of the employees, but it is very doubtful that it would work any great saving in manpower. The efficiency and economy of the Postal System depend upon the continual maintenance of a high degree of integration of all services and operations.

It was in the light of all these problems and factors, which I have here attempted to discuss as briefly as possible, that I made the five recommendations

which are set forth in the early part of this communication. The fact that the problems confronting the Postal Establishment are of great difficulty and complexity should not act as a deterrent to the proposal of the Committee on Ways and Means.

Irrespective of the ultimate decision of the Congress on the motion proposed by your committee, or on the recommendations I have made, it will be my policy, provided that the Congress authorizes the necessary expenditures, to implement and augment the work of cost ascertainment and cost analysis to the end that there should be continuing scientific studies of postal rates for mail and services in order that the most dependable data obtainable be available for use by the Post Office Department and by Congress. Furthermore, it will be my policy to bring together in one place in the Postal Establishment all work incident to the proposing and fixing of rates for mail matter and postal services, and to so organize this work that evaluations based upon the data collected continually in cost ascertainment and cost studies will receive adequate consideration and scientific study in the determination or fixing of rates and classification of mail matter and services.

By the action of your committee in proposing a scientific study of rates to be developed publicly, I am encouraged in the work I have started in the Department, and I will continue on that program so that by the joint and cooperative action of the executive and legislative branches of the Government the public may be assured that the Postal Service will continue to be the finest service of its kind in the world.

Respectfully submitted.

FRANK C. WALKER, *Postmaster General.*

COMMITTEE ON WAYS AND MEANS,
HOUSE OF REPRESENTATIVES,
Washington, D. C., July 8, 1943.

HON. FRANK C. WALKER,
Postmaster General, Post Office Department,
Washington, D. C.

DEAR MR. WALKER: In acknowledging receipt of your letter of July 7 with reference to postal rates, which was a reply to our letter of June 25, the Committee on Ways and Means desires to inform you that the letter was presented to the committee by the chairman this morning. Its contents were thoroughly discussed.

The committee recognizes the magnitude and importance of the subject, but it also appreciates the fact that the question of bringing rates of postage in the second- and third-class mail matters more closely in line with the cost of handling such mail, has been the subject of consideration and discussion for the past 30 or 35 years. Certainly you realize that it is not a good business practice to permit these deficits to continue without some remedial action. In spite of past discussions, nothing has ever been done.

We find that in 1933 the President of the United States was given the authority to do the very thing that our committee desires to have done, but so far no move has been made in that direction. Now, while we are in the very uncomfortable position of trying to find much needed revenue for the support of our Government in these precarious times, we feel this is one place where a very large saving should be effected.

We are particularly pleased to note that you approve the principle of our proposal, but you do make some recommendations, which are not entirely clear to us, many of which are beyond the jurisdiction of our committee. Furthermore we recognize that jurisdiction on all postal matters, not involving revenue, lies in the Committee on the Post Office and Post Roads. We certainly have no desire to violate this jurisdiction. Therefore, we decided to eliminate the proposed section from the tax bill and assume that you will not permit this matter to lie dormant.

Copies of our original letter to you dated June 25, of your reply of July 7, and of this letter are being sent to the Honorable M. A. Romjue, chairman of the Committee on the Post Office and Post Roads, leaving to him such action as his committee deems appropriate.

By direction of the Committee on Ways and Means.

R. L. DOUGHTON, *Chairman.*

LIBRARY OF CONGRESS, LEGISLATIVE REFERENCE SERVICE, DATA ON EFFECTS OF CHANGES IN POST CARD RATES OF POSTAGE DURING LAST WAR

LIBRARY OF CONGRESS,
LEGISLATIVE REFERENCE SERVICE,
November 29, 1943.

Hon. RALPH E. CHURCH,
House of Representatives,
Washington, D. C.

DEAR CONGRESSMAN: This is in response to your inquiry about the effects of changes in post-card rates of postage during the last war. The figures available relate to Government-printed postal cards sold or requisitioned by post offices; the Post Office Department states that privately printed cards may be assumed to be equal in volume of sales. For fiscal years the figures are:

	Cards
1916	1,047,894,800
New rate in effect on Nov. 3, 1917	1,112,337,700
1918	707,111,300
Rate reduced on Feb. 24, 1919	466,924,490
1920	986,156,087

Sincerely yours,

ERNEST S. GRIFFITH, *Director.*

POST OFFICE OPERATIONS AS SUMMARIZED FROM THE ANNUAL REPORT OF THE POSTMASTER GENERAL FOR THE FISCAL YEAR ENDING JUNE 30, 1942

Post Office operations

[Source: Postmaster General's Annual Report]

For fiscal year ended June 30, 1942:	
Operating deficit, i. e., cash deficit, without any credits for free services	$11,825,186
Postage credits, authorized by act of June 9, 1930, computed at regular rates of postage:	
Penalty matter by offices of Government (other than Post Office Department), including registry fees	71,924,122
Franked matter mailed by—	
Members of Congress	706,839
Others	189
Second-class publications free in county	601,105
Free mail for the blind	297,208
Second-class publications exempt from zone rates on advertising	320,665
Total	73,916,128
Additional credits:	
Other free services (custodial, maintenance, sale of War Savings bonds, etc.) rendered to the other Government departments without charge	10,879,334
Estimated postage that would have been received on free mail of armed forces	[1] 4,646,000
Total	15,025,905
Grand total credits	88,942,033
Net profit	77,116,849

[1] Estimated amount for 3-month period free mail was in effect in the fiscal year 1942.

Post Office operations

[Source: Post Office Department, except as otherwise shown]

For fiscal year ended June 30, 1943:	
Operating deficit, i. e., cash deficit without any credits for free services	$3,543,000
Postage credits authorized by act of June 9, 1939, at regular rates of postage:	
Penalty matter by offices of Government (other than Post Office Department) including registry fee	119,000,000
Franked matter mailed by—	
Members of Congress	[1] 768,830
Others	[1] 189
Second-class publications, free in county	[1] 601,105
Free mail for the blind	[1] 297,208
Second-class publications exempt from zone rates on advertising	[1] 326,665
Total	120,992,006
Additional credits:	
Other free services (custodial, maintenance, sale of War Savings bonds, etc.) rendered to other Government departments without charge	[1] 10,379,334
Estimated postage that would have been received on free mail of armed forces	[2] 23,230,000
Total	33,609,334
Grand total credits	154,601,340
Net profit	150,058,340

[1] Figure from Postmaster General's report for fiscal year 1942, the figure for fiscal year 1943 not being available.

[2] The item of $23,230,000 is estimated by extending the Post Office Department estimate for this item for 3 months of the fiscal year 1942, to 12 months, and increasing by 25 percent to allow for increase in armed forces.

BRIEF OF T. Q. BEESLEY ON POSTAL-RATE INCREASES AS TAXATION, WHICH ARE PROPOSED IN HOUSE REVENUE BILL OF 1943, H. R. 3687

The increases in postal rates and charges for special postal services proposed in the revenue bill for 1943, as passed by the House of Representatives and now before the Senate Finance Committee, are unsound and unscientific on three principal counts, as follows:

1. The increases proposed bear no relationship to the deficits incurred by the Post Office Department for each class of mail or service rendered.

The House Committee on Ways and Means, in its report accompanying the revenue bill of 1943, states that "The Post Office Department shows that while first-class mail service was operated at a profit of $163,000,000 during the fiscal year 1942, all other classes of mail operated in the aggregate at a loss of $172,000,000, and that a similar over-all situation has existed with respect to the Postal Service for years." The implication here must be apparent that the modifications proposed by the committee are to correct any deficiencies in revenues over expenditures where they occur. This is not the case, however, as exhibit A attached and the following comments will show:

First-class mail.—Local first-class mail shows a profit of $25,885,000, or 29.4 percent of its total revenue. It is proposed to increase the local rate 50 percent and to provide $44,000,000 additional revenue.

Air mail.—Shows a loss of $3,091,000, or 9.3 percent, and it is proposed to increase the air-mail rate 33⅓ percent and to provide $11,000,000 additional revenue.

Second class.—Shows a loss of $80,034,000, or 321 percent of the total revenue produced, and no increases are proposed.

Third class.—Shows a loss of $23,954,000, or 32.2 percent and it is proposed to increase all third-class rates 100 percent.

Fourth class.—Regular parcel post shows a loss of $9,289,000, or 6.8 percent. Books show a loss of $8,620,000, or 270.6 percent. It is proposed to impose a 3-percent tax on all parcel-post shipments. Regular parcel post showing a loss of $9,289,000 is expected to contribute $4,425,000 in additional revenue, or 47.5 percent of its loss, whereas books, with a loss of $8,620,000, are expected to contribute only $95,000, or 1.1 percent of their loss.

Foreign mail.—Shows a loss of $5,001,000. No increase suggested.

Penalty mail.—Shows a loss of $24,770,000. No recommendations for reimbursing the Post Office Department for cost of handling this free mail.

Registry.—Paid registry mail shows a loss of $3,340,000, or 24.7 percent. It is proposed to increase the fees 33⅓ percent and to provide $4,500,000 additional revenue. Also, no account taken by committee of $4,492,000 loss incurred in free registry services.

Insured mail.—Shows a loss of $1,488,000, or 2.8 percent, and it is proposed to increase insurance fees 100 percent and to provide $6,500,000 additional revenue.

Cash on delivery.—Shows a loss of $4,541,000, or 83.4 percent, and it is proposed to increase cash-on-delivery fees 100 percent.

Special delivery.—Shows a loss of $593,000, or 4.7 percent. No increases proposed.

Money orders.—Show a loss of $6,725,000, or 21.4 percent. It is proposed to increase money-order fees 66⅔ percent and to provide $21,000,000 additional revenue.

To summarize the foregoing:

Where increases are proposed

	Loss (−) or profit (+)	Percent	Percent increase proposed	Additional revenue to be raised
First-class, local	+$25,885,000	32.4	50	$44,000,000
Air mail	−3,091,000	9.3	33⅓	11,000,000
Third class mail	−23,914,000	32.2	100	74,400,000
Fourth class:				
Regular	−9,289,000	6.8	3	4,425,000
Books	−8,620,000	270.6	3	95,000
Total fourth class	+17,909,000	11.8	3	4,520,000
Registry	−3,340,000	24.7	33⅓	4,500,000
Insured	−1,488,000	2.3	100	6,500,000
Cash on delivery	−4,541,000	83.4	100	5,400,000
Money orders	−6,725,000	21.4	66⅔	21,000,000
Total	−83,071,000	13.1	42.4	171,320,000

Where increases are not proposed

	Loss	Percent ratio
Second class	$56,034,000	221.0
Foreign	5,001,000	22.3
Penalty	24,770,000	.....
Free registry	4,942,000	.....
Special delivery	593,000	.....
Total	121,343,000	.....

The committee also failed to take into account that the accuracy of the figures shown in the cost-ascertainment report have been challenged by mail users and public bodies during the past 25 years. One organization, of which we are members, made a study of the formulas used in allocating revenues and expenses to fourth class and it was found by disinterested experts employed, that revenues were understated and expense overstated to the amount of $35,000,000 and that fourth-class mail was actually earning a substantial profit instead of a loss as was reported in the cost-ascertainment report.

Postmaster General Walker before the Subcommittee on Appropriations, House of Representatives, on January 12, 1943, admitted the inaccuracy and unreli-

bility of the data shown in the cost-ascertainment report for rate-making purposes and requested an appropriation for the employment of outside experts to survey the methods and formulas used. Congress granted this appropriation.

In another class of mail it was found that after all expenses were prorated to each class, a deduction of 50 percent was arbitrarily made of the indirect expenses allocated to a certain class of mail, and this amount was reallocated to all other classes of mail, resulting in an understatement of expenses in one class of mail which had received the arbitrary credit, and an overstatement of expenses in all the other classes of mail.

2. Estimate of additional revenues to be raised failed to take into consideration curtailment in volume and revenues that will result if higher rates are adopted.

Exhibit B attached shows how the committee arrived at its estimate of additional revenues to be obtained under the proposed higher rates as shown in the table that appears on page 31 of the committee's report accompanying the revenue bill. 1942 postal revenues as reported in the annual cost-ascertainment report were simply multiplied by the percentage of increase in the proposed rates * * * a straight mathematical extension with no allowance being made for curtailment of volume.

Time does not permit an extensive survey of the mail users affected by the proposed rate increases to determine what curtailments are planned in their mailings should the higher rates be adopted. The Post Office Department through its 15,000 first- and second-class post offices could obtain accurate and comprehensive data by contacting local chambers of commerce, association, and local mailers. However, experience with rate increases in the past has shown that curtailment in volume inevitably follows when rates are abnormally increased.

Two of the most significant instances on record are the following:

1. In 1917 the rate on post cards was raised from 1 to 2 cents, an increase of 100 percent. Prior to the increase, the Post Office Department had been receiving an annual revenue of $20,000,000 from this source. After the increase became effective, revenue dropped to $10,000,000 * * * not only failing to produce the anticipated revenue, but actually cutting the former revenue in half.

2. When the first-class local rate was raised from 2 to 3 cents in 1932, volume dropped from 4,000,000,000 to 2,000,000,000 and the actual revenue was less than before.

Obviously, mail users, when confronted with increases of from 50 to 100 percent in postage costs, will seek to curtail either through elimination or diversion and the volume and revenues of the Post Office Department will suffer. When money-order fees are raised 66⅔ percent, the public will divert to checks; if the minimum cash-on-delivery and money-order fees on a cash-on-delivery transaction are raised from 18 cents to 34 cents, there will be less cash-on-delivery transactions and more cash ones; if third-class rates are raised 100 percent, and that means $30 per $1,000 instead of $15, a high percentage of advertising matter that has been flowing through the mails will be distributed by some other method. In many instances, third-class mailings may be largely or almost totally eliminated because the higher rates will make the results unprofitable.

Curtailment will not only affect third-class mail revenues, but will also result in curtailment of collateral first-class and fourth-class mail, money order, cash-on-delivery, insured, special delivery, and other special services.

Third-class mail is distinctly the businessman's mail service. It is the service that is primarily used for promoting sales. Everything from a 5-pound package of pecans or a jar of honey to the building material required for building a house has and is being sold through third-class mail. It is third-class mail matter that creates first-class letters, parcel-post shipments, money orders, cash-on-delivery transactions, insured mail, and so forth. Any curtailment in third-class volume results in a curtailment in all other classes of mail and service.

One large user of third-class mail who mails out 15,500,000 pieces of third-class matter annually, reports that he spends $222,500 in third-class postage. The mailings sent out produce the following collateral revenues for the Postal Service:

First class	$64,000
Money-order fees	76,700
Fourth class, parcel post	373,000
Total	513,700

Each dollar of third-class postage spent by this mailer produces $2.30 in collateral revenue for the Postal Service.

There is no question but that a substantial curtailment in third-class mailings would also result in a substantial loss of volume and revenues in first class, fourth class, and special services, with the result that actual revenues at the end of the fiscal year for the entire service may be less under the proposed rates than if current rates are allowed to remain.

The accompanying exhibit C has been drawn up from the Post Office Department's annual cost ascertainment reports for the years 1933 to 1942, inclusive, to show the growth in volume and revenues during the past 10 years. We find that the following increases in volume are shown in this period:

	Percent
First class	150
Third class	161
Fourth class	184
Money orders	159

There is a very close parallel in the rate of growth in the volume of these classes. Obviously, the increase in first-class mail from 10,900,000,000 pieces in 1933 to 17,435,555,000 in 1942 does not represent merely an increase in purely social and personal correspondence. It must reflect an increase in general business activity as shown by the figures for third class.

Although the Post Office Department has no data to show the amount of collateral volume and revenues produced by third-class mail, those familiar with the use of the mails for business sales promotion will agree that the collateral contribution of this class of mail to the other classes of mail is substantial. Exactly what this contribution actually amounts to no one knows. We have given the figures supplied by one large user in the foregoing paragraph.

If we assume that the volume of third-class mail will fall off 50 percent, based upon the experience with post cards in 1917 and first-class mail in 1932, there would be a loss of 3,000,000,000 pieces of third-class matter and the amount of third-class revenue would not amount to $1 more than under present rates. In addition to that there are very real possibilities that there will be a substantial falling off in the volume of first class, fourth class, money orders, cash-on-deliveries transactions, etc. The number of pieces of first-class mail average about 2.7 pieces to each piece of third-class mail. A loss of 3,000,000,000 pieces of third-class mail might result in a loss of 8,100,000 000 pieces of first-class mail and a loss in first-class revenue amounting to $228,000,000. That probably is a rather extreme estimate. Adopting a more conservative one, that the volume of first-class mail might drop 25 percent if there were a drop of 50 percent in third-class mail, there would be a loss of 4 000,000,000 pieces of first-class mail and a loss of $114,000 000 in revenues. In addition, there would be losses in fourth class, money orders, cash-on-deliveries, etc. This could easily amount to more than the $171,000,000 additional revenue which the committee hopes to raise through the proposed increases.

3. A dual set of rates—temporary ones adopted now and permanent ones to be adopted within a month or 2, would create a chaotic situation in the Postal Service, as well as with mail users.

The committee in its report suggest the desirability of adjusting rates immediately to be followed by further adjustments within a month or 2 when the Post Office Department makes its report and recommendations and the House Post Office and Post Roads Committee submits recommendations for permanent rates.

The committee surely did not take into account the tremendous tasks imposed upon the Postal Service in changing over to the rates now proposed which are to be superseded again within a month or 2 with an entirely new set of permanent rates, and the chaos and confusion that would result throughout the Postal Service.

It also did not take into account that mailers generally plan and budget their mailings months in advance, and as postage represents such a substantial part of their cost mailers must be able to rely upon rates. They cannot successfully plan according to one set of rates now, which within a month or 2 may be completely changed and of which they have no information at the time of their planning.

To avoid chaos and confusion, the postal rate increases should be stricken from the revenue bill and the Committee on Post Offices and Post Roads should be permitted to take up the subject of rates and make their recommendations for permanent rate adjustments. Hasty action now will result in lost revenues and hurt the taxpayer. Deferment of action for a month or 2, permitting orderly and intelligent adjustment of the rates, will produce more revenue, help Government financing, help the taxpayer, and help business.

EXHIBIT A.—*Relation of proposed increases to losses and gains in operations of Postal Service*

	Loss	Gain	Loss	Gain	Proposed increase	Estimated additional revenues
			Percent	*Percent*	*Percent*	
First class:						
Other than local		$140,182,000		37.8		
Local		25,853,000		29.4	50	$44,000,000
Air mail	$3,091,000		9.3		33⅓	11,000,000
Total		162,976,883		33.06	33.7	55,000,000
Second class:						
Exempt from zone rates	15,745,000			708.6		
Newspaper:						
Daily	26,425,000			302.9		
Others	12,691,000			296.6		
Other publication	34,623,000			243.1		
Free in county	6,859,000					
Total, publications second class	86,345,000			345.4		
Transient		310,000			19.38	
Total	86,034,000			351		
Third class	23,954,000		32.2		100	74,400,000
Fourth class:						
Reg. parcel post	9,289,000		6.3		3	4,425,000
Books	8,620,000		270.6		3	96,000
Total	17,909,000		11.8		3	4,520,000
Foreign	5,001,000		23.3			
Penalty	24,770,000					
Registry:						
Paid	3,340,000		24.7		33⅓	4,500,000
Free	4,942,000					
Total	8,283,000		61.2		33⅓	4,500,000
Insured	1,488,000		2.3		100	6,500,000
Collect on delivery	4,641,000		83.4		100	8,400,000
Special delivery	596,000		4.7			
Money orders	6,725,000		21.4		66⅔	21,000,000
Postal savings		4,333,000		45.6		
Total	11,835,000		1.36		1452	171,320,000

EXHIBIT B.—*How estimated additional revenues under proposed rates were calculated*

	1942 revenue	Increase in rate	Additional revenue	Committee's estimate
		Percent		
First-class	$88,056,000	50	$44,028,000	$44,000,000
Local				
Air mail	33,417,000	33⅓	11,139,000	11,000,000
Third-class	74,378,000	100	74,378,000	74,400,000
Money orders	31,469,000	66⅔	21,113,666	21,000,000
Registered mail	13,540,000	33⅓	4,453,000	4,500,000
Insured mail	6,521,000	100	6,521,000	6,500,000
Collect-on-delivery mail	8,447,000	100	8,447,000	8,400,000
Total			167,120,666	166,600,000
Fourth-class	156,736,000	3	4,522,080	4,500,000
			171,642,746	171,300,000

EXHIBIT C.—*Number of pieces and revenues from first-, third-, fourth-class, and money orders, 1933–42*

	First-class		Third-class		Fourth-class		Money order	
	Pieces	Revenues	Pieces	Revenues	Pieces	Revenues	Pieces	Revenues
1933	10,938,000,000	338,457,000	3,753,000,000	50,926,000	530,090,000	100,236,000	172,626,000	16,447,000
1934	11,613,000,000	331,213,000	3,612,000,000	50,146,000	530,839,000	101,904,000	199,514,000	18,845,000
1935	12,498,000,000	350,338,000	4,029,000,000	54,729,000	572,738,000	112,054,000	214,200,000	20,358,000
1936	12,731,000,000	365,112,000	4,674,000,000	62,974,000	617,790,000	121,511,000	229,397,000	21,833,000
1937	14,049,000,000	394,655,000	5,355,000,000	71,778,000	684,531,000	132,206,000	247,324,000	23,678,000
1938	14,433,000,000	404,543,000	5,272,000,000	71,283,000	670,323,000	129,420,000	249,230,000	23,841,000
1939	14,878,000,000	416,794,000	5,178,000,000	70,163,000	677,925,000	132,110,000	261,283,000	23,773,000
1940	15,433,000,000	432,196,000	5,550,000,000	75,105,000	683,403,000	131,194,000	285,442,000	24,425,000
1941	16,312,000,000	456,128,000	6,070,000,000	82,964,000	710,186,000	139,267,000	273,935,000	26,249,000
1942	17,435,000,000	492,885,000	5,429,000,000	74,878,000	745,510,000	147,551,000	316,611,000	31,409,000

	Units	Revenues	Expenditures	Loss	Gain	Percent loss to revenue	Percent ratio gain to loss
First class:							
Other than local	12,730,000,000	$371,412,000	$231,229,000		$140,182,000		37.8
Local	4,241,000,000	88,066,000	62,170,000		25,895,000		29.4
Air mail	463,234,000	33,417,000	36,508,000	83,091,000		9.3	
Total	17,435,000,000	492,885,000	329,908,000		162,976,883		33.06
Second class:							
Exempt from zone rates	850,763,000	2,222,000	17,967,000	15,745,000		708.6	
Newspaper:							
Daily	1,678,154,000	8,526,000	34,951,000	26,425,000		309.9	
Others	760,782,000	4,293,000	16,955,000	12,661,000		295.6	
All other public	1,232,731,000	10,126,000	34,750,000	24,623,000		243.1	
Free in county			6,859,000	6,859,000			
Total publications	4,822,391,000	25,108,000	112,813,000	86,345,000		343.4	
Transient	48,649,000	1,635,000	1,314,000		310,000		19.36
Total, second-class	4,577,040,000	26,763,000	112,828,000	86,034,000		321.	
Third class	5,434,559,000	74,378,000	98,332,000	23,954,000		32.2	
Fourth class:							
Reg. parcel post	745,810,000	147,550,000	155,839,000	9,289,000		6.3	
Books	33,348,000	3,185,000	11,806,000	8,620,000		270.6	
Total	778,859,000	150,736,000	168,646,000	17,909,000		11.8	
Foreign	174,793,000	21,408,000	26,410,000	5,001,000		23.3	
Penalty:							
Post Office and Government	1,696,534,000		23,607,000	23,607,000			
Franked	24,460,000		974,000	974,000			
Free for blind	1,829,000		188,000	188,000			
Total			23,770,000	24,770,000			
Total, all classes mail	30,117,633,000	766,202,000	760,896,000		5,305,000		.72

SPECIAL SERVICES

	Units	Revenue	Expense	Loss	Gain	Ratio loss to revenue	Ratio gain to revenue
Registry:						*Percent*	*Percent*
Paid	58, 490, 000	$13, 540, 000	$16, 880, 000	$3, 340, 000		24.7	
Free	17, 126, 000		4, 942, 00	4, 942, 000			
Total	75, 616, 000	13, 540, 000	21, 823, 000	8, 283, 507		61.2	
Insurance	92, 657, 000	6, 521, 000	8, 009, 000	1, 488, 000		2.3	
Collect-on-delivery	39, 142, 000	5, 447, 000	9, 988, 000	4, 541, 000		83.4	
Special delivery	115, 654, 000	12, 854, 000	13, 450, 000	596, 000		4.7	
Money orders	316, 611, 000	31, 466, 000	38, 194, 098	6, 725, 000		21.4	
Postal savings	2, 812, 000	9, 451, 000	5, 119, 000		$4, 333, 000		45.6
Total		79, 283, 000	96, 586, 000	17, 303, 000		21.6	
Unassignable		15, 466, 000	12, 017, 000		3, 358, 000		22.5
Total postal services		866, 656, 000	878, 492, 000	11, 835, 000		1.36	

TELEGRAM FROM ASSOCIATED BUSINESS INTERESTS OF DETROIT, MICH.

[Western Union]

ZA 321 285 1/144/18

DETROIT, MICH., *30—5: 33 p. m.*

NATIONAL COUNCIL ON BUSINESS MAIL (THOMAS QUINN BEESLEY),
Washington Representative,
Second National Bank Building, Washington, D. C.

Points on postage rates:

1. The Postal Service of the character of a public utility, owned and operated by, and for the convenience of all the people, and as such is not properly as subject for revenue-producing taxation.

2. Moreover, no revision of postal rates should be authorized by any branch of the Government without thorough analysis and review on the part of postal authorities.

3. Doubling third-class rates will (in practice) actually defeat the very purpose intended or desired, because it will so greatly decrease the volume-use of the service. (The record of previous similar experiments will furnish ample and convincing proof.)

4. Reduction or elimination of third-class volume will greatly and seriously affect thousands of small businesses dependent, in large measure (often exclusively) on third-class mail, and who, in turn, pay millions in taxes in some other forms.

5. Reduction or elimination of third-class volume will have ruinous effect on the major business activity of thousands of direct-mail-service companies, printers, lithographers, etc., from whom, also, millions in taxes are now being collected.

6. Free use of third-class mail is actually the basis of much of the revenue derived from other classes of Postal Service money orders (and the first-class mailings in which are enclosed) C. O. D. and registered mail, parcel post, etc., all of which would similarly decline in volume along with the volume decline of third-class use.

7. Maintenance of third-class volume is essential to the efficient and economical operation of the "mechanics" of the Postal Service, employment and employee earnings.

Adcraft Club of Detroit, Retail Merchants' Association of Detroit, Typothetae Franklin Association, Detroit, Photo Engravers' Association, Employing Lithographer Association, Master Bookbinders' Association.

TEXT OF ADVERTISEMENT IN WASHINGTON (D. C.) POST, DECEMBER 1, 1943

ESSENTIAL MAIL SERVICE IS NOT A PROPER CHANNEL OF TAXATION

The House of Representatives has passed a tax bill including a surprising provision for drastic taxes on the services rendered the people of the United States by our efficient and well-managed Post Office Department.

No one experienced in postal affairs can understand the proposed increases in postal rates.

No tax is levied by the pending bill on the class of mail carried at the greatest loss. Taxes on other classes of mail range from 3 to 50 to 100 percent.

The 100 percent tax is levied on printed matter (third-class) upon which American business depends to convey information and prices to prospective buyers. This means of communication is of special importance at a time when salesmen's travel is practically prohibited by limited railroad facilities and rationing of gasoline.

Doubling the rates on third-class mail will put many smaller concerns out of business.

Money paid by the larger companies in the drastically increased rates will come almost wholly out of excess profits taxes—out of one Government pocket into another—but with a serious hazard to civilian economy.

The only taxes which tap new money—instead of decreasing other tax revenue—are those levied on purchases by individuals, such as the taxes on, liquor, cosmetics, tobacco, and so forth.

The bracket the essential mail service with these luxury items is obviously unsound.

The Postal Service is an essential public utility. It was established to promote interchange of information and opinion between citizens at the lowest possible cost. This policy should not be scrapped.

In view of turn-backs from war appropriations, postal facilities offered to citizens should not now be crippled by doubled or radically increased rates.

Furthermore the proposed increases in postal rates while they will play hob with business, will not raise the expected revenue. We cite two instances:

1. In 1917 the penny post-card rate was increased to 2 cents. Prior to the increase the Post Office Department had been receiving an average annual revenue of $20,000,000,000 from this source. After the raise became effective, revenue fell to $10,000,000,000 a year, not only failing to produce the anticipated increase, but actually cutting the former revenue in half.

2. When in 1932 the first-class local letter rate was increased from 2 to 3 cents, the volume dropped from 4 billion pieces to 2 billion and revenue also was less than before the increase. It required 10 years to retore the volume to its 1932 figure.

The two-thirds increase in money order fees will result in more remittances by check, private money orders, or (worst of all) by postage stamps or currency.

Increased rates on insured mail, together with the tax on parcel post, will result in more shipments sent by express.

No authorities on postal rates or practices have been consulted on the proposed rate increases. The House Committee on Post Offices and Post Roads, some members of which have devoted years of study to postal problems, has been completely ignored with respect to the pending proposals.

The postal rate structure is a delicate one, requiring thoughtful and expert revision. No service is more vital to the varied activities of our citizens.

Every citizen is willing to pay his proper share of taxes. But we have not as yet heard of any taxes of 100 percent on services. Until such a percentage of tax is levied on all services, it should not be levied on the mail service, artery of the Nation's bloodstream.

Only a few months ago the Congress ordered a study of postal rates, the findings to be reported by January 1. Why, therefore, this premature, and inadvised action on mail rates?

The proposals for increasing postal rates should be deleted from the general tax bill, and referred for consideration to the Senate and House Committees on Post Offices and Post Roads which know postal needs intimately.

To levy a confiscatory tax of 100 percent on an essential service, without hearings or public discussion, is not a democratic procedure.

We urge Members of the Senate to give careful—not hasty—consideration to these proposals and base their action on knowledge and experience.

NATIONAL COUNCIL ON BUSINESS MAIL, INC.
105 West Monroe Street, Chicago 3, Ill.

E. H. Bevers, Scranton, Pa.; Charles A. Bethge, Chicago, Ill.; Homer Buckley, Chicago, Ill.; David Burpee, Philadelphia; Arthur C. Davis, Gloucester, Mass.; A. R. Erskine, Memphis, Tenn.; George W. Hall, Los Angeles, Calif.; A. B. Hirschfeld, Denver, Colo.; Arnett W. Leslie, Minneapolis, Minn.; R. N. McArthur, Atlanta, Ga.; Frank McCaffrey, Seattle, Wash.; Douglas G. McMurtrie, Chicago, Ill.; C. B. Mills, Marysville, Ohio.; James M. Mosley, Boston, Mass.; Dr. Frank B. Robinson, Moscow, Idaho; L. E. Stacy, Niagara Falls, N. Y.; Roscoe C. Wadsworth, Indianapolis, Ind.; Mrs. May O. Vander Pyl, Detroit, Mich., (Committee).

STATEMENT OF HOMER J. BUCKLEY, REPRESENTING THE NATIONAL CONFERENCE, SMALLER BUSINESS ASSOCIATIONS

Mr. BUCKLEY. My name is Homer J. Buckley, and I represent the National Conference, Smaller Business Associations, whose offices are located at 407 South Dearborn Street, Chicago, Ill.

Our members are greatly concerned regarding the proposed sections of the new tax bill relating to postage increases for third-class mail.

In a release issued by the Post Office Department on November 28, 1943, Postmaster General Walker gives the following interesting information concerning postal revenue:

For the first time in history postal revenues for a 12-month period have now exceeded $1,000,000,000. The revenues for the 12 months ending September 30 were $1,006,000,000. During the same period expenditures were $994,000,000, resulting in a $12,000,000 surplus of revenues over expenditures.

This excess of revenues for the 12 months resulted despite the payment of more than $60,000,000 in increased salaries to postal employees. Under new legislation, the handling of vast volumes of mail free for Government agencies and members of the armed forces, and increases in contract rates for transportation of mails in the star route, mail messenger, and motor-vehicle services.

In view of this report, certainly there is no justification for considering postal rate increases on the basis of postal revenue deficiencies.

This statement proves conclusively that the answer to profitable operations of the Post Office Department is increasing volume, and not increasing rates.

There has been a great deal of confusion in the minds of the smaller businessmen of the country due to press dispatches reporting postal increases being eliminated in the tax bill. This has been due to the fact that the Ways and Means Committee of the House did eliminate second-class rates from any increase, and the public is not aware of the fact that third-class mail is being penalized 100 percent.

Third-class mail represents catalogs, booklets, broadsides, and merchandising price lists issued regularly by business houses, small and large, throughout the Nation. The Smaller Businessmen's Conference believes that the proposed increase in third-class mail is economically unsound, and will not bring forth the anticipated revenue which the House Ways and Means Committee has indicated.

The increase in third-class mail will result in either one or two things happening, which will reduce volume to the post office and defeat the objectives anticipated in the tax revenue bill:

1. Business houses will of necessity be required to reduce circulation. Where a firm might regularly issue 100,000 catalogs, they will be forced to curtail the mailings to 50,000, or

2. Business firms will be compelled by necessity to reduce the page size or the number of pages in the catalogs.

A business firm that normally budgets $10,000 per year for third-class postage, for mailing catalogs, and merchandising price lists cannot automatically increase its postage budget to $20,000, without seriously affecting the costs of doing business, and under price ceilings, cannot increase selling prices. The result will be a curtailment in the distribution of catalogs and the anticipated revenue will not be forthcoming.

Third-class mail is the businessman's mail. It is the salesman of his business. It would be a fallacy to put a tax on salesmen of any business. The post Office and Post Roads Committees of both the House and Senate, knowing from their studies what the economics of postal rates really are, would not, I am sure, arbitrarily approve 100 percent increase in third-class mail rates.

It is our greatest recommendation that section 403 of the tax bill be deleted, and referred to the Post Office and Post Roads Committee for consideration and recommendation. Then, if the Congress feels the necessity for increasing rates, let the proposal come in a separate bill and on a scientific basis that will not be destructive to the smaller business firms of the Nation.

The CHAIRMAN. Mr. Ribble.

STATEMENT OF JOHN RIBBLE, REPRESENTING THE BOARD OF CHRISTIAN EDUCATION OF THE PRESBYTERIAN CHURCH

Mr. RIBBLE. May I have less than 5 minutes, Mr. Chairman?

The CHAIRMAN. Yes. I was going to ask you to be as brief as possible.

Mr. RIBBLE. My name is John Ribble, Presbyterian Board of Christian Education, Witherspoon Building, Philadelphia.

The Protestant church-owned publishing houses are associated together in the Publishers Section International Council of Religious Education, and it is this organization which I am representing in expressing this concern.

Generations ago the Congress established second-class mail rates as a special classification in order that periodically published reading matter might be more widely distributed to the people. In 1917 the Congress went further by establishing within the second class a preferential rate for religious, scientific, and other periodical matter published by nonprofit organizations, that is, organizations whose profits, if any, did not inure to the benefit of private stockholders.

The publishing enterprise of the Protestant church-owned publishing houses has been based largely upon this preferential consideration by the Congress. The price structure for Sunday-school lessons and other church periodicals has been based upon the special postage rate of 1½ cents a pound.

Any considerable change in this postage-rate structure would reflect itself in immediate increases in prices of the publications which Sunday schools and churches require of their publishing houses. But equally important is the fact that major changes in such postage rates would

go far toward nullifying the original intent of the Congress in the establishment of preferential rates. It could be expected that price increases in Sunday-school publications would reflect themselves in decreased use of these materials. The contributions by Sunday-school pupils are very modest. The average Sunday school is attended by about 100 pupils and is located in a rural area.

It is our understanding that the provision for increases in second-class postage rates applicable to religious publications was struck out of the revenue bill for 1943 by the House Ways and Means Committee. However, this matter is of such vital concern, that the church-owned publishing houses have asked me to convey to you the sincere hope that this provision will not be restored by the Senate Finance Committee before the bill is reported out.

The CHAIRMAN. Thank you.

Mr. Howard Korman.

STATEMENT OF HOWARD KORMAN, REPRESENTING THE DIRECT MAIL ADVERTISING ASSOCIATION

Mr. KORMAN. Mr. Chairman, my name is Howard Korman, I represent the Direct Mail Advertising Association, with headquarters in New York. We have taken seriously your suggestion as to consolidation and I am also representing, in a sense, five other associations; the Mail Order Association, the Lithographers Association, the National Paper Trades, and the Advertising Federation of America, who have read our brief and who have approved of it.

We are interested in postal rates generally. Postage rates now in existence are the basis on which our industry, which is an industry doing an annual business of $600,000,000, was born, has lived, and may die.

We are primarily interested in third-class rates, money orders, and c. o. d. mail, for these rates are our bread and butter, but, because all post-office rates are interrelated, any change in any postal rate without careful consideration of its effect on all other rates is, in our opinion, a dangerous and unprecedented step.

The Post Office Department has a monopoly on only one class of mail, first-class mail. In one way or another all other rates act as feeders to the first-class rate. But—and, in our opinion, this is a mighty important but—every one of these feeder rates is subject to intense competition from identical services in private industry.

Up to now all the feeder rates have been slightly less than those offered by private competition for equivalent services. And that's not strange when you consider the fact that the Post Office Department does have the monopoly on first-class mail.

If private industry is capable of competing on a profitable basis with the post office without the cushion of a monopoly on the profitable end of the business, can't you imagine and appreciate the fact that, if all these post-office feeder rates are increased to the point where they exceed those of private industry, the Post Office Department will lose out, not only on the feeder-rate revenue, but on the highly profitable first-class revenue as well.

We would like to remind the committee that while every so-called luxury industry, liquor, beer, wine, fur, luggage, theatrical, and so on, was invited to and did present their views in hearings held in camera

by the House Ways and Means Committee, our industry from whom they expected to collect 70 percent of the additional postal revenue was not permitted a hearing and did not even learn that hearings had been granted until after the bill had passed through the House.

Apart from the statements I am about to make, there are certain letters and excerpts from letters and reports which I should like to make a part of this record with the thought that they may be studied by your committee and its members at a more convenient time.

Additional postal revenue expected to be $166,800,000. The amount that is expected from this source may be a possibility but it is our opinion that it is more theoretical than practical. In the case of large business organizations having substantial incomes and therefore subject to large income and excess-profits taxes, up to 97 percent of their additional postage expenditure would come out of their income-tax funds thus reducing one tax in order to pay another; whereas, companies with reasonable profits—or losses—and nonprofit organizations might probably, for economic reasons which I will outline in this brief, curtail their use of the mails and decrease their postal expenditures rather than increase them.

FIRST-CLASS MATTER TO RAISE $44,000,000

While first-class mail has been considered, and in the last war was used, as a source of additional revenue, it is likely the proposed increase in local delivery rates for letter mail from 2 to 3 cents will produce a situation in many large cities from which the bulk of this income is derived whereby department stores, telephone companies, electric light companies, and many other substantial users of the mails will discontinue sending out bills each month and revert to the practice of sending them out every second month, or of sending them out by hand, that is, through their own organizations.

There is also the possiblity that a substantial number of private users of the mails will resort to the telephone which is already overworked, because the combined cost of envelope, paper, and stamp, in many cases, would exceed the cost of a local telephone call.

Finally, to look at the record, in July 1932, the Greater Boston Post Office due to the increase in first-class rates expected an increase of 50 percent in revenue or $1,720,081. Instead, the revenue dropped $400,000.

Air mail expected to raise $11,000,000.

The policy of the Post Office Department in sponsoring air mail has been and can be one of the greatest influences in sustaining our air forces for war and for peace. Each succeeding reduction in air mail postal rates seems to have been followed by an increase in the popularity and use of the Air Mail Service. Thus, it would appear, that the closer the air-mail rate can be kept to the first-class rate, the easier it will be to maintain a substantial part of our aviation industry when the war is won.

In second-class matter no increase is projected.

The rate of postage on second-class mail has been the subject matter of a number of extended investigations and thus far no method of changing rates has been suggested which would be aceptable to all concerned. However, it may be interesting to note that the accumulated excess of apportioned expenditures over revenue for the past 10 years amounts to $864,023,433.32.

Third-class matter is to raise $74,400,000.

The third-class rate, which deals in the main with circulars, is probably the most misunderstood rate in the entire postal rate structure. It is also the main source of business for a $600,000,000 industry with some 15,000 participants. When that statement is analyzed, you will understand that this rate is used in the main by small organizations, Bible societies, missionary societies, schools of all kinds—all of which depend on the pulling power of third-class mail for their contributions. The competition between business organizations using third-class mail is so great that it is our considered opinion that the net profit per thousand circulars mailed before income taxes is considerably less than the proposed increase on this class of mail of a minimum of $10 per thousand pieces mailed.

In this connection, we have had many letters from our members whose mailing operations account for approximately 10 percent of the entire third-class volume. These letters indicate that most of the concerns who depend on third-class mail may be forced to substitute house-to-house distribution for third-class mailings. It is interesting to note that some types of house-to-house distribution by private organizations may be purchased for less than present third-class rates. However, with the proposed increase in third-class rates, the comparable service will be approximately 40 percent less than the then existing rates. The other concerns, usually the larger ones, those spending from $50,000 to $300,000 a year on third-class postage, although they, too, will, where possible, use house-to-house distribution, may curtail their activity in this class of mail by as much as from 50 to 75 percent; and, where they can, substitute magazine, newspaper, and radio advertising.

Since it appears to have been necessary to strike out any increase in second-class matter as a source of additional revenue, the net effect of such a switch will be to further increase the present excess of apportioned expenditures over revenue in second-class matter.

Again looking at the record in 1917 the penny post-card rate was increased from 1 to 2 cents. The revenue from this 1-cent rate was about $20,000,000 a year but after the increase the revenue fell off almost one-half and instead of increasing revenue a decrease of almost $10,000,000 resulted.

Summing up, then, with regard to third-class matter, it is our opinion that any increase in this rate will be followed by an actual reduction in the use of this service by all types of mailers; and that instead of the $75,400,000 increased revenue, there will be an actual reduction of upward of 25 percent, or about $20,000,000, in the present revenue. It is our opinion that, since third-class mail is used largely in competition with the advertising sections of newspapers and magazines, it should receive similar consideration.

Fourth-class matter to increase $4,500,000.

While the language of the House bill having to do with the proposed increase in parcel-post rates is not clear, the intention is to collect $4,500,000 additional revenue from this source. It is important to note that the average transportation charge for parcel-post shipments is around 19 cents. Therefore, the great majority of shipments handled must average less than 15 cents each on which a tax rate of 3 percent amounts to less than one-half of 1 cent per

shipment. If the intention is to exact a tax of 1 cent as a minimum, then the rate for millions of shipments amounts not to 3 percent, but rather to an average of 6 percent, and normally will run from 10 to 16 percent.

Nearly 1,000,000 postal money orders are issued every working day. This service is used largely by the workingman and the farmer. The average remittance is $9.84 at a present cost of 10 cents. Increasing this rate by 67 percent in order to obtain additional revenue would, in our opinion, result in the transfer of more than half of the present business to banks and express companies whose rates remaining static will be considerably less than the rates voted by the House of Representatives. Unfortunately, in the case of outlying districts not covered by the express companies or the banks, the farmer would either have to accept the higher rate or send currency remittances through the mails, the latter a practice long discouraged by the Post Office Department.

However, even if the farmer does continue to use the money-order system, the urban workingman will undoubtedly use the less expensive competitive service and the post-office revenue instead of being increased will be decreased.

COLLECT ON DELIVERY EXPECTED TO BRING $5,400,000

This service is largely used by the public in cases where credit relations have not been established with the seller. Millions of these transactions are for $1 and $2 each.

The proposed c. o. d. fee increase means a new minimum rate of 24 cents which, when added to the proposed minimum money-order fee of 10 cents, makes a total of 34 cents in service charges for these small remittances compared to 24 cents, the present charge of the Railway Express Agency for identical service. Here again, it would be the farmer, woodcutter, and the miner in the outlying districts who would be chiefly hurt by the fact that he could take it or leave it as far as the Post Office Department is concerned. It is our opinion that the bulk of the city patrons of the Post Office Department using the c. o. d. service would promptly switch to the express company.

In all likelihood, this type of business would be considerably reduced insofar as the Post Office Department is concerned. It might even disappear altogether and with it the present considerable income of $31,000,000 annually.

Registered mail to raise $4,500,000 and insured mail, $6,500,000.

The total amount of additional revenue expected from these two sources, $11,000,000, while it is a substantial sum, is a small portion of the total expected increase in postal revenue.

Both of these services of the Post Office Department are in a highly competitive field with the present postal rates slightly lower than the competition's. However, in many cases, these postal services do serve areas where there are fewer express companies and fewer opportunities for private insurance of individual package mail.

In each of these classifications, special divisions, routines, and forms are in use in nearly 50,000 post offices and branches. All the routines and forms would have to be revised. Employees would have to be reeducated. Transactions not consummated as of the

effective date of any new regulations might become the source of endless confusion within and without the Post Office Department.

Large quantities of paper, forms, applications, and so forth, would have to be destroyed and replaced; and, while some additional revenue could be forced from the less favored patrons of these branches of Postal Service, it is unlikely that the net amount would offset the additional internal costs.

Gentlemen, there's only one thing to be done in this matter: We recommend that the entire question be referred to the respective Post Office Committees of the House and the Senate. We are confident that they, in conjunction with the Post Office Department, can set up a slightly different rate structure—but a rate structure based on sound economics—and with due consideration given to the fact that the Post Office Department is one of the most amazing business organizations in the world.

Thirty billion transactions handled at a cost so fine that a change in the average cost of handling each transaction of the tiny sum of one-one hundredth part of a cent per transaction means a difference of $3,000,000.

Thank you gentlemen.

I am filing with the committee various letters on this subject.

The CHAIRMAN. Thank you, sir.

STATEMENT OF M. J. FLYNN, REPRESENTING THE INTERNATIONAL ALLIED PRINTING TRADES ASSOCIATION

Mr. FLYNN. The International Allied Printing Trades Association, comprising the 5 international unions in the printing industry, with more than 200,000 skilled printing-trades workers, 4 of which organizations are affiliated with the American Federation of Labor, are very much opposed to the proposed taxes levied in the form of increased postal rates in the pending tax bill. We believe, as some of the previous speakers have said, that with the Congress having provided the money for a cost ascertainment, that a study should be made before the rates are increased. It is something like 20 years since a study was made. As we see it, the Post Office is now operated at a profit. The loss is occasioned by the charge to the Post Office of the penalty mail, which it credits to itself as having received, although no money passes.

The report of the Postmaster General, which I understand will be out shortly, will show that for 1943 the Post Office charged or credited itself with $119,000,000 for the distribution of Government penalty mail. That is outside of the franked mail of the Congress.

Ten years ago the cost to the Post Office Department for the handling and distribution of mail issued by governmental departments and agencies was around $9,000,000, and, using some 21,000 tons of paper. In addition to the increase in cost of handling and distributing this "penalty" mail from $9,000,000 in 1933 to $119,000,000 in 1943, the waste of paper has increased from 21,000 tons of paper in 1933 to 147,000 tons of paper in 1943.

If the Post Office should charge, as it should, for much of that mail, there wouldn't be any deficit in the Post Office. We believe with the cost ascertainment study now going on, we believe believe penalty mat-

ter should pay its share, and we don't believe the Government should tax the transportation of mails for a profit.

We would greatly appreciate a reference of the whole matter to the Post Office and Post Roads Committee. Incidentally, since the matter has been touched on by others, the Post Office and Post Roads Committee did send a committee of five of its members to the House Ways and Means Committee protesting the usurpation of the prerogatives of that committee. We understand the division in the committee was very, very close, and we think it would be to the best interests of all concerned if the matter was referred to the Post Office and Post Roads Committee.

The CHAIRMAN. Thank you very much, Mr. Flynn.

STATEMENT OF R. R. LIVINGSTON, STATE PRESIDENT, NEBRASKA THEATER ASSOCIATION

Mr. LIVINGSTON. Mr. Chairman and members of the Senate Finance Committee, I am appearing here today at my own request and upon permission having been granted by your committee. I appear in the interest of the small-town theaters and as State president of the Nebraska Theater Association.

In opening, let me state briefly, that we small-town theater owners are only too happy to assist our Government in this time of emergency and thus far, we have demonstrated our patriotism in this regard. I think you members of the committee will agree that we have advertised and assisted in scrap drives; we have advertised and assisted in the sale of War bonds; we have run war activity pictures; and in addition to these activities, we have assisted the Red Cross and other philanthropic organizations whose activities have been increased because of this emergency.

Not one of you men, I know, need to be reminded of the great assistance which small-town theaters have furnished to the Government in scrap drives; and no member of this committee can help but be aware of the fine work that country and small-town theaters have done in advancing and advocating the sale of War bonds.

We have been aware in this period of emergency of the need for placing people in the right frame of mind insofar as this particular time is concerned and motion pictures have contributed no small part to the efforts along those lines. The assistance which our industry has rendered to the Red Cross and other similar organizations is well known. I need not mention that our industry is probably the greatest means of advertising and of putting over an idea to the people, than any other method which is used, because we have something which our patrons cannot only hear but also can visualize.

It has been said that if this tax is passed, many of these small town theaters will close and it might be that this tax will result in the closing of some such theaters; but in the main, these theaters will continue to operate and will pass on the tax to the patron. Now, such procedure is not particularly important in the larger towns and cities, having defense activities and war plants, because in those towns, the patron has more money now than he has had in the past and he is willing to pay the price; however, in those towns which have not received such tem-

porary blessings, this tax will hurt; it will be passed on to the patron; and will have to be paid by the man who is not now benefiting from war activities.

Take our Nebraska farmer for an example; this man has no more money available than he had years ago and you are going to force him to pay the tax. He may get more money for his grain and his corn, and his beef, and other produce, but the cost of production has increased to the point where he has limited much of his previous operations. Manpower costs more; feed costs more. In fact, everything this man buys has gone up tremendously and his profit margin is narrower than ever before. Cattle feeders are not putting cattle in the pens any longer in Nebraska; farmers cannot farm their acreage in Nebraska because they have no implements nor manpower; thus it is that they have no increased profits. This is the man that you are going to penalize, not particularly the members of my association, and this Nebraska farmer is the man who should be protected at this time. Of course, the additional tax will affect the members of my association in less paid admissions, which will result in a narrower profit margin, and their incomes will thus be lessened.

In closing, let me say that I am not opposed to luxury taxes, provided such taxes are not ruinous and provided such taxes do not injure individuals who can ill afford at this time to be injured. Our Nebraska farmer has received no profit from this war emergency and should not be forced to pay this tax.

In our State, we have but two towns, namely, Omaha and Lincoln, which exceed 20,000 in population and we have many little country towns at the crossroads that are going to be penalized by this method of tax provision.

Thus, according to my way of thinking, this tax provision as now written will (1) close some small-town theaters, (2) lessen attendance at all theaters, (3) deprive the Nebraska farmer of normal entertainment, (4) lessen the income of theater owners, and (5) put the tax on the Nebraska farmer who can ill afford to pay.

In conclusion, let me state that a short time ago, the Senate passed a bill to pay the newspapers of this country $15,000,000 for War bond advertising, but the bill did not include the radio, the periodicals, outdoor advertising, or the theaters, and no industry is more entitled to be paid for War bond advertising than the theaters.

If the newspapers are entitled to be paid for advertising, why, then, cannot the theaters be paid for the war work that they have done? Frankly, we do not want to be paid. We are patriotic and we are only too happy to add our bit; but no agency or line of activity has contributed more to the war effort in this period of emergency than our industry and I respectfully petition this committee and respectfully request that serious thought be given by this committee to our request that this tax provision in the tax law be eliminated, or if that cannot be done, then, that the tax be fixed on a more equitable basis.

In regard to the latter may I suggest a flat 20 percent tax on every 5 cents charged for admission. In other words 1 cent tax on every nickel. This would be more fair and equitable than the present tax and bring to the Government, I believe, approximately the same amount in tax income as the present tax.

The CHAIRMAN. Mr. Crawley.

STATEMENT OF JOHN J. CRAWLEY, PRESIDENT, WILLIAM H. WISE & CO.

Mr. CRAWLEY. Mr. Chairman and members of the committee, I wish to bring to your attention certain facts which have to do with the affairs of William H. Wise & Co., Inc., book publishing concern with offices in New York City. As president of the company, it has been my job to become thoroughly familiar with postal rates, as they are the lifeblood of our business. With this background, I may be qualified to state my conviction that the $166,000,000 of additional revenue expected from postal rates and more particularly that part of it—$74,000,000 expected from third-class rates—is a myth.

I state as my conviction that doubling these rates will actually produce less revenue than the present rates.

As you gentlemen have learned, nobody in the direct mail group had an opportunity to present the views of our industry to the House Ways and Means Committee during the conduct of its public hearings on this measure. While the explanation of that is simple, the results are terrific. I suppose the reason we did not present our views to the Ways and Means Committee was because postage as a potential source of additional revenue was not included in the original proposals of the Treasury Department. The Ways and Means Committee began hearings on October 4 and all kinds of industries had the opportunity of presenting their views. Public hearings were closed on October 20, presumably after everyone interested had had a chance to voice his opinion. Insofar as I have been able to determine, it was not until after the Ways and Means Committee had retired to executive session that consideration was given to the prospect of increasing postal rates. In any event, the first information we had on the subject was from a newspaper report which announced that newspapers were exempt from any increases.

I would like to state the problem of our company, which I believe to be similar in many respects to thousands of other concerns throughout the country.

Our company publishes a line of self-educational books and pamphlets covering many subjects, and without going into details of the numerous titles I can make a point by quoting from a letter received from the War Manpower Commission:

> Eighty-eight percent of the total activities of William H. Wise & Co. and associated enterprises is devoted to the publication of scientific, professional, and technical publications. Consequently William H. Wise & Co. is interpreted as being in an essential activity.

We mail about 50,000,000 pieces of mail each year, most of it under the third-class rate. A typical advertising outfit such as we mail is an enveloped circular on which the postal rate is 1 cent apiece, or a maximum of 1⅓ ounces—commonly known as the 12-cent-a-pound rate. In addition, we are substantial users of newspaper and magazine space, as well as radio time.

Our company with 500 employees has built its business around the third-class postal provisions. On the basis of last year's figures, the all-around increase in postal rates would have resulted in a net operating loss to us of nearly half a million dollars and—insolvency. Of course, we would not have continued on that basis, and by the same

token the Post Office Department would not have received any $900,000 in postal revenues, our over-all postal expenditures for last year.

With our annual volume of nearly 5,000,000 first-class mail remittances and well over one and one-half million business reply returns, we can demonstrate that the profit on first-class mail generated by our own mailings exceeds the loss, if any, on third-class mail. (Consideration is given here to the fact that there are two third-class bulk mailing rates—8 cents a pound and 12 cents a pound. We and the great majority of mailers pay the post office for circularizing at the rate of 12 cents per pound.)

The use of circulars to reach customers is analogous in every respect to the use of salesmen who make personal calls on the prospect. Indeed, our business grew out of just such a sales organization. Mail-order selling organizations—and this includes thousands of institutions, charitable organizations, Red Cross chapters, and political organizations, who make their solicitations by mail—could no more operate successfully under a 100-percent increase in postal rates than could an organization employing salesmen afford to double commission rates.

It may be that the Ways and Means Committee has felt that raising the third-class postal rates would decrease the amount of circularizing and thereby aid in the wartime conservation of paper. May we submit that the net effect of forcing us out of circularizing would be to increase our appropriations for newspaper and magazine advertising, eventually making us entirely dependent on these media. Our statistics show that it takes twice as much paper, pound for pound, to produce an order from a magazine or a newspaper than it does from a circularizing effort.

Furthermore, increasing our use of magazines and newspapers would only further increase the so-called deficit which exists each year in second-class mail matter. Even at the present rates, circular advertising mail (third class) yields a revenue to the post office of nine times the pound rate or two and one-half times the piece rate of second-class mail. Forcing us to abandon third-class mail would only increase the deficit in second-class matter at the expense of revenue in the third-class matter.

The Post Office Department, in the person of the Postmaster General, as reported in the hearings (p. 42) on the 1944 Post Office appropriations bill, admits in substance that it was dissatisfied with the results obtained by its Cost Ascertainment Division. The Postmaster himself summed it up in nine words:

> We have a vast discrepancy in our cost ascertainment.

Because of this discrepancy, the Appropriations Committee granted on June 30, 1943, the amount of $300,000, a substantial portion of which was for the purpose of making a cost and rate ascertainment survey of the Postal Service. It is our understanding that this study will be completed in the near future. It may be that it will show an entirely different picture, one which will make a more intelligent basis for deciding which rates are profitable and which are not.

Let me go into the business of rates for a moment. Let us consider third-class rates on which various official reports indicate that the Post Office Department handled 5½ billion pieces of third-class mail

with the resulting deficit of nearly $24,000,000, and I have in mind a statement attributed to the Ways and Means Committee chairman, Mr. Doughton, in the Congressional Record of November 24, 1943:

> The last 15 years third-class mail matter has enjoyed a subsidy at the expense of taxpayers of the United States of at least $250,000,000. For 1942 it was about $24,000,000.

I wonder if Mr. Doughton recalls that there are two separate and distinct third-class rates. One of them is a preferred rate of 8 cents a pound. The other is the regular bulk mailing rate of 12 cents a pound which is used by ourselves and in number of pieces accounts for about 80 percent of all third-class transactions. Now it seems to me that a greater portion of the deficit must be attributable to that group using the third-class mail which pays the lower rate, and so I inquired of the Post Office Department if they could furnish me with any figures showing the number of pieces mailed or the pounds, and was advised officially that the figures were not available. I had to make up my own figures, and while they may not be accurate I believe they are reasonably close to the facts. There are about 500,000,000 pieces of 8-cent-a-pound mail sent out under third-class rates each year. The gross weight is about 125,000,000 pounds, an average of 4 ounces each. The gross revenue received by the Post Office Department from this source might be estimated at $10,000,000, and the cost based on the fact that these 500,000,000 pieces constitute approximately one-third of the weight of the total of third-class mail is around $32,000,000. That makes a deficit of $22,000,000 and, considering the fact that it is a rough estimate, it comes mighty close to being the total deficit of third-class mail.

Gentlemen, it is my considered opinion that the present rate of 1 cent apiece for enveloped circulars needs no adjustment in order to pay its way. It does pay its way and our company cannot withstand a compromise rate which will permit us to mail circular letter mail at 1½ cents a piece, suggested by other sources. Obviously such a compromise would be to the advantage of magazine mailers who use the third-class rate, so while they may be perfectly willing to compromise with a minimum rate of 1½ cents a piece they do not want it and up to now have not had any need for it.

We submit for your consideration then our belief that an endeavor to raise revenue through increasing the postal rates, and particularly the third-class, mail order, and c. o. d. rates, is unsound because—

1. It will drive out of business many firms who depend on letter circularizing to reach their customers leaving them without a suitable alternative other than using presently organized and high competitive agencies who distribute advertising matter (including enveloped circulars) on a door-to-door basis in cities and in factories at a rate equal to one-third of the proposed new postal rates.

2. It will force circular letter advertisers to use magazines and newspapers resulting in a greater consumption of paper and a further increase in the 85-million-dollar annual deficit already existing in the second-class rates.

3. In three of the classifications—money order, c. o. d., and insured mail—it will mean simply the transfer of a considerable portion of the present revenue of the Post Office Department, to express companies,

banks, and insurance companies whose present rates are now considerably lower than the proposed rates, for what amounts to in many cases more efficient service.

4. It seems unfair to attempt to collect 70 percent of the additional revenue expected of postal rates from the users of third-class letter mail when in our opinion third-class letter mail users are the only group outside of the first-class mail paying their way. Of the thirty-four-billion-odd transactions which the Post Office handles in a year, the direct-mail industry is responsible for only 5,000,000,000, or about 15 percent. On the other hand, out of a total of $166,000,000 in additional revenue, $101,000,000 is expected from the services used by third-class mailers.

5. The entire proposal for increasing postal rates is probably based on an inaccurate picture of the rates and cost structure of the Post Office Department. Therefore it can only lead to greater and continuing errors of rate making, as well as a substantial reduction in the amount of revenue presently received by the Post Office Department.

6. In the case of William H. Wise & Co., Inc., instead of spending $900,000 in postage for 1944, I can tell you we will spend less than $400,000 if the proposed rates are enacted into law.

7. I do not wish to close this discussion without trying to once again emphasize the fact that postal rates are a complex matter. It is my opinion that no single rate can be changed without it having a serious effect on the revenue from all other rates. Were I permitted to make a suggestion I would recommend that the entire matter of postal rates be transferred to the duly organized Post Office and Post Roads Committees of the House and Senate who have been living with this problem in one way or another for many years. I have the thought that the special survey which I referred to earlier will be forthcoming in a short time and when it does it may reveal a different picture, one which may justify the fact that third-class letter mail is an economically sound and valuable mass selling force and should not be treated in the same category as excise taxes on furs, jewelry, and other similar items.

It is not unlikely that study now being made by the experts of the Post Office Department will disclose other inequities such as the existence of a possible 30-million-dollar deficit buried in the first-class mail profits, resulting from the estimated cost of handling private and Government post cards.

In conclusion I wish to express my sincere thanks for your courtesy in giving me so much time.

The CHAIRMAN. Thank you, Mr. Crawley.

Mr. Habernickel.

STATEMENT OF M. HABERNICKEL, JR., REPRESENTING THE HABAND CO.

Mr. HABERNICKEL. Mr. Chairman, I think I am going to set a record here for brevity. My name is M. Habernickel, of the Haband Co., Paterson, N. J. We are a very small mail-order house selling by mail exclusively. When I say small, I think our volume last year was just short of the million-dollar mark. We are 18 years old in business.

We are capitalized, roughly, at $200,000, which classifies us, I think, as a small business.

Last year we used third-class mail to obtain our business. We distributed 4,008,000 pieces of advertising matter, on each of which we paid 1 cent, $48,000 for third-class postage.

Now with the kindness of Providence, more than we were entitled to, I guess, we made a handsome profit on our operations, a very satisfactory profit, and I think that year showed an exceptional profit. That profit, including the investment on our business, all the earnings of the partners, all the salaries that possibly could be included in there, was $44,000.

Now, it is obvious, gentlemen, that a doubling of that $48,000 would have left us out of business and it would have left the post office further out than the $48,000 that we spent on third-class postage, for to fulfill that business, deliver the goods and one thing and another, we handed the post office for parcel post and other service an additional $35,000, and the four partners, separately, on these $44,000 that we earned, paid the Internal Revenue $17,000.

Our customers, to deal with us, send us their orders and correspondence, and we estimate very conservatively that they spent $35,000.

I could not resist yesterday, when I left the office, sticking that handful of money orders in my pocket, one day's accumulation, which you see here, which were purchased by people all over the United States to deal with us, and which forms part of this $35,000 that I refer to.

Therefore, if the postage was doubled and I am put out of business, I see a loss there of either $70,000 or $118,000 to the post office in revenue, whichever way you figure it.

The Haband Co., in the eyes of other people in the business, occupies a very favorable position. I don't know if they are all doing that well or what they think about it, but I rather feel that we are on the fortunate side, and if this rate is going to affect us that way, it is going to affect the other people the same way, and I think instead of the post office having additional revenue they are going to face a serious loss of revenue, and I think the Internal Revenue Department is going to be very much disappointed in what they get.

Thank you, gentlemen.

The CHAIRMAN. Thank you very much, Mr. Habernickel.

The next witness is Mr. Kuykendall, who will speak on behalf of the Motion Picture Theatre Owners.

STATEMENT OF ED L. KUYKENDALL, REPRESENTING THE MOTION PICTURE THEATRE OWNERS OF AMERICA

Mr. KUYKENDALL. Mr. Chairman, my name is Ed Kuykendall. I live in Columbus, Miss., where I have owned and operated motion-picture theaters for many years. I am president of the Motion Picture Theatre Owners of America, which is the oldest and largest trade association of the exhibitors of motion pictures in this country.

In my organization are represented 19 State and regional exhibitor associations from California to Florida and from Massachusetts to the State of Washington. All of these State organizations were most anxious to send a personal representative to oppose the heavy increase

in the tax on theater admissions proposed in House bill No. 3687, the Revenue Act of 1943, but in deference to the limited time the committee can give to these hearings and because of the travel difficulties today, they will not be able to appear. They would bring out many points in their own way which I will not be able to cover in the limited time at my disposal.

In my organization are represented about 6,000 theaters of all types of theater operation, but the big majority of them are rather small independently owned and operated theaters in country towns, suburban areas, and in the residential neighborhoods of the larger cities. It is principally on behalf of this type of theater operation that I want to bring to your attention some of the problems and difficulties presented by the proposed tax of 20 percent and more on each separate admission ticket at these theaters.

The exhibitors I represent did not send me down here to get them out of paying their fair share of the necessary taxes, nor to oppose any and all taxes on them. What they want is for you to get a clear picture of our situation today, so that you will realize how much of a tax burden their theaters can carry, and that there is a limit to the amount of taxes they can pay and stay in business.

We realize the tremendous responsibility this committee has in trying to raise the huge tax revenues necessary to carry on the war and how difficult your job is. We did not oppose the present special tax of 10 percent plus on theater admissions when it was imposed by this committee, as we knew the need and we expected to pay our share and more. We believed we could carry that tax burden, heavy as it was, so we made no objection to the tax as such.

It is quite obvious that there is a limit somewhere to the amount of special tax on admissions that the motionpicture theaters can carry on top of the regular taxes they must pay today. We doubt if anybody knows exactly where that limit is even at a particular theater, but many owners of small theaters, particularly in farm and agricultural sections away from the war industries and boom areas, believe that the present tax, which takes about 12 percent of their total cash intake, is getting rather close to that limit.

The admission tax hits all theaters, prosperous and poor alike.

How much of a tax on its retail sales, which in our case is the theater admission, a theater can carry no doubt varies a great deal as between different theaters. While a 20-percent tax on gross sales will hit all theaters hard, it is the weaker ones that are most likely to be forced out of business. That is self-evident.

The theaters that have a struggle to make ends meet now, that have no extensive financial resources to tide them over, that do not enjoy abnormal business in an overcrowded war industry center, will naturally go under first, though other theaters may survive all right.

The small and weak theaters face extinction from excessive tax.

It is on behalf of these theaters, and there are a very large number of them, that I am making this appeal to you against what we believe will prove an excessive and unbearable tax at many thousands of such community theaters.

There are a very large number of such theaters throughout the country, though they are not nearly so prominent and well-known as the less than 500 first-run theaters in the 94 so-called key cities with

more than 100,000 population. But these thousands of smaller theaters are just as important to the community in which they are located, perhaps more so, as the principal source of mass entertainment and popular diversion, giving these people relaxation from the trials and troubles of their daily life as nothing else can.

A careful survey of theaters made last year by Motion Picture Herald revealed that there are 16,951 theaters in 8,488 separate towns and cities in the United States, and that the average seating capacity of these theaters is 617 seats. A big majority of these 17,000 theaters, however, are small houses with less than the average seating capacity. This same survey disclosed that there are 9,963 motion-picture theaters with less than 500 seats, and that there are 7,512 theaters located in towns of less than 5,000 population.

The small theaters are not prosperous today.

These theaters cater largely to working people and rural populations, as they are small-town theaters and last-run theaters in the large cities. Their patronage is mostly working people. The well-to-do go to the more expensive, first-run theaters, while the family trade goes to the less expensive neighborhood theaters and country town theaters.

These theaters, even today, are not in on the war boom, and a very large number of them barely make ends meet. A considerable number of them only operate part time because they cannot take in enough at the box office on other days to meet their operating expenses. It is obvious to those of us who are close to the small towns and to the small theater operations that a full 20 percent or more taken out of their gross receipts by an increase in the Federal admission tax will compel many of these theaters to close up and go out of business. Endless examples of specific theaters could be provided where such will be the case unless the theater is able to miraculously increase its cash receipts over its present business.

More than 6,000 of these small theaters are located in towns in which there is only one motion-picture theater. If that theater goes out of business, the people of that particular country town no longer have motion-picture entertainment. Does this committee want to deprive these people of their most popular and one of the most wholesome forms of entertainment and recreation, particularly in view of the fact that facilities for recreation and amusement in these small towns, other than the motion pictures, are very limited at best?

While the average weekly attendance at the 17,000 movie theaters now operating may be 90,000,000, not more than 60,000,000 people go to the movies, as in these attendance estimates are included, of course, a considerable number of people who go to the movies more than once a week. In other words, not more than 6 out of every 13 of the people in this country are movie patrons. Every theater operator knows that those who go to the movies are working people, country people, and people of moderate means. Wealthy people and people with very large incomes have other and more expensive diversions and amusements. They are not movie-goers. This tax hits those least able to pay.

Not only that, but a considerable part of the movie audience are women and children. Why should they be singled out for a special tax not imposed on other people, just because they like to go to movies? Is

it fair to the movie patrons of this country to make them pay a larger proportion of the cost of war and government than is expected to be paid by the rest of the population who may not care for motion pictures? No doubt, the committee is interested in getting the full amount of tax revenue needed to prosecute the war and in spreading the tax burden fairly so that everyone will pay his fair share of the taxes necessary. This tax on amusements does not accomplish this purpose.

DUPLICATE STATE AND CITY TAX ON ADMISSIONS

In a number of States the Federal tax on theater admissions is a double tax, as the State has already levied a tax on admissions to movie theaters. In Mississippi and Kentucky the State tax is 1 cent on each 10 cents or fraction thereof. In Washington State it was 1 cent on each 20 cents over 20 cents until recently, when the State law was replaced by city taxes on theater admissions; in three States there is a 3-percent tax on theater admissions (Ohio, South Dakota, and Tennessee), and in 12 States the tax is 2 percent on admissions (Alabama, Arizona, Arkansas, Colorado, Iowa, Kansas, Missouri, New Mexico, North Dakota, Oklahoma, Utah and Wyoming) while two States tax admissions at 1 percent (Indiana and Maryland).

NEW TAX A HEAVY BURDEN ON INDUSTRY

It is now proposed to double the present Federal tax of 1 cent on each 10 cents or fraction thereof to a rate of 2 cents on each 10 cents or fraction thereof, and it is estimated, I understand, by the Treasury that this will produce a total of $327,000,000 of annual revenue from the tax on admissions. We believe that the greater part of this tax burden will be carried by the motion pictures, and while this industry expects and is quite willing to pay its full share of taxation necessary to carry on the war and is subject to all of the corporation income and profits taxes imposed on other industries, we submit that this special tax is excessive and may prove disastrous to an essential part of the motion-picture industry.

Please understand this is not a tax on the producers of motion pictures nor on Hollywood salaries; it is a tax on the motion-picture theaters and the theater patrons and on the box-office cash receipts of every theater, taken out before any of the gross receipts can be used by the theater owner for pay roll, film rental, or operating expenses. Only indirectly can it affect the producer and distributors of the films used by the theaters.

We realize that this tax is collected from each patron separately from the admission charge at the time the ticket is purchased. This is required by the law, and we are not objecting to this separation, so that the inquisitive patron knows how much is for the show and how much is for the tax. Nevertheless, to the theater patron the tax represents just an added cost to get into the show.

It has been argued that the theater passed on the tax and only bears the cost of collecting it, because the tax is separate from the admission price. This may be quite true of such taxes on tangibles, but it is a false delusion with respect to theater admissions.

We sell time. And we are dealers in mass entertainment. Unlike most retail businesses, we can't sell a few articles or admissions, with-

out suffering disastrous losses. The number of admissions we sell at each performance is much more important to us than the price we charge for each admission. And we can't sell Tuesday night's performance on Wednesday, thought it may be the same show. If the theater doesn't sell its Tuesday night performance on Tuesday, it is gone forever and represents a dead loss.

It is a peculiarity of theater operation that there is no fixed and definitely ascertainable profit that can be computed on each admission sold. Profits and losses in theater operations depend equally as much on the number of admissions as on the prices charged. Actually they can only be computed on the gross receipts for the day, week, or engagement on a particular show, program, or attraction.

The admission prices are fixed by the public not by exhibitors.

As a consequence of these unique characteristics, theaters must charge what the people in the immediate vicinity are willing to pay for the shows they offer, no more and no less. Equitable and efficient admission scales cannot be fixed arbitrarily by the management of a successful theater; they must be adjusted by trial and error in such a way that the largest number of patrons will attend the theater at the highest prices they are willing to pay.

If the theater's prices are too high, attendance falls off rapidly, and the business goes to pieces; if too low, the theater doesn't take in enough to meet its pay roll and expenses. The number of admissions is the most important factor, but the price charged directly affects the number of admissions that will be sold.

A theater now charging 27 cents admission and 3 cents tax obviously could get 30 cents without the tax from its patrons without reducing the number of admissions sold, if the present tax was removed. The patron would pay 30 cents to get in, either way, though the tax is collected separately from the admission price.

But if the tax is raised to 2 cents on each 10 cents instead of 1 cent, the theater owner has this dilemma: He can then charge 24 cents plus 6 cents tax and have the same number of people come to each performance at his theater, but lose 10 percent of his present gross receipts each week, which may force him to close the theater; or he can charge 27 cents (his present price) plus 6 cents tax for a total of 33 cents. But all his experience with arbitrary increases in admission prices teaches him that fewer people will come to the theater, or they will come less often, so that the number of admissions will inevitably drop.

Experienced theater operators have always known that any increase in admission prices inevitably will decrease the number of admissions sold, and vice versa. To exaggerate it so that you will see how it works: If a theater charging a 25-cent admission raises the price to 50 cents, far less people, under normal conditions, enter the theater. If more than one-half of the attendance is lost as a result of such an increase, as would certainly be the case at most theaters, the enterprise suffers a heavy loss. This principle applies, in varying degrees, to any increase in the cost of admission, however small, where it is an increase in price for whatever reason for the same show with no increase in value.

The only exception to this principle may be where the theater is overcrowded by boom business due to such abnormal conditions as now

exist here in Washington, where twice as big a population must use the same theaters that were here 3 years ago.

Because of this there is good reason to doubt that the tax on admissions is all passed on to the public, and there is strong evidence that none of it is actually passed on, other than with respect to the fact that the movie-going public pays for everything through the box office of the theater, which is the industry's sole source of revenue. At least a large part of this tax comes out of the gross sales of the theater, no matter how you figure it, before the theater owner can meet his pay roll and operating expenses. Just how much of the proposed $327,000,000 total tax on admissions we will have to absorb and carry cannot be definitely determined, of course.

But this doesn't help the people who go to the movies, who will be hit by this tax just the same. They are, perhaps, unorganized as such and inarticulate, with no authorized spokesman here to protest or present their views. Just the same they are entitled to some consideration in the matter.

This tax as proposed now means, if it is added on to the present admission scales, a 10-percent increase in the cost of their entertainment to each man, woman, and child who goes to the movies. If adding it on is a false illusion, as we believe it is, then it means that each theatergoer will get not more than 80 cents worth of show for every dollar they spend on motion-picture entertainment when this bill becomes law. Either way the movie-going public will suffer from such a special tax on admissions. Should they be penalized because they like movies? Will they think that this is a fair tax?

So many small theaters have a 15-cent matinee price for children. The tax proposed of 2 cents on each 10 cents imposes a 4-cent tax on such tickets, a tax of 26.7 percent, while a 50-cent price gets only a 20-cent tax. If the practice now is to charge 13 cents admission and 2 cents tax for a total of 15 cents even, and the theater feels the even 15 cents has to be continued, it becomes even worse, as it must then be 11 cents admission and 4 cents tax under the new rate, because then the tax is 36.3 percent.

The most popular admission prices below 50 cents are probably the 15-, 25-, and 35-cent prices. In each instances the tax is in excess of 20 percent, just because the amounts are not even dimes.

The motion-picture industry is in the significant position of being one of the few industries that has no Government contracts at a profit. Whatever war work is being done by us is either done without compensation at all, or done at exact cost as our contribution to the war effort. Over 6,000 film programs, consisting of a feature picture and enough short subjects to provide a show not less than 1½ hours long, have been given free of charge in the last 2 years to the Army for use overseas, by the motion-picture industry.

Over 16,000 theaters in the country have pledged to the war-activities committee of the motion-picture industry that they will show war-information films provided by the Government and approved by the committee. We are proud of our devotion to our Government and to our country, and I challenge any industry to show more unselfish support and cooperation than we have demonstrated in this business without profit and without compensation from such war work.

The American Red Cross, the U. S. O., the War Savings staff of the Treasury Department, the United Nations Relief Fund, the National

War Fund, the Army-Navy Emergency Relief Fund, and many other war agencies can testify to the unhesitating cooperation and active support they have received from the motion-picture theaters throughout the country and the motion-picture industry as a whole.

An excessive tax burden that would compel large numbers of theaters to close up and go out of the business can destroy a considerable part of these activities, which we believe are important in every town and community throughout the country and which reach those places through the organized activities of the motion-picture theaters in this country.

If a retail sales taxes of 20 percent was imposed on all industries including theaters, I doubt if any exhibitor would object to carrying the tax, even if it breaks him. We would feel that we were only carrying our share of the tax burden required to prosecute the war, however burdensome.

But we can't help but feel that we are already carrying a special tax now on our retail sales at 10 percent that is out of line with the tax levied on most retail business. We want to do our share but we believe that if this tax is doubled, as is proposed in the new tax bill, it will prove to be excessive and disastrous at a very large number of the Nation's theaters.

The majority of the exhibitors I represent very earnestly believe that they cannot stand this much of an increase in their tax burden, and would like respectfully to suggest and recommend that the tax on admissions be fixed at not more than the rate of tax which is reported to be recommended by Mr. Colin F. Stam, chief of staff of the Joint Congressional Committee on Taxation, which we understand is 2 cents on each 15 cents. This will allow thousands of small theaters to stay in business and continue to pay their taxes. We believe this would be the limit of special taxation that can be imposed on these theaters without irreparable injury.

The men and women in uniform look to the motion picture for leisure and recreation and we in recognizing this generally have voluntarily reduced our admission prices to them. Any increase in taxation places additional financial burden on those men and women in uniform. I call the attention of you gentlemen to the fact that if 1 out of every 5 present patrons were to stay away from the theater, it would defeat your purpose. Mr. Stam's proposal of 2 cents on each 15 cents admission as a basis would be a distinct concession to the children, and the smaller towns generally, not to mention our men and women in uniform. You have been gracious in your consideration of our problem as an industry and I deeply appreciate it.

Senator CLARK. You appeared before this committee on the last tax bill, didn't you?

Mr. KUYKENDALL. That is right. We did not oppose the 10 percent tax.

Senator CLARK. My recollection was that you predicted that the 10-percent tax would put a very large number of theaters out of business.

Mr. KUYKENDALL. I don't want to differ with the Senator, but I don't think I said that. I made an appeal especially for the uniformed men and especially the children in school.

Senator CLARK. I may be mistaken.

Mr. KUYKENDALL. I don't think I said that.

The CHAIRMAN. Thank you very much.
Mr. Myers, how much time will you require?
Mr. MYERS. Twelve minutes at the outside, Mr. Chairman.
The CHAIRMAN. Proceed.

STATEMENT OF ABRAM F. MYERS, REPRESENTING THE ALLIED STATES ASSOCIATION OF PICTURE EXHIBITORS

Mr. MYERS. I am chairman of the board of directors and general counsel of Allied States Association of Motion Picture Exhibitors, a national association which is composed of regional associations of independent motion-picture theater owners located in various parts of the United States. In addition, I represent on this occasion 11 regional associations of independent exhibitors not regularly affiliated with Allied States Association. Thus I offer this brief statement in behalf of 23 organizations with members in 28 States and the Territory of Alaska. I will not detain the committee to recite the names of the associations represented or the territories covered; that information is contained in the manuscript which I will hand the reporter, with the request that it be included in the record.

Allied States Association of Motion Picture Exhibitors maintains an office at 729 Fifteenth Street NW., Washington, D. C. Its affiliated regions and the territories covered are Allied Theaters of Connecticut, Inc. (Connecticut); Allied Theater Owners of New Jersey, Inc. (New Jersey and a few in the Albany district of New York); Allied Independent Theater Owners of Eastern Pennsylvania, Inc. (Eastern Pennsylvania); Allied Motion Picture Theater Owners of Western Pennsylvania, Inc. (Western Pennsylvania and a few in West Virginia); Independent Theater Owners of Ohio (Ohio); Allied Theaters of Michigan, Inc. (Michigan); Associated Theaters of Indiana, Inc. (Indiana and a few in Kentucky); Allied Theaters of Illinois, Inc. (Illinois and a few in Indiana); Motion Picture Theater Owners of Maryland, Inc. (Maryland); Independent Theaters Protection Association of Wisconsin and Upper Michigan (Wisconsin and Michigan Peninsula); Allied Theater Owners of Texas (Texas).

Regional associations represented which are not regularly affiliated with Allied States Association: Independent Exhibitors, Inc. (Maine, Vermont, New Hampshire, Massachusetts, Rhode Island); Pacific Coast Conference of Independent Theatre Owners comprising (*a*) Independent Theatre Owners of Southern California (Southern California, Arizona, Nevada); (*b*) Independent Theatre Owners of Northern California (Northern California); (*c*) Independent Theatre Owners of Oregon (Oregon); (*d*) Independent Theatre Owners of Washington, northern Idaho, and Alaska (Washington, Idaho, and Alaska); Allied Independent Theatres of Iowa-Nebraska (Iowa and Nebraska); Motion Picture Theatre Owners Union of the Northwest (Minnesota, North Dakota, South Dakota); Allied Theatre Owners of the Northwest (same as Theatre Owners Union); Kentucky Association of Motion Picture Exhibitors (Kentucky—may have additional representation); Cleveland Motion Picture Exhibits Association (Cleveland, Ohio).

I fully recognize that the long box-office queues outside Washington's downtown theaters are a temptation to those who have the bur-

den of raising revenue. The same condition prevails with respect to the first-run theaters in many of the large production centers. While the independent subsequent-run and small-town theaters do not begrudge these producer-owned first-run theaters their good fortune, we nevertheless must ask the committee to distinguish sharply between their situation and ours in the consideration of that provision of the bill which would double the present tax on admissions. We do not want to be in the position of poor relations who are suspected of being wealthy merely because we have been seen in fast company.

The independent theaters for which I speak are, for the most part, located in the smaller towns and rural communities and in the residential districts of the larger cities. They play the pictures after—usually a long time after—the city downtown theaters. They cater to the family trade, especially the children, and their admissions are, and perforce must be, much lower than those charged by the first-run houses. These theaters provide entertainment for the masses, the laboring people and the white-collar workers; they have not cracked the carriage trade. The money paid in at the independent box offices does not represent excess wartime spending. Rather it is a question, in most instances, whether the amount required can be spared from the family budget.

The pricing of admissions for this class of patrons is a very delicate matter. Exhibitors by long experimentation have arrived at prices which will produce the maximum revenue. While the law requires that the established price and the amount of the tax shall be posted on the box office and printed on the tickets, actually this means nothing to the patron. To him the admission price is the total amount he must pay to get into the theater. Thus if a child asks its parent for the price of a movie and the parent asks "How much?" the child replies, "15 cents" not "13 cents plus 2 cents tax."

Under the present tax of 1 cent on each 10 cents or fraction, the theaters by absorbing a penny or adding a penny have arrived at established total admissions, in round figures, which are familiar to the patrons and which should not lightly be disturbed. It is very easy to speak of taxing admissions 10 percent, 20 percent, or 30 percent, but in many instances that is a mathematical impossibility; it never has been accomplished and it never will be accomplished.

Let me illustrate my point by referring to some of the popular combined admission prices charged by the independent theaters. Fifteen cents has long been a popular price for children and for matinees. Under the present tax this means 13 cents admission and 2 cents tax—very much more than a 10-percent tax. An admission price of 25 cents consists of 22 cents admission and 3 cents tax—again more than the 10 percent which the existing law is popularly believed to impose. Now let us apply the House provision for doubling the tax to some of the established admission prices and note its disastrous effects. In order to continue the 15-cent children's admission, the theater owner would have to absorb 4 cents, making the combination of 11 cents admission price and 4-cent tax, and this the small exhibitor simply cannot afford. As for the very popular 25-cent admission—possibly the largest revenue producer of them all—it would be abolished by the House proposal. If the base admission should be fixed at 20 cents, the tax would be 4 cents, making a total of 24 cents, which

involves the absorption of 4 cents by the exhibitor. If the base price should be fixed at 21 cents, the tax would be 6 cents, making a total of 27 cents. There is no way in which it can be figured so as to retain the 25-cent admission.

The same is true with respect to 50-cent admissions; you can figure combinations that will land you on either side, but you cannot hit an even 50 cents.

The Treasury recommendation of 3 cents on each 10 cents or fraction which was disregarded by the House, besides being unbearable, would have been equally unworkable. Under it 15 cents and 40 cents total admission would be abolished.

There may be those who will say the solution is to raise admission prices. That is hardly consistent with sound economics or the general policy of the Government. But the conclusive answer is that in the neighborhood and small-town theaters the traffic will not bear a heavier load. As members of the committee may recall, motion pictures were exempted from the General Price Control Act. With no ceiling on admissions, and with prices rising in nearly all other lines and operating costs relentlessly going up, the temptation to increase admissions has been great. Nevertheless, Audience Research, Inc., a Gallup enterprise, recently has reported that the average increase in admission prices during the past 3 years has been only 5½ cents, exclusive of tax. That includes theaters of all types. It is fair to assume that a majority of the increases have been in the downtown first-run houses. Had the public been able to absorb a heavier general increase, I am certain that, following the trend of the times, it would have been forthcoming. The fact that there has been such a moderate increase since 1940 demonstrates that the movies have reached their limit in the matter of admission prices.

Under the present tax rate of 1 cent on each 10 cents or fraction, the Government is deriving a handsome revenue. Federal admission tax collections for the first 10 months of this year total $136,293,040. This compares with $119,136,541 last year. Of this gratifying total for the first 10 months of 1943, $122,407,360, approximately 90 percent, came from motion-picture theaters. It is estimated that the total receipts from admission taxes this year will be very close to $163,000,000. In October the collections set a new high record of $16,499,395, an increase of $2,500,000 over September. The committee should pause to consider the class of admissions on which this revenue is being raised. The same Gallup survey to which I referred shows that the average admission price in the motion-picture theater houses of the country is only 32½ cents. That means that the very popular and sensitive 15 and 25-cents admissions, which the House bill would virtually stamp out, contributing very largely to this revenue. The 60-cent admission charged by the Washington first-run theaters are not representative of conditions throughout the country and provide a defective standard for taxing general admissions.

If the committee will give due consideration to all the factors involved, I am confident it will reach the conclusion that the existing tax of 1 cent on each 10 cents or fraction is yielding the maximum return to the Government; that any further tampering with the admission tax, especially on the popular admissions up to and including

50 cents, may destroy the bird that is laying the shiny eggs. The experienced and thoughtful members of this committee will quickly grasp the effect on this or any other business of abolishing by law its two or three most popular prices. Moreover, they will realize how extremely dangerous it is to add an additional burden, however small, on the admissions paid by the hard-working low-income groups that make up the bulk of the attendance at the independent movie houses.

In the consideration of this matter I hope that the committee also will take into consideration the effect on the theaters in rural communities occasioned by shifts of population. Population shifts of major proportions have adversely affected the theaters in many sections of the country. The condition has become so acute that certain of the major distributors are adjusting the film rentals of the affected theaters so as to tide them over the emergency. A survey made by one of the motion picture trade papers a year ago showed that vast areas had been affected, especially in New England, on the prairies and in the Rocky Mountain region. I need not remind you Senators who have rural constituencies that the removal of a family from a small community to a large production center may add temporarily to the prosperity of the production center, but it also depletes the spending power in the community that has been adandoned. Not only that, but the income of many families is being reduced by the difference between the earnings of an able-bodied husband, father, son, or brother and the allowance for a soldier's dependents.

Not only should the committee distinguish between the producer-owner circuit theaters and the independent theaters in the consideration of this tax, but it should not be influenced by published reports of the earnings of the large prolucing companies and the fancy salaries paid by those companies to their executives and stars. These facts might have some bearing on the provisions of the bill relating to income and excess-profits taxes, but they have no possible bearing on the admission tax. Of the 222 persons in the montion-picture industry cited in a recent Treasury report as having received salaries of more than $75,000 during the calendar year 1941, or during fiscal years ending in 1942, not one was an independent exhibitor or employee of an independent theater. On the other hand, a survey made by Allied States Association among the independent exhibitors last summer indicated that their total film rentals had increased from 25 to 40 percent during the past 3 years. Therefore, the reputation of the production branch as a big money maker should not affect the consideration of this tax.

There is another aspect of the matter which I think I can mention with propriety. I realize what the feeling of the committee may be toward those who parade their voluntary contributions to the war efforts as a reason for seeking special consideration. But I cite the efforts of the theaters in that behalf for an entirely different reason. The motion-picture theaters have been at the forefront in raising funds for the U. S. O., Red Cross, and many other worthy causes and have been so successful in selling War bonds and stamps that Secretary Morgenthau has referred to them as the "cash registers of the Treasury." President Roosevelt within the past few days has declared that "Motion pictures and motion-picture theaters occupy an impor-

tant position in the community life of the American people. This places on the film industry a serious responsibility."

This responsibility the theaters acknowledge and assume. But in order for the theaters to do the job that has been assigned to them, to take up collections, to gather scrap metal and sell bonds, and to deliver the Government's messages to the people, they must have audiences. People do not congregate at the theaters merely to contribute to the drives or to view the Government reels. In a war-torn world wholesome diversions are not a luxury, but a necessity, and are so regarded by the people. It is problematical how long the people would tarry in the theaters to participate in these wartime activities if they were not awaiting the remainder of the program for which they have paid an admission price. When these considerations have been pondered I do not believe the Government, and least of all the Treasury, will want to discourage attendance at the theaters, or risk a falling off in revenue, by doubling the existing admission tax.

The motion-picture business has its own peculiar problems and this committee will not want to hamper it with unnecessary restrictions. We hope that the committee will see fit to retain the present tax without change. It is productive, the public is accustomed to it and the theaters can live under it. However, if the committee should conclude that the admission tax must be increased to some extent, we wish there was some way whereby the experience and advice of the theater owners could be utilized so that the provision, when drafted, may have some flexibility and the theaters may be spared the harmful effects of imposing taxes in terms of flat percentages. Please understand that we are not seeking to keep our foot in the door so as to continue our pleas and arguments after the hearing is closed. Our only thought is to offer suggestions for carrying into practical effect any decisions at which the committee may arrive. Allied States Association maintains an office in Washington and we would be very happy to serve the committee in any way we can.

Senator JOHNSON. Is there any way relief can be given the small country theater without upsetting the tax on the downtown theaters?

Mr. MYERS. Senator, the only way I can think of would be by a graded tax, depending on the price of the admission, on the theory that the high admissions are paid in the downtown first-run theaters in the large cities, whereas the popular admissions I speak for, the 15- and 25-cent admissions, obtain in the neighborhoods and in the rural communities.

Mr. Kuykendall ventured to say that what we understood to have been the recommendation of the Joint Committee on Internal Revenue Taxation, that is, a tax of 2 cents on each 15 cents or fraction, would be satisfactory to the group he represents. A lawyer who concedes away any part of his case is going to have some dissatisfied clients, but I would have to say, speaking on my own responsibility, Senator, that that might be a very sound solution of the problem, because it lends very great flexibility and enables the theater owner to compute almost any kind of combination of admission and taxes that he sees fit, whereas under the House provision he cannot compute round figures to meet the requirements of his trade in these popular admissions.

The CHAIRMAN. Thank you very much.

STATEMENT OF DAVID NEWMAN, REPRESENTING THE COOPERATIVE THEATERS OF MICHIGAN

Mr. NEWMAN. Mr. Chairman and gentlemen, the Cooperative Theaters of Michigan, Inc., a corporative organization of motion-picture theater owners, formally protests against the pending tax bill which doubles the present rate of admission taxes from 10 to 20 percent. The said cooperative organization comprises approximately 50 members operating 100 neighborhood theaters located in principal cities throughout the State of Michigan, the majority of which are located in the city of Detroit, Mich.

The organization supports any bill to levy taxes to help defray the costs of the war. It opposes, however, any tax measure which operates inequitably and tends to destroy the economy of any industry, particularly that of motion pictures.

The progress and success of the motion-picture industry has been mainly due to the operation of neighborhood theaters in large cities and small towns. Such theaters have always offered movie entertainment to the public at comparatively low admissions. If the industry is to continue to grow and prosper it will have to follow this policy of low-priced admissions. Experience over long years has definitely established the principle that increased admissions do not increase the gross receipts and definitely decrease the number of people attending the movies. It may very well follow that increased admission taxes will fail by a great margin in accomplishing the purpose of doubling the present tax revenue. It will definitely decrease the net admissions to theaters with the resultant decrease in profits. Considering the reduction of income taxes by theater owners, it seems certain that the sum total of revenue to our Government from both such sources will not show any increase over what is now being obtained at present rates of admission tax and income taxes.

Theater owners generally, and the members of Cooperative Theaters in particular, have willingly fulfilled their duty in the regular exhibition of Government-sponsored motion-picture subjects. They have also carried out their obligation in the sale of War bonds and stamps, especially during designated drive periods. Within the last year, acting in cooperation with the Treasury Department, the motion-picture industry pledged to sell to its individual employees and to the public a billion dollars worth of War bonds within a short period of time. The theater owners and their employees met their quota in the purchase of bonds, also by bond-buying rallies among the patrons during show time. As a result of such activity on the part of theaters, the pledge was more than fulfilled. Numerous other bond-selling drives were successfully undertaken by these same theater people. All this in addition to the regular everyday sale of bonds and stamps in theaters.

Assuming, as we must, that increased taxes will bring about a reduction in the number of people regularly attending shows, it definitely follows that the efforts of the exhibitors in the sale of War bonds will be adversely affected. So also will the value of the exhibition of Government reels be impaired by the reduction in the number of people attending shows.

The importance of entertainment and relaxation which the movies afford to war workers should not be underestimated during the present emergency. People will be unable to enjoy their movies as often as in the past if the tax rate is doubled. Nor will much morale-building entertainment be available to as many people. Money-raising campaigns for the Red Cross and Infantile Paralysis Foundation, in which practically all theaters participate, will be similarly adversely affected by reduction in the number of patrons attending theaters.

Many independent theater owners operating neighborhood theaters in large cities and the owners of theaters in small towns have not enjoyed any great prosperity during the last 2 years. In fact, many such owners are not doing the business at present comparable to a few years ago. The lack of war industry, the inroads brought about by the draft and exodus of workers to other parts have in many areas caused a great loss of business. The people cannot increase gross admissions. They will have to absorb any additional tax themselves, thereby reducing net income and profits. Doubling the present tax will force great numbers of independent owners to the wall. These same theater owners have their entire investment in their business from which they earn their livelihood.

Surely it is not the intention of Congress to place the movies out of the reach of the average man and his family. Doubling the taxes will result in preventing many individuals from attending theaters. Motion-picture entertainment cannot and should not be placed in the class of luxury commodities. The average theater owner justly feels that any increase in present amusement tax is discriminatory and therefore a tax inequitably levied. With respect to those theater owners who cannot increase their admission nor absorb the tax themselves, any doubling of taxes may very well be confiscatory.

In summation it is urged as follows:

1. Low admission prices are the lifeblood of the exhibition field of the motion-picture industry.

2. Doubling the present taxes will not increase the revenue to the Government in view of the decrease in gross receipts, also the decrease in income taxes.

3. Fewer people will attend movies with the increase in gross admissions, resulting in the impairment of the morale-building qualities to the war workers, generally rendering less effective the dissemination of vital information contained in Government reels.

4. Loss of patronage will also adversely affect the efforts of the exhibitors in the sale of War bonds, collection of funds in behalf of the Red Cross and Foundation for Prevention of Infantile Paralysis.

5. Any increases in present amusement taxes are discriminatory and also confiscatory in a great many instances.

In conclusion, this honorable committee is respectfully requested to carefully consider all facts we have submitted.

The CHAIRMAN. Mr. Reeve.

STATEMENT OF HENRY REEVE, REPRESENTING THE TEXAS THEATER OWNERS, INC.

Mr. REEVE. Mr. Chairman, my name is Henry Reeve. I own and operate the Mission Theater in Menard, Tex.; and for the past 2 years have been president of the Texas Theater Owners, Inc., an organization

composed of and representing the great majority of the 1,100 theaters in our State. Our organization is made up of independent individually owned theaters, independent circuits and the affiliated circuits of Texas, thus covering a large and varied field of theater operation. For your further information, we of the Texas Theater Owners are not connected with either of the national exhibitor organizations and with no regional group. We have centered our efforts in the interest of Texas theaters and the welfare of our business in our home State, though we have always reserved the right to lend our support and our best efforts for and with any movement no matter by whom sponsored which we feel is for the good of our motion-picture industry.

Today the Senate Finance Committee is considering the problem of proper taxation of admissions for amusements, which vitally affects our motion-picture industry. We know that we discuss this problem with a common purpose, the successful combat of this great war in which our country is involved.

I am speaking to you from 21 years of theater operation in this small Texas town, one that has thousands of counterparts all over this country of ours. I am speaking only of that which I know, of the needs, the accomplishments, the hopes and the possibilities of our business. Just of those things the four hundred-odd exhibitors in the small places of Texas and their fellow-showmen all over this Nation are asking you gentlemen to consider as you endeavor to most satisfactorily meet a serious problem.

The Mission Theater serves Menard, a county seat town with a 1940 census population of 2,560 and a total county population of 4,500. There are over 350 towns in Texas with less than 5,000 population, more than 150 with less than a thousand. Shortly I will tell you what has actually happened to many of those towns down there. Gentlemen, our people think that the theaters in their towns have been the greatest single factor our Government has had in informing them of this war, its scope, its true nature, and of the ways for the folks back home to meet it and help win it.

Our people at home, with loved ones in the service, keep in contact with them by mail but our theater screens have shown them where those soldiers and sailors are. We have lost six boys in this war in our little county, two more are in German prison camps—their families have seen where they did their utmost. The father of a young lieutenant, a bombardier killed over France some months ago, came to me last week and told me how much the theater had meant to him and to his wife since their loss. They have steeled themselves through tough war pictures, thinking of their son and knowing the good and the bad he went through. The Army presented this mother and father with two posthumous decorations for their son in our theater during the Third War Loan when Menard bought $165,000 of a $282,000 bond quota in our theater bond rally.

Our people have seen Guadalcanal, north Africa, Sicily, and Italy. They have seen why they should buy bonds, back their Red Cross, United War Fund, and every other similar job today. In the last war, there were no theaters in our towns. Today our people have heard our President's every important utterances; they know our generals and admirals, and they have seen Capt. Hewitt Whelless decorated; they have seen who Admiral Chester Nimitz is, who decorated two Menard boys. Over 5,000 theaters in the country, besides showing

Government and Army and Navy films, are governmental issuing agents for the sales of War bonds and stamps. Gentlemen, I am not trying to wave a flag or speak boastingly of this work, but if it means nothing in the consideration of a tax question that vitally concerns our future as theater operators in the small places of America, then there is a misunderstanding or a misconception of our needs and possibilities somewhere.

If we can lay one true fact before you so that it may be understood clearly, we feel that it will be of real help in the solution of your problem. That fact is the tremendous variance in theaters, in theater operations and in the present conditions in the towns and cities of America. In New York, in Dallas, here in Washington at your Earle Theater and kindred theaters, you see huge attendance. It is very easy to think that sort of thing is general all over the country. Within a 100-mile radius of my town, we have towns with Army camps, war plants; big towns and little towns that have been aided materially by the war and its accompanying activities. But, gentlemen, we also have Menard and many towns like it right around us where, in our own case, there is no new activity. We have sent 611 men and boys into the service from our modest population. Over 300 men, women, and children have left us for war jobs, construction jobs, and higher-pay jobs. We are the head of our chamber of commerce down home—we know these facts to be true, and there is a situation prevalent in a vast number of American towns today.

Our job in the theater has been to keep up our end against this vital loss in population. If unfair taxes cause too high admissions our attendance will decrease. The record has been clear through the years on that point. On the current tax basis our Government will receive approximately 156,000,000 from the theaters. Diminishing returns in tax receipts will follow the lowering of gross receipts though the tax itself may be higher. We, of the theaters, face that known fact. In the small town our audience must come to us two or three times a week if we are to keep open. We cannot charge city prices in the small-town show. People who go to the big theater go but once a week at the high price. We show three and four changes of program a week in the single-theater town. Many theaters will close if attendance is curtailed by even a small number today.

Gentlemen, our business is not a luxury. Perhaps a hundred years ago, if they had existed, the movies like all amusements would have been called that. That is not true today, and with due respect to any and all other businesses, the theater man truly resents, on the record of what our theaters have done, the classification apparently of our business with the liquor, tobacco, perfumery, and horse-racing activities, as a subject for a higher rate of tax than any industry we know of.

When the Secretary of the Treasury, Mr. Morgenthau, called the theaters of the country "the cash registers of the Treasury," we took pride in our Third War Loan efforts and all similar activities. We are dedicated to the continuance of this task, come what may. When the Treasury Department advocated a 200 percent increase in admission taxes, we were frankly shocked. We know that there is too much talk of big money in our industry—millions of dollars seem to be thrown around rather liberally. But, gentlemen, may I say to you that there are several thousands of us who operate theaters who

are not working with millions of dollars, but for millions of people who count on us to give them much in recreation for a modest sum in return for 2 hours of pleasure which daily includes some message from our Government that inspires them and starts them off the next day with new zest and new will for the job at hand.

We of the small theaters were astonished when we learned that any increase in admission tax was contemplated. We could not feel on the record that this added tax could be put on that vast number of small town and suburban low-price theaters throughout the country, handicapped as they are today by labor, replacement, and maintenance difficulties plus a steadily rising operating cost.

But, sirs, theater men have proved themselves game and willing fighters, wholeheartedly behind our Government. We theater owners of Texas have filed with the chairman of your committee our honest thought as contained in this resolution before me. I have a copy for each of you if you wish it.

We do not oppose an increase in admission taxes, we will do our best to help provide it. But, gentlemen, we ask for an increase that will not be destructive, one that will not disrupt the part of this industry we little fellows hold. We ask you to consider and if possible recognize the needs of the children of America, and the needs of the rank and file of the American public in our towns and in our localities. We ask you to recognize the wisdom of the tax experts who originally advocated a tax of 2 cents for each 15-cent unit of admission. With no thought of throwing another plan at you, we ask you to consider the following brief proposal. We ask this because we feel that it will bring our Government the financial aid it needs, and yet it will allow us to continue to operate as we feel very sure our Government would have us operate, continuing to do this war job which we have accomplished so well to date.

Gentlemen, we ask your consideration for an increase of admission taxes to theaters of 2 cents for each 15-cent unit of admission, or major fraction thereof. It works this way:

Net admission:	Tax
10 to 22 cents inclusive	2 cents.
23 to 37 cents inclusive	4 cents.
38 to 45 cents inclusive	6 cents, and so on.

Three vital points will be obtained by this tax set-up; such a plan would protect the children's prices over the country. It will protect the small suburban third and fourth run low-price theater without cutting your present revenue. It will allow round figure admission prices of 15, 20, 30, 35, and 40 and 50 cents, as gross admission, a vital result in view of penny and copper conditions in some parts of the country. Finally, it will permit the higher tax on all higher-price admissions, admittedly able in big theaters and at large amusement events to absorb or pass on larger taxes. Gentlemen, to conclude my moments with you, I must tell you frankly that the time limitation given me leaves many things untouched. There may be varied discussions pro and con regarding the New Deal, but there is one common basic American belief in a fair deal. To you, my thanks for this opportunity and the thanks and very real appreciation of a great number of exhibitors all over this country who have been doing a great job under adverse conditions. I know that I

speak for a group of men down in Texas who still have hope and faith that this tax problem which is now before you will be so solved that we may continue to carry on our part of this American way of life for the good of our American people who know that their home picture show is their great means of recreation and one of their greatest aids in knowing how to help their Government and have their home town ready to greet those men and boys who are away from us in the service when they come home again. We, of the theater, believe that we are doing that job, gentlemen—our folks at home have told us so.

On the seal of the Texas Theater Owners in this dedication:

"The public's best interest is our first interest." We are dedicated to the job of working for the good of our country and for the good of our industry. We feel that the future of both is largely in your hands.

The CHAIRMAN. Thank you. I understand that Mr. Rowe is not here, and that Mr. Buchanan will speak in his place.

STATEMENT OF HARRY E. BUCHANAN, REPRESENTING THE THEATER OWNERS' ASSOCIATION OF NORTH CAROLINA AND SOUTH CAROLINA

Mr. BUCHANAN. Mr. Chairman, I have been asked by Mr. Roy Rowe of Hendersonville, N. C., to speak for him as representing the Theater Owners of North and South Carolina, as he is not able to be present. I will state, Mr. Chairman, that, not as printed on the calendar, I represent the motion picture theaters of North and South Carolina, not North and South America.

The CHAIRMAN. Well, we are broadening your scope a little.

Mr. BUCHANAN. In the interest of time I wish to state that the remarks of Mr. Ed Kuykendall, president of the M. P. T. O. A., in regard to the proposed increase in admission taxes, convey in the main the feelings of the theater owners of our association in regard to this proposed tax.

I have been operating theaters in North Carolina since 1919 and there are over 700 theaters in the two Carolinas.

We realize the problem confronting your committee and want to carry all the burden of the war cost that is possible and practicable. However, this is a matter that goes right back to the people and their acceptance of it. Just as there is a stopping place in the amount of tax burden that the people can bear, there is also definitely a stopping place in the increase of admission prices beyond which a fewer number of people will attend the theater.

No one knows this better than we who run theaters. We have experimented in our respective towns in every price level and when we go beyond what the traffic will bear we get fewer patrons.

We believe the same rule applies here. The large theaters in war industry centers at the present are in a temporary and abnormal condition, but the overwhelming majority of the theaters in my State and throughout the country are not in this category.

We think that a 100-percent increase in the present tax will complicate the arrangement of total admission price into the line of diminishing returns.

We suggest a 50-percent increase in the form of a 2-cents tax on each

15 cents instead of the provision as it now stands in the bill. This figure will fit into admission prices with a minimum of decreasing attendance, we believe, and we ask the committee to consider it.

The CHAIRMAN. Thank you.

The next witness is Mr. Biechele.

Mr. KUYKENDALL. Mr. Biechele is not here and he asked that I tell you that he endorses what I said.

The CHAIRMAN. Mr. Brennan.

STATEMENT OF JOSEPH H. BRENNAN, REPRESENTING THE ALLIED THEATERS OF NEW ENGLAND, INC.

Mr. BRENNAN. Mr. Chairman, my name is Joseph H. Brennan, representing the Allied Theaters of New England. Everything I might have said has been covered by Mr. Kuykendall, Mr. Myers, and the others. I concure in what they say and leave the fate of our 200 theaters in the hands of you, Mr. Chairman, and the members of your Committee.

The CHAIRMAN. Thank you very much, Mr. Brennan.

The next is Mr. Levy.

Mr. LEVY. My name is Herman M. Levy, representing the Motion Picture Theaters of America. My views have been consolidated with those of Mr. Kuykendall, and I would like to have that count as my appearance.

The CHAIRMAN. Thank you very much. Mr. Fay.

Mr. KUYKENDALL. Mr. Fay is not here, sir, but he asked me to speak for him.

The CHAIRMAN. Mr. Crockett.

Mr. CROCKETT. Mr. Chairman, I shall not take more than 2 minutes of your time.

The CHAIRMAN. Proceed.

STATEMENT OF WILLIAM F. CROCKETT, REPRESENTING THE MOTION PICTURE THEATER OWNERS OF VIRGINIA

Mr. CROCKETT. Mr. Chairman, and gentlemen of the committee, the Motion Picture Theater Owners of Virginia, Inc., is an organization comprised of approximately 150 theater owners operating over 200 theaters in the State of Virginia. The theaters of our country are now carrying a box-office or excise tax of 1 cent on every 10 cents or fraction thereof. It is proposed in the revenue bill pending before this committee to double this tax, making it 2 cents for evey 10 cents or fraction thereof. In many instances the theaters have absorbed all or a portion of the present tax and, therefore, would be forced to increase their rates of admissions and pass on to the public this proposed increase.

Many theaters in the State of Virginia which are not located in defense areas are finding it very difficult to continue operation under the present tax. An increase in admission price will mean a loss of revenue for these operators already faced with the problems of transportation for rural patrons, caused by gas and rubber shortage. For this reason I do not feel that the proposed increase will produce $312,000,000 in place of the $156,000,000 anticipated for this year under the

present tax. I depend on two small theaters located at Virginia Beach, Va., a town of 5,000 people, for my livelihood. Our box-office tax last month ran around $1,800 and over the period of a year will be about $24,000, this representing approximately 13 percent of my gross take.

When this tax was enacted my theater absorbed it, and we are now charging the same admissions that we charged in 1938 and 1939. We want to offer the people in our town good, wholesome recreation and keep them off the streets as much as possible, soldiers, sailors, and war workers who have been added to our community and are not afforded the normal recreation and comforts of their home life in peacetime. We know that we can best do this by not increasing our admissions and driving many of these people to less desirable types of amusement.

The proposed increase in admission tax becomes a hardship when you consider it from the standpoint of the working man when he brings his family to the movies and has the additional admission to pay on himself, his wife, and probably three children. This is especially significant with rural and agricultural workers.

Theater owners throughout Virginia feel that the present tax is sufficient and we do not feel that we can pay from 20 to 25 percent of our gross take as a tax and successfully operate our theaters giving service to the public at all times as we now do.

Many theaters located in areas not affected by the war effort, or with the population decrease due to the war effort, will be forced to close, thereby taking at least a portion of this type of recreation from these localities and not producing the 100 percent increase in boxoffice tax as anticipated.

Gentlemen, I appeal to you, representing a group of practical theater men who provide recreation for people who have to have the cheaper entertainment as well as those who can financially afford to select other types of entertainment. We feel that we could not still do this job under as heavy a tax as is proposed at the box office of our theaters. Thank you.

The CHAIRMAN. Thank you very much.

Mr. Lamb.

Mr. KUYKENDALL. Mr. Lamb of Rome, Ga., was unable to come, and I was speaking for him also.

The CHAIRMAN. Mr. Williams.

Mr. KUYKENDALL. Mr. Williams is in the same category.

The CHAIRMAN. Mr. Wehrenberg.

Mr. KUYKENDALL. Mr. Wehrenberg is a member of our organization also.

The CHAIRMAN. That finishes this call, with the exception of Mr. Marsh. You are not appearing on the admission taxes.

Mr. MARSH. No, sir; I think that subject has been pretty well dealt with.

The CHAIRMAN. Yes, sir; we have had a very good hearing on it. We appreciate the fact that many other theater owners and motion-picture people could have given us information, but I think we will get it from the briefs that are filed, and the appearances that have been made today.

All right, Mr. Marsh.

STATEMENT OF BENJAMIN C. MARSH, REPRESENTING THE PEOPLE'S LOBBY

Mr. MARSH. My name is Benjamin C. Marsh; I appear as executive secretary of the People's Lobby, with offices here.

The revenue bill passed by the House of Representatives is moral treason, and whether through design or in ignorance, a stab in the back of our armed forces.

It serves notice upon soldiers that they were conscripted not only to fight the war but to pay altogether too much of the cost. It is a double-cross of our defenders.

It is highly inflationary.

The deficit for this year will be about $57,000,000,000, and at the end of the war the debt will probably, under present tax rates, be about $250,000,000,000.

A $250,000,000,000 debt means, if we estimate the number of families as 34,000,000, a per family debt of about $7,400, and annual interest charges thereon at only 2½ percent, of $185.

Perhaps I ought to say that possibly one reason the House Committee on Ways and Means voted out such a pernicious bill, which, of course, was not discussed on the floor of the House, was that owing to my absence in the West I could not appear before the committee and suggest something intelligent to them, but I am doing that for the benefit of this committee.

The bill should be Americanized to raise at least $17,500,000,000 additional revenue, without taxing any family or individual with an income less than required for a healthy standard of living, and this above compulsory savings where they are practical.

Of course, there are sins of commission as well as omission in the bill which you have from the House without the assent, I am sure, of many Members of the House. All these taxes on people who have less income than they need to live on, and the reduction of the exemption to $500, is clearly un-American.

Immediate post-war planning can be started now, by a fair tax bill, which means raising about $12,000,000,000 more by taxes on personal incomes and corporation profits, $5,000,000,000 by a progressive capital levy with a moderate exemption, and a Federal excise tax on the privilege of holding land based on its value, with a low exemption to protect small farm and home owners.

I would like to call the attention of the committee to the fact that this suggestion for the capital levy is not new in American tax history and experience. Both parties, all parties, perhaps I should say, have favored the principle of a progressive Federal estate tax, and the capital levy is merely a pre-mortem estate tax, since, of course, we can't wait for all the wealthy and good people of America to die before we pay this war debt.

Secretary of Agriculture Wickard recently stated to the National Association of Real Estate Boards:

> Today we are in great danger from a farm land boom which is already under way—

and he recommended a capital-gains resale tax, which he explained—

> simply means the levying of a much stiffer tax on deeds or transfers of land than we now have.

This does not go far enough, for the selling price of farm lands has since the war started increased about $5,000,000,000, while net income of agricultural proprietors increased from 1939 to 1943, 216 percent.

That was a larger percentage increase than any other group or occupation in America, even a larger percent increase than the profits of corporations.

This tax on land values will limit speculative gains of urban, as well as agricultural, Astors and should yield at least $500,000,000.

Failure to tax the increased incomes of highly paid workers in industries and transportation, and wealthy farmers, and permitting them to buy bonds, is a confession that our boasted system of private enterprise has collapsed, and an effort to shore it up a little by providing a shock absorber for a few million families.

Such a tax program must be tied in with strictly enforced price ceilings and rationing and full Government controls.

America is just beginning to fight, but hasn't yet begun to tax.

Fighting—psychological as well as physical—can win the war, but a pay-as-you-go, through pay-as-you-can tax program is essential to win the peace.

I shall take only a very few minutes more. It seems to me that Congress should, in facing this tax problem, use the same principle exactly as we followed in conscripting the Army. The Army and Navy determined how many men were needed; then the Congress enacted the conscription law designed and intended to provide the number of men needed. It seems to me that, instead of having a hit-or-miss taxation program, which is evidently what is in prospect, that Congress should determine, and primarily through the House Ways and Means Committee and the Senate Finance Committee, how much money should be raised and should then, on that basis, ascertain the rates.

Of course, it would not be incumbent on me to suggest the exact rates, because it involves a lot of very careful actuarial work, but fortunately your Joint Committee on Taxation has such statisticians and the Treasury Department has others, and they can ascertain what those rates should be. We certainly should pay between a half and two-thirds of the cost of the war currently—that is, by current taxation—and we can do it without in any way going counter to the basic canon of taxation, that of not impairing the patrimony of the State.

It seems to us the Treasury Department is absolutely correct in asking for ten and a half billion—we make it seventeen and one-half billion—more to be raised by taxes. They simply don't go far enough.

I don't know whether your committee can revise the House bill before you in time to get the rates we suggest and the principles we suggest incorporated, but, if you don't, I am very sure that it will mean simply that you have got to go through this whole problem in the very beginning of the next Congress and get out a tax bill which will not leave us with such a terrific debt.

I should like, with your permission, to read into the record a very brief article from the columns of the Washington Daily News, by Raymond Clapper, appearing Monday of this week, November 29, on this tax bill.

The CHAIRMAN. You may do so.

(The article referred to is as follows:)

UNSOUND REASONING

By Raymond Clapper

The old-timer in Congress will tell the freshman that the way to stay in office is to vote in favor of all appropriation bills and against all tax bills. This is sound advice for one whose object is to be reelected.

But shouldn't some chances be taken, considering it is wartime?

If you swallow what some are saying around Washington you become convinced that the country can't stand another penny of taxes.

Although the administration asks for 10½ billion more in taxes, Republicans and Democrats alike cry that this will break the country.

Republican members of the House Ways and Means Committee join in solemnly reporting that they would be false to their trust were they to "saddle this heavy additional burden on the backs of taxpayers already heavily burdened." Democrats sided with the Republicans and they appeared in a love feast recommending 2½ billions instead of 10½. Senate Republicans and Senate Democrats indicate that they will take the same position. The administration won't stand for a sales tax. That would be unpopular in the lower brackets.

So there you are.

They do put up two excuses. One excuse is that the Government war expenses won't be as heavy as had been estimated some months ago. True. We will spend 92 billion instead of 100 billion. By June the national debt will be 194 billions instead of 8 or 10 billions more.

The second excuse is that the country can't afford more taxes. You can get hard-luck stories from every group in the country. And by the time the testimony is assembled it appears that there is not a single cent left that Internal Revenue could take.

Taxes are high and we could well believe that they could not go higher, and that, as the House Ways and Means Republicans say, it takes only one straw to break the camel's back, and that if we put on more taxes now people will slow down in war production and their morale will break. Maybe so.

But it is interesting to look in the back of the newspaper at the financial-page news. I got so depressed over this cry-baby tax stuff that I turned to the New York Times' financial section to brace up my morale.

There I found department-store sales, as reported by the Federal Reserve Board, running 20 percent more than a year ago, and in some cases 40 or 50 percent higher.

Some allowance must be made for higher prices this year. Even so, there must be a terrific amount of money to spend when department-store sales are up over a year ago by such percentages as these: Akron, 26; Atlanta, 37; Birmingham, 29; Boston, 20; Buffalo, 22; Chicago, 17; Cincinnati, 23; Columbus, 40; Dallas, 61; Fort Worth, 47; Houston, 51; Indianapolis, 42; Louisville, 31; Oklahome City, 54; San Antonio, 30; Tulsa, 42.

Further in the New York Times' financial section I see the Security and Exchange Commission report on salaries, headlined: "Salary increases heavy in 2 years. "Many increases of 100 percent." These are reports of 121 corporations, mostly doing war work. Probably the men are worth what they are paid. As a hired hand I always favor high salaries.

But the figures don't indicate any condition of poverty e[illegible]r on the part of the companies or of the executives. Eugene Grace, of Bethlehem Steel, remained the individual leader, his salary going from $478,000 in 1940 to $537,000 in 1942. Second place went to Roland Chilton, of Wright Aeronautical, who jumped from $168,000 in 1941 to $372,000 last year. Some jumps appear to cover increased taxes.

People who make good money should be the last to complain of high taxes. If a man is earning enough to pay to the Government money that will keep the war going 30 seconds, or a full minute, or that will pay for a hospital where the casualties of those bloody hours at Tarawa can be restored, he ought to be glad to serve as a tax collector for Uncle Sam. Big taxpayers always have enough left to live on.

Mr. MARSH. I would also like to point out that in the decade from 1932 to 1942 the increase of property income was four times labor's increase; that is, the increase from wages and salaries of those in

private enterprise, which I think is a very strong argument for the tax program I have suggested. I have a short article here from the People's Lobby Bulletin, which I would like to insert in the record at this point.

The CHAIRMAN. You may insert that.

(The article referred is as follows:)

NEW DEAL DECADE INCREASES PROPERTY INCOME FOURFOLD LABOR'S INCREASE IN INCOME

Despite the claims of New Dealers to be a labor government, the increase in income from ownership or control of property, was four times greater than increase in salaries and wages, in private industry, in the New Deal decade ending in 1942.

The New Deal decade was a killing for—not of—economic royalists.

The Department of Commerce (Survey of Current Business, March 1943) analysis of national income by distributive shares, shows who have been the real beneficiaries of nonproductive employment at public expense, of party and conservation payments to farmers, of relief, of subsidies, and of taxes upon consumption instead of upon property income.

In 1932 national income was, in round figures, $39.9 billion; in 1942, $119.8 billion—an increase of 200 percent.

In 1932, wages and salaries in private industry were $26.1 billion; in 1942, $66.7 billion—an increase of 156 percent.

PROPERTY INCOME SOARS

In 1932, income from ownership or control of property—net income of incorporated business and of proprietors, and from interest and net rents and royalties—was $4.3 billion; in 1942, $32.7 billion; an increase of $28.4 billion or 661 percent—which was over four times the increase in income from salaries and wages in private industry.

The increase in income from net rents and royalties was, in the decade, $1,600 million, or more than six times greater than the $250 million decrease in interest payments, on Government and non-Government debt.

The increase in net income of all proprietors (not corporations), was $15.2 billion, or 319 percent.

The increase in net income of agricultural properties was $8,200,000,000, or 555 percent, and this increase gave strength to the farm bloc of speculators in farm lands, seeking to serfize producers on farms, and to create a Wall Street for agriculture.

It is true many farmers operated at a loss in 1932, but many unemployed were hungry and ragged.

The Bureau of Internal Revenue reports that in 1941, 339 persons had net incomes of $300,000 to $500,000; 146 of $500,000 to $1,000,000, and 44 of over $1,000,000. From 85 to 90 percent or more of such incomes is from property.

The increase in salaries and wages in civil government agencies is carefully concealed by including noncivil agencies—the entire armed forces of the Nation.

CIVIL PAY-ROLL RISES

In 1932 salaries and wages in all governmental agencies were $4,971,000,000; in 1942, $13,536,000,000, an increase of $8,565,000,000, or 173 percent.

In neither year do the figures include subsistence of the armed forces, and salaries and wages thereof could not have much exceeded $500,000,000 in 1932 or $3,500,000,000 in 1942.

Even geniuses in our armed forces, and there are many, would have to get a huge increase in salary before they would be affected by a $25,000 limit on salaries.

Salaries and wages in civil government agencies probably increased about three-quarters in this decade.

The monthly Federal executive pay roll jumped from $141,000,000 in September 1939 to $170,300,000 in December 1942. In March 1943 it was $552,700,000.

During this decade, supplements to salaries and wages increased from $634,000,000 to $3,375,000,000—by $2,741,000,000, or 432 percent.

Of this increase a new item, social-security contributions of employers, accounted for $2,039,000,000—almost three quarters.

PRODUCERS' SHARE FALLS

In 1932 salaries and wages in private industry were about 66 percent of national income; in 1942 only 56 percent.

In 1932 total compensation of employees was almost 80 percent of national income; in 1942 only 70 percent.

These Department of Commerce figures of national income by distributive shares do not indicate the maldistribution of such income by classes.

That is shown by the reports of the Commissioner of Internal Revenue in giving the number of persons in income brackets above the minimum health standard, and even those figures are not satisfactory, since the family income is not reported.

HOW PENSIONERS FARE

The Office of Price Administration reports the average monthly income, in the second half of 1942, of various classes on fixed incomes:

2,230,000 with old-age assistance	$22.80
460,000 on general relief	27.40
62,000 getting old-age insurance, etc	20.40
800,000 getting veterans' pension (Dec. 1942)	42.90

A footnote states: "Excluding interest, rents, and military pay," but this would not materially affect the figures.

The increase in the national income—of which total compensation of employees constituted a smaller proportion most years from 1932 to 1942—was in large measure due to "deficiteering," that is, increasing the national debt rapidly, and interest charges gradually, as national debt piles up.

This record has an important bearing on our foreign policy, starting in Spain, and can be more candidly discussed after we defeat the Fascist Axis, abroad, and can turn major attention to the Fascist Axis at home.

The United Nations know that unless America practices the four freedoms at home during the war it won't export any of them after the war.

Mr. MARSH. I have suggested a new feature advocated by an important Government official, the Secretary of Agriculture. He made a talk on this land increment tax for farm lands at the National Association of Real Estate Boards in Cleveland on November 18, and made the same suggestion to the National Grange at their annual meeting the day before. It is a few pages, and it gives the reason for such a tax. If you are willing, I should like to incorporate that in the record, and that is the last request I shall make.

The CHAIRMAN. Yes, sir; it may be put in.

(The address referred to is as follows:)

[United States Department of Agriculture, Washington 25, D. C.]

HOLDING THE LINE ON FARM-LAND VALUES

Address by Secretary of Agriculture Claude R. Wickard Before the National Association of Real Estate Boards, Cleveland, Ohio, Thursday, November 18, 1943, at 2:30 p. m.

I was glad to accept the invitation to speak to this meeting of the National Association of Real Estate Boards because I know you have a definite interest in land values.

Today we are in great danger from a farm-land boom which is already under way and unless we do something about it soon we are going to build up future headaches for farmers and their families and for a good many real-estate men as well.

I want to review with you what has been happening to land values in the recent past and to give you my best estimate of what lies ahead. Finally, I want to bring to your attention some possible actions which we may take to protect ourselves against a runaway land market.

Those of you who have not followed the farm-land situation closely may be somewhat surprised to know that land values in this war have increased at just

about the same rate that they did in World War I. But we must remember that in the last boom the peak did not come until more than a year after the war ended.

Even though prices have gone up, it seems certain they would be much higher today if it had not been for certain factors. For one thing, a good many of the farmers owning land cannot forget what happened after the last war and they have been most reluctant to extend themselves to purchase more land at high prices because they know what happened to them or their neighbors who did just that during and after the last war.

As you know the last big boom reached its height in 1919–20. Then, for 18 long years, land values were on a toboggan slide. The slope was steep from 1920 to 1924, fairly gentle from 1924 to 1930, but again steeper than ever from 1930 to 1933.

But this ill-fated ride that land values took doesn't tell the real story of what happened to literally hundreds of thousands of people involved in that terrific plunge that ended so disastrously for them. In 1921 farmers and "investors" began losing their farms in mounting numbers. Estimates have placed the number of farms and tracts lost by forced sale since 1920 at more than 2,000,000. This means that the equivalent of one-fourth to one-third of all land in farms has gone through forced sale in the last 22 years. The great bulk of these involuntary transfers had as their chief cause an initial mistake of a man's paying too much for land.

Even the figures on how many people lost their land only begin to tell the story. In scores of thousands of cases, loss of the farm meant loss of a man's or a family's life savings. Usually it meant moving—and being forced back down the "agricultural ladder" to the status of a tenant. A continuing sense of frustration, failure, and fear became the lot of many unfortunate farm families.

The more dogged, stubborn owners did not yield easily. They "hung on"—many for just a few years, some even until today. Because of the heavy required payments for interest and principal on excessively mortgaged farms, great numbers of farm families were reduced to low levels of living in their attempts to retain ownership.

Some were so determined to make the best of a bad bargain that they funneled every dollar and cent they could rake and scrape into that rat hole of inflation, leaving them and their families with scarcely enough funds to provide even the simple necessities of life. All too often farmers overcropper their land and mined their soil in their struggle to retain ownership of their farms and homes.

The old saying has it that a burned child dreads the fire and for those farmers who were "burned" once the memory of their previous experience is enough to hold them back. However, the last boom occurred nearly a quarter of a century ago and there are many others who can come into the land market now.

A second reason why land values have not gone up farther and faster than they have to date is that many farmers have been using their increased income to pay off the mortgages against their land now. Farmers not only are keeping their payments up better but in a great many cases they are making prepayments on their obligations and in numerous instances have gotten themselves entirely out of debt. We estimate farm mortgage indebtedness today is about 80 percent of what it averaged from 1935 to 1939. This is all to the good, because it indicates that farmers are getting into a better situation regarding mortgaged land.

A third moderating influence is the fact that this war is an all-out struggle and has brought difficulties to farmers which undoubtedly have kept some of them from buying land up to this time. To a much greater extent than in the last war farmers have been unable to get necessary equipment, fertilizer, labor, and other essentials for operating more land.

Finally, the hold-the-line program has had a stabilizing influence on farm commodity prices and thus has served as a brake on any scramble for farm land in an effort to cash in on extremely high commodity prices.

Although these factors have operated thus far to moderate the rise in farm-land values I want to say to you, with all the emphasis that I can command, that we must not be lulled into a sense of false security by what has happened so far. In fact, when some of these factors disappear, the stage will be set for even a steeper and faster rise than after the last war. For instance, when farmers can get machinery and labor and they are free of debt, the demand for farms will increase by leaps and bounds because they will have more credit to buy land and more facilities to operate it. We are prone to compare present land values

with the peak of the inflation following the last war and to be comforted by the fact that we are still considerably below that peak.

Again, I ask you to remember that the rise since the beginning of this war has been just about as much as the rise during the comparable period in the last World War. And we know this is going to be a much longer war than the last one. That in itself should warn us of trouble ahead.

Despite the restraining influences I have named the evidence available to the Department of Agriculture clearly indicates that a genuine farm land boom has gained momentum in some of the important agricultural regions of the country. The Department of Agriculture's national index of the average per-acre value of farm real estate and improvements on July 1, 1943, was 23 percent above the 1935-39 base; we expect our estimate for November to be 27 percent above.

Much larger increases have occurred in the eastern Corn Belt and in the East South Central States, approximating 50 percent in Indiana and Kentucky. For the United States as a whole, the average rate of increase in values has been about 1 percent a month during the last year—the highest rate of increase on record except in 1919-20, at the crest of the World War I boom.

The volume of voluntary transfers during the last year was also the highest on record, with the single exception of that same peak year of 1919-20.

In contrast to the usual sharp seasonal decline, the volume of sales during the second quarter of 1943 was only slightly under that of the first quarter, and almost 75 percent above the second quarter of 1942. Preliminary figures for the third quarter are also substantially above those for the comparable quarter a year ago. Should this trend continue the volume for the year ending next March will exceed that of the record year 1919-20. Reports are also being received of farms changing hands two or more times within a single year at higher prices—a sure sign that speculation has begun. And, despite the fact that the total farm mortgage debt for the country as a whole has declined, evidence is accumulating that on many farms now being sold, unsafe mortgage debts are being incurred that will make trouble later on.

The subject is now receiving increasing attention in both the urban and rural press, on the radio, in banking and financial circles, by farm organizations, and by Members of Congress.

I will give you one example to illustrate what is happening. A friend of mine from Iowa was in my office last week and told me about a farm that he bought in 1934 for $87 an acre. He has made some improvements on that farm and he now values it at $125 an acre. That is what he thinks the land is worth over a period of years. His farm is not for sale, but the farm next to his sold recently, not for $125 an acre but for $225 an acre. This example can be multiplied over and over again.

The information we have available indicates rather clearly that not nearly all farm land is being bought by bona fide operating farmers. Much of it is being bought by city people for one reason or another. Because city people are entering the land market I am especially desirous of bringing the whole land boom problem to the attention of you members of the National Association of Real Estate Boards.

One important reason for city people buying farms is that there are less restrictions on the purchase of land than there are on some of the other purchases which city people might normally make.

Under these conditions it is only natural that city people are putting their money into land either in the hope of making good investments or as a hedge against inflation, which they fear. I suppose few of them realize it, but the very fact that they are bidding up the price of farm land is contributing to the inflation which they are trying to escape by their purchases.

Another factor that I want to mention among those which threaten to push the price of land up is really the basic fiscal problem facing the country today. That is the disparity between the amount of income being earned by the people of the United States and the amount of goods and services which are available.

Income payments to individuals are estimated for the year 1943 at $142,000,000,000. Of this amount about $18,000,000,000 is being absorbed by taxes falling directly upon individuals, leaving them with $124,000,000,000 to spend or save. The goods and services available will amount to about $90,000,000,000 worth, leaving $34,000,000,000 of excess spending power. This $34,000,000,000 is the lever which is pushing upward against our price controls in other directions, and which makes positive action necessary if we are to hold the line on land values as we have on other things.

It seems to me in view of the facts I have mentioned there can be little doubt that a land boom is well under way and may, unless checked, reach even greater proportions that the last one and that the consequences of the following deflation will, of course, be even more devastating.

The evil aftereffects of the land boom of 1915-20 spread like wildfire into nearly every part of our economic system and for two decades worked a havoc whose scars can never be erased. School, road, and similar bonds went into default, banks closed, business stagnation resulted. Many communities found it difficult even to keep the schools open. Aside from the economic repercussions, the second major wave of foreclosures which began in 1930 gave rise to a great deal of social bitterness within communities. Farmers' feelings of deep resentment were directed toward creditors and officials who sought to carry through foreclosure and dispossession. Not infrequently a farmer and his neighbors resorted to physical force to prevent eviction.

Creditor's agents, judges, and sheriffs were threatened with violence—threats which sometimes were carried out. In some areas, the normal civil process of foreclosure and execution was virtually suspended. Federal and State lending agencies stepped in to "bail out" private lenders and to adjust the burden on mortgagors by refinancing hundreds of millions of dollars of farm-mortgage debt. Much of the cost of these programs was a public cost, paid by the general taxpayer.

You as real-estate dealers can do many things right now in applying the brakes to inflated land values. For instance, you can advise people of the dangers of falling prices in the post-war period. Tell them they should think in terms of normal prices and not war prices when they purchase real estate.

Also, you can help create sentiment in this country for a more adequate tax program. One of the domestic questions which should be more clearly understood is the great need for an adequate tax program to drain off the "dangerous" dollars which people have in their pockets and which they are trying so hard to spend. I cannot believe that the people of this country fully realize the great need for more taxes. Perhaps it is a question of failing to see what will happen if we do not have a good tax program for 1944. I know that taxes are never pleasant and I know also that it is not possible to write a tax bill that does not result in some inequities.

However, I would rather have the slight inequities which arise from an adequate tax program than the great inequities which will result from an inadequate tax program and an inflation which can wreck the hopes and aspirations of millions of our people. Surely, it is easier and better to pay taxes now while we have good incomes than to defer the collecting of taxes to a time when we will have less income, and when our fighting men will have returned from war and we shall be struggling to maintain employment. I sincerely believe that a program providing for increased taxes now will pay us in dollars and cents and happiness in the long run.

In addition to whatever we may do, so far as increased taxes are concerned, I am sure we will need an additional and more direct attack on the problem of rising land values. I firmly believe the time has come to take some decisive action to put the brakes on the price of land.

We must hold the line on the price of land just as we must hold the line on other prices and wages in our economy.

I would like to think that this matter of controlling land inflation could be worked out without the necessity for Government action. But knowing the complexity of the problem, and the nature of present price trends, and mindful of our experiences of the past, I am convinced that some form of direct action is necessary now.

To delay is to court more and more the dangers of what happened during and after the last war. By all means we need to find some way to curb the land speculator.

Now I should like to discuss briefly some of the methods which have been proposed as possible brakes on the land boom. Before I outline them I want to say that all of the proposals have objectionable features in that they interfere with the people's freedom of action in one degree or another. The very nature of the problem is such that this is inevitable. It's a question of weighing the freedom of action of a relatively few people against the welfare of the Nation. It is a startling fact that a relatively few people involved in this land-boom business can cause a far-reaching catastrophe.

The direct emergency controls in the land market which have been suggested include such types of measures as (1) restriction of credit, (2) ceiling prices on

land-use permits to purchase, (3) transfer tax, and (4) capital-gains resale tax.

The restriction of credit would operate to limit the direct use of credit in the purchase of farm real estate and also to limit the possible expansion of credit on farm real estate not transferred. Credit control would really mean making loans on a basis of normal land values, as the Farm Credit Administration is doing now, instead of running the loan appraisal sky high. A weakness of the credit-control principle is that it does not reach the man who has the cash.

The ceiling and permit plan would apply on land values in much the same way that commodity ceilings are applicable now. This plan would require prospective owners to obtain a purchase permit from some local committee before they could buy land. The fact that this plan—the ceiling and the permit—has been considered shows how concerned people are over this matter of inflation, because it is far reaching in principle and drastic in application.

The transfer-tax plan simply means the levying of a much stiffer tax on deeds or transfers of land than we now have. This would get at part of the problem, but one objection which has been raised to it is that it would affect all transfers and would not operate against only the speculator.

After studying the various plans that have been set forth, and obtaining the advice of the farm organization leaders, I am convinced that the approach most worthy of our consideration at this time is the so-called farm-land boom profits tax or capital-gains tax. Briefly, this plan calls for a stiff special tax on profits made from the resale of farm real estate acquired during the emergency period. It would work this way: Profit arising from the first sale of a farm following adoption of this plan would not be subject to this special tax. The tax would apply only on the second sale, or any subsequent resale during the emergency period. The longer the farm was held by one owner the smaller would be his tax.

The reason this plan appeals to me is that it does not interfere with or penalize in any way the bona fide farmer. For instance, a farmer who decides to retire and sells his farm is not subject to the special tax. Nor is the tenant who buys such a farm. However, the speculator who buys a farm and resells it within a month or 6 months or a year is hit, and hit hard. In other words, the tax is designed to encourage stability of ownership and to discourage circumstances such as we experienced in the last boom when a farm might change hands as frequently as several times in a year, each time at a higher figure. I urge you to study this plan. I believe we should adopt it or some other effective and equitable measure.

Our post-war problems are going to be difficult enough even if we are fortunate enough to escape the inevitable consequences of inflation and a land boom. But if we have to deal with the aftermath of a land boom on top of our other inescapable problems of adjustment and employment, the sledding will be that much tougher and the suffering that much greater. We must take steps to avoid such a circumstance, because we owe it to ourselves and our children. We certainly owe it to those brave boys who are fighting for our freedom and happiness. When they have made victory complete let us see that they don't suffer because we have permitted a few speculators to get us into a skyrocketing land boom.

Mr. MARSH. Thank you very much, and I want to express my appreciation for the patience of this committee, which has sat continuously for hours.

The CHAIRMAN. Thank you.

We will recess until tomorrow morning at 10 o'clock.

(Whereupon, at 5:45 p. m., the committee was in recess until 10 a. m. Thursday, December 2, 1943.)

REVENUE ACT OF 1943

THURSDAY, DECEMBER 2, 1943

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

The committee met, pursuant to adjournment, at 10 a. m., in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

Present: Senators George (chairman), Walsh, Barkley, Clark, Byrd, Guffey, Johnson, Lucas, Vandenberg, Davis, Taft, Thomas, Butler, and Millikin.

The CHAIRMAN. The committee will come to order.

Senator Hatch, did you wish to make a statement?

Senator HATCH. No, except that Mr. Davis is going to give some information concerning an amendment which I offered yesterday. It was printed and is before the committee at this time.

The CHAIRMAN. Did not the House put in an amendment?

Senator HATCH. The House puts in an amendment but it made some changes in existing law which I do not think should be made.

The CHAIRMAN. Restricting it for the duration?

Senator HATCH. Yes, and did away with a discovery allowance, which has been a permanent thing, and gave a depletion allowance to restrict the depletion during the duration.

The CHAIRMAN. All right, Mr. Davis.

STATEMENT OF F. O. DAVIS, TREASURER, POTASH CO. OF AMERICA

Mr. DAVIS. Mr. Chairman and gentlemen, my name is F. O. Davis. I am appearing for the potash industry.

I should like to file a memorandum and make a brief statement with reference to the depletion amendment.

The CHAIRMAN. All right, Mr. Davis, you may proceed.

Mr. DAVIS. (1) Importance and use of potash: Potash is of vital interest to the American farmer. Over 90 percent of domestic production is consumed in agriculture. The principal consuming areas are in the New England, Middle Atlantic, and Central and Southern States. The balance is widely used in the chemical industry.

(2) Prior to World War I, all potash consumed in the United States was imported from Germany through the European potash cartel. In January 1915 Germany placed an embargo upon the exportation of potash. During the first war period the potash shortage in this country became acute, comparable to the rubber shortage in the present war. Existing potash stocks became exhausted. Potash prices increased more than tenfold. Due to this crisis, desperate efforts were made to secure potash from any source, and 128 plants

were put into operation during the war. Shortly after the end of the war European competition reentered our market with the result that only one primary domestic producer was able to survive.

In the face of intense foreign competition, production of potash commenced in New Mexico in 1931 and the infant domestic potash industry developed to a point where, at the beginning of the present war in 1939, it was supplying 55 percent of the American potash market. The balance was furnished by the German potash cartel.

Senator VANDENBERG. Is there a tariff on it?

Mr. DAVIS. There is no tariff on it. The present war again cut off importation.

In spite of the fact that domestic consumption has almost doubled since 1939, the domestic producers have made every effort to meet this demand.

(3) Foreign competition: The domestic potash industry has developed despite foreign competition and without tariff protection. The European potash reserves are sufficient to supply the entire world needs for hundreds of years to come and are immeasurably greater than our domestic reserves. The European potash producers can reach the principal American consuming areas at a transportation cost approximately half that incurred by the domestic industry.

It is obvious that the European producers will make every effort to regain their lost American market. The domestic industry will be faced again with intensive foreign competition at the end of the war. The foreign producers will, therefore, have strong advantages over the domestic producers in the coming competitive battle.

Known world potash reserves are estimated as follows in tons of K_2O: K_2O is the pure potash content as it is used in the trade.

Germany	2, 500, 000, 000
Palestine	1, 200, 000, 000
Russia	700, 000, 000
France	300, 000, 000
Spain	270, 000, 000
United States	85, 000, 000
Poland	10, 000, 000

The source of the foregoing table is Potash in North America, by J. W. Turrentine, president, American Potash Institute.

The CHAIRMAN. 85,000,000 was the limit of our deposits?

Mr. DAVIS. 85,000,000 is the limit of our known deposits today.

Senator GUFFEY. Are you making searches for additional deposits?

Mr. DAVIS. Yes, sir; we are constantly carrying on exploration.

Senator GUFFEY. How much of this is in New Mexico, and where are there other deposits?

Mr. DAVIS. There are only two major points in the United States: One is in New Mexico where there is an underground potash deposit, and the other is in California at Searles Lake. There is an additional deposit in Lake Bonneville, which is the dry lake area west of the Great Salt Lake and where there is now a small operation in force.

(4) Future needs: Present demand for potash in the United States is in excess of present productive capacity. There will be a further substantial increase in demand for potash in 1944. Government officials have advised us that post-war requirements for a period of years will equal if not exceed current demand. The future needs of agriculture for potash to meet essential plant requirements and rectify needed potash soil deficiencies will continue to grow. American

agriculture must, therefore, be assured of an increased supply of domestically produced potash in order to obtain maximum crops. Present productive capacity can only be increased if productive facilities are expanded. Furthermore, it is desirable to develop new sources of production through exploration. Both of these require large capital outlays. It has been stated to this committee by a Treasury representative that the granting of percentage depletion cannot be expected to bring about the discovery and development of new potash deposits. The granting of permanent percentage depletion to producers will make possible the expansion of present facilities and prospecting for additional deposits. All potash deposits now being mined in this nation were discovered and developed by private capital at an expenditure of many millions of dollars.

Under existing circumstances there is no incentive for present or prospective producers to engage in an expensive program of increased plant facilities or exploration, both of which involve expenditures of vast sums of money. In the face of increased production which is resulting in accelerated depletion of mineral reserves, the industry is suffering diminishing returns. In addition, it is faced with the post-war threat of competition from imports. The percentage depletion which for many years has been granted to other members of the mining industry was based to some degree on this incentive feature, and the situation is not different with respect to potash.

(5) Price trend: During the past 12 years, representing the period of the domestic industry's major growth, the price of potash has been substantially reduced, saving the American farmer millions of dollars. (Price charged by German cartel, 1913–14, $44.89 per ton; peak price World War I, $485 per ton; average price 1921–33, $37.66 per ton; 1933 price, $36.86 per ton; price 1937 to date, $28.72 per ton.)

Senator VANDENBERG. Is that a controlled price?

Mr. DAVIS. No. It is, of course, now under the general O. P. A. ceilings, but it was in force before those went into effect.

Senator LUCAS. What do you mean by "it is in force"?

Mr. DAVIS. It had been the price of the industry for some 5 years before.

Senator LUCAS. Why is there such a disparity between the price of potash during this emergency and the previous emergency?

Mr. DAVIS. Primarily because the American producers have been able to maintain it and have passed on the benefit of their lowered costs.

The CHAIRMAN. We had no potash production in World War I.

Mr. DAVIS. We had no potash production whatsoever before World War I.

The CHAIRMAN. The production started since. We were wholly dependent on Germany at the time of World War I, and pretty soon after the war started we were out of it and we paid enormously high prices for the potash we could get.

Mr. DAVIS. Yes.

The price of potash has remained unchanged for the last 7 years in the face of the rising costs of supplies, labor, transportation, and taxes.

(6) The potash industry has never received percentage depletion. The bill under consideration, H. R. 3687, provides for percentage depletion for the potash industry only for the duration of the war. It takes away from present companies entitled thereto discovery depletion. Potash is not a wartime industry, yet, due to the war, it

has been forced to accelerate its production greatly and such added production has not resulted in additional profit to the producers. American potash producers are depleting their known limited raw material reserves at a time when labor and other costs are high, and they should receive permanent percentage depletion for their diminishing raw material reserves in accordance with the well-established policy of Congress of granting such depletion to other minerals.

(7) The foregoing statements with respect to supply, present and future demand, and the essentiality of potash in times of peace as well as war, can be substantiated by Mr. Dale C. Kieffer in charge of the administration of the potash program in the War Production Board, and Mr. Cedric Gran who holds a similar position in the Office of Price Administration.

The CHAIRMAN. Are there any questions of Mr. Davis?

There seem to be no questions. Thank you very much, Mr. Davis.

Senator HATCH. Mr. Chairman, there are other representatives of the potash industry here.

The CHAIRMAN. Do they wish to file a brief?

Senator HATCH. I think the brief filed covers the whole situation, unless the committee desires to hear from them.

The CHAIRMAN. I do not think so, Senator Hatch. We understand the position. The House has given you a certain percentage depletion, but limited it to the wartime, and made certain changes in the act.

Senator HATCH. Yes.

(The memorandum submitted is as follows:)

MEMORANDUM RE PERCENTAGE DEPLETION FOR POTASH

I. THE PROPOSED AMENDMENT

The House bill (H. R. 3687) extends percentage depletion to potash, but only for the duration of the present war. The amendment proposed by Senator Hatch, which we support, is intended to continue the allowance after the war, and to clarify the computation of "income from the property."

The proposed amendment is as follows:

(1) On page 32, line 6, after "(b)" insert the following: "(except as they relate to potash)".

(2) On page 32, after line 17, insert the following new subsection:

"(e) INCOME FROM POTASH MINES OR DEPOSITS.—Section 114 (b) (4) is amended by adding at the end thereof the following sentence: 'In the case of potash, whether extracted from a mine or from a brine or other deposit, there shall be included in gross and net income from the property the income from other minerals or mineral salts extracted therefrom.'"

The necessity for this amendment is discussed in detail below.

II. THE POTASH INDUSTRY NEEDS AND MERITS PERCENTAGE DEPLETION ON A PERMANENT BASIS

Importance and use of potash.

(1) Potash is of vital interest to the American farmer. Over 90 percent of domestic production is consumed in agriculture. The principal consuming areas are in the New England, Middle Atlantic, and Central and Southern States. The balance is widely used in the chemical industry.

(2) Prior to World War I, all potash consumed in the United States was imported from Germany through the European Potash Cartel. In January 1915 Germany placed an embargo upon the exportation of potash. During the first war period the potash shortage in this country became acute, comparable to the rubber shortage in the present war. Existing potash stocks became exhausted. Potash prices increased more than tenfold. Due to this crisis, desperate efforts were made to secure potash from any source, and 128 plants were put into operation during the war. Shortly after the end of the war European competition

reentered our market with the result that only one primary domestic producer was able to survive.

In the face of intense foreign competition, production of potash commenced in New Mexico in 1931 and the infant domestic potash industry developed to a point where, at the beginning of the present war in 1939, it was supplying 55 percent of the American potash market. The balance was furnished by the German potash cartel. The present war again cut off importation.

In spite of the fact that domestic consumption has almost doubled since 1939, the domestic producers have made every effort to meet this demand.

Foreign competition.

(3) The domestic potash industry has developed despite foreign competition and without tariff protection. The European potash reserves are sufficient to supply the entire world needs for hundreds of years to come and are immeasurably greater than our domestic reserves. The European potash producers can reach the principal American consuming areas at a transportation cost approximately half that incurred by the domestic industry.

It is obvious that the European producers will make every effort to regain their lost American market. The domestic industry will be faced again with intensive foreign competition at the end of the war. The foreign producers will, therefore, have strong advantages over the domestic producers in the coming competitive battle.

Known world potash reserves are estimated as follows (in tons of K_2O):

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United States	85, 000, 000
Poland	10, 000, 000

The source of the foregoing is Potash in North America, by J. W. Turrentine, president, American Potash Institute.

Future needs.

(4) Present demand for potash in the United States is in excess of present productive capacity. There will be a further substantial increase in demand for potash in 1944. Government officials have advised us that post-war requirements for a period of years will equal if not exceed current demand. The future needs of agriculture for potash to meet essential plant requirements and rectify needed potash soil deficiencies will continue to grow. American agriculture must, therefore, be assured of an increased supply of domestically produced potash in order to obtain maximum crops. Present productive capacity can only be increased if productive facilities are expanded. Furthermore, it is desirable to develop new sources of production through exploration. Both of these require large capital outlays. It has been stated to this committee by a Treasury representative that the granting of percentage depletion cannot be expected to bring about the discovery and development of new potash deposits. The granting of permanent percentage depletion to producers will make possible the expansion of present facilities and prospecting for additional deposits. All potash deposits now being mined in this Nation were discovered and developed by private capital at an expenditure of many millions of dollars.

Under existing circumstances there is no incentive for present or prospective producers to engage in an expensive program of increased plant facilities or exploration, both of which involve expenditures of vast sums of money. In the face of increased production which is resulting in accelerated depletion of mineral reserves, the industry is suffering diminishing returns. In addition, it is faced with the post-war threat of competition from imports. The percentage depletion which for many years has been granted to other members of the mining industry was based to some degree on this incentive feature, and the situation is not different with respect to potash.

Price trend.

(5) During the past 12 years, representing the period of the domestic industry's major growth, the price of potash has been substantially reduced, saving the American farmer millions of dollars. (Price charged by German cartel, 1913–14, $44.89 per ton; peak price World War I, $485 per ton; average price, 1921–33, $37.66 per ton; 1933 price, $36.86 per ton; price 1937 to date, $28.72 per ton.)

The price of potash has remained unchanged for the last 7 years in the face of the rising costs of supplies, labor, transportation, and taxes.

(6) The potash industry has never received percentage depletion. The bill under consideration, H. R. 3387, provides for percentage depletion for the potash industry only for the duration of the war. It takes away from present companies entitled thereto discovery depletion. Potash is not a wartime industry, yet, due to the war, it has been forced to accelerate its production greatly and such added production has not resulted in additional profit to the producers. American potash producers are depleting their known limited raw material reserves at a time when labor and other costs are high, and they should receive permanent percentage depletion for their diminishing raw material reserves in accordance with the well-established policy of Congress of granting such depletion to other minerals.

(7) The foregoing statements with respect to supply, present and future demand, and the essentiality of potash in times of peace as well as war, can be substantiated by Mr. Dale C. Kieffer in charge of the administration of the potash program in the War Production Board, and Mr. Cedric Gran, who holds a similar position in the Office of Price Administration.

III. THE UNDERLYING THEORY OF PERCENTAGE DEPLETION IS APPLICABLE TO POTASH

Percentage depletion as a tax policy is based on three underlying considerations:

(1) The simplicity of determining the annual percentage depletion allowance—as compared with the insuperable difficulty of determining fair and accurate unit depletion allowances based on cost, discovery, or March 1, 1913, values.

(2) The wise public policy of stimulating the search for new mineral deposits.

(3) The equalization of tax burdens among competitors within a single mining industry.

These considerations have been the basis for applying percentage depletion to oil, gas, coal, iron, copper, lead, zinc, gold, silver, fluorspar, clay, rock asphalt, sulfur, and many other minerals. They have equal application to potash, which should be similarly treated.

Simplicity considerations.

The difficulty of ascertaining proper unit depletion allowances is extraordinarily acute in the case of potash. One leading producer was engaged in a dispute with the Bureau of Internal Revenue for more than 6 years over the question of the fair market value of the property for discovery value depletion purposes.

Litigation was ultimately required and a number of experts testified, all finding different valuations—some as high as 10 times the value proposed to be allowed by the Bureau. The Tax Court of the United States (then the United States Board of Tax Appeals) found a value which differed from all the experts, and appears (with deference to the Court) to have arbitrarily chosen a figure simply as a means of terminating the litigation.

Another leading producer was forced to go through similar protracted negotiations with respect to discovery value, and ultimately accepted an arbitrary valuation in order to avoid the expense and risk of unpredictable litigation. The properties of a third large company, whose depletable basis depends on March 1, 1913 value, were valued as high as $75,000,000 by valuation engineers in 1913. Nevertheless, it was forced to accept a compromise value of approximately $18,000,000 in 1931 on a purely arbitrary basis, because of the difficulties of undertaking proof of value 18 years earlier.

These valuation difficulties are not surprising. The industry is such that only the analytical appraisal method of valuation is available. This involves an estimation in advance of prices and costs for many years—more than 25 years in the case of one company. The sound determination of such valuation factors is obviously impossible.

In addition to valuation difficulties, the determination of the recoverable content of the deposit, in order to arrive at a unit depletion rate, is particularly unreliable. Tonnage estimates in potash mines are notoriously a matter of fortuitous guesswork. In the case of subterranean brine deposits, from which a large part of domestic potash is recovered, it is almost an engineering impossibility to forecast reliably the amount of potash which will ultimately be recovered from the underground brine deposit. Consequently, the unit rate can never be fixed with any real permanence, and is the subject of continued disagreement with the Bureau.

These are precisely the administrative difficulties which percentage depletion is designed to avoid.

Encouragement of new discoveries.

Incentive to search out new mineral resources is another fundamental purpose of percentage depletion. This principle could hardly be more appropriate in any mining industry than in potash. The vital importance of potash to our agriculture and chemical industries has been pointed out; the dangers incurred in depending on a foreign supply have already been forcibly demonstrated in this country, and have been described above; and the competitive difficulties encountered in continuing a domestic supply from known deposits have also been outlined. These considerations remove any doubt that potash is within the group of minerals, the search for which should be promoted by percentage depletion.

Equalization of competitors' tax burdens.

A major vice of depletion based on cost, or discovery, or March 1, 1913, value, is wide variation of depletion allowances among competitors. The potash industry is a standard price industry. Moreover, since approximately 80 percent of the output is from the same area (Carlsbad, N. Mex.), labor, material, and overhead costs are substantially uniform. When these factors are coupled with the fact that the depletion reserve constitutes a large portion of earnings after taxes, it will be seen that any substantial variation in depletion allowances will strengthen the cash position of one producer as against another. Upon cash resources depend, of course, any technological improvements and expansions of the enterprise.

This very situation was a major reason for the adoption in 1932 of percentage depletion for mining in general. One producer may have a relatively high discovery value, another a low discovery value, a third an intermediate March 1, 1913, value, and a fourth, a still different cost basis for depletion. One may have a large tonnage estimate and be able to count on depletion allowances for a long while to come. Another must prepare against the time, soon to come, when the estimated tonnage will have been recovered and the depletion deduction ended. Yet these differences may be largely fortuitous, depending upon how arbitrary is the settlement of valuation controversies.

This is exactly the present situation in the potash industry. If percentage depletion were applicable, however, the depletion allowance would be uniformly determined for all companies on a flat basis—thus strengthening and prolonging the life of the industry.

IV. INCOME "FROM THE PROPERTY"

Percentage depletion is based on a percentage of gross income from the property, and limited to 50 percent of net income from the property. Potash operations are such that the phrase "from the property" should be clarified so as to make it clear that the entire income from the single mineral property will be included. It is believed that this is a proper interpretation of the phrase "income from the property," but the peculiar nature of certain potash operations makes such a construction indispensable to a practical application of percentage depletion to potash. The attached amendment is also designed to remedy this weakness in the bill.

This problem exists in all types of potash operations, but is particularly acute and most easily demonstrated, however, in connection with the extraction of potash from brine deposits. Approximately 15 percent of the total production is from this type of operation.

In the case of the leading brine producer, the mineral property consists of a nonreplenishing subterranean lake of heavy brine containing the potash in solution. The brine is pumped from the lake by means of drilled wells, and the potash is extracted from the brine at the lake site by means of unique evaporation and crystallization processes developed by the company for that purpose. The brine recovered from the company's potash deposits also contains varying amounts of borax, soda ash, and salt cake, and small quantities of lithium phosphate and bromine. Potash is the principal mineral in the brine, but the foregoing supplementary minerals are recovered in commercial quantities from the identical brine as an integral part of the same extractive processes. Their recovery and sale is a necessary incident to the profitable operation of the potash deposit in competition with ordinary potash mining. Accordingly, the deposit is a single mineral property from both a physical and an economic standpoint.

Because of the unusual character of the company's production operations, it would certainly be extremely difficult, and probably entirely impossible, to determine the net income from potash alone on any satisfactory and sound accounting basis. The company has never been able to develop, for any purpose, a

product-by-product cost accounting system on other than purely arbitrary assumptions.

The evaporation and crystallization processes are elaborate in nature. Brine is pumped continuously through a series of processes which constantly require delicate adjustments of temperature, pressure, etc., and chemical analyses of the liquors and products. The separation of the chemical constituents hinges on their differing limits of solubility at different temperatures and under varying pressures.

A characteristic feature is the evaporation of the liquor at high temperatures (except for which the liquor would be supersaturated) followed by quick cooling to a point at which a particular salt will be precipitated in solid form, while other constituents remain in solution. At one stage of the general process, soda ash, and salt cake are partially segregated, and at another stage, but while the liquor still contains about half the potash, borax is removed. Having gone through the process, the liquor is then repeatedly turned back along with the incoming fresh brine from the lake deposit and goes through the whole cycle again and again for further removal of the potash and other products.

Since the various minerals are removed at different stages of the process, and not always at the same time, and in varying quantities from the brine, there is no practical or realistic basis on which to determine the extractive costs properly attributable to any particular mineral taken out in the general processes. For this reason, the determination of net income from the potash alone presents an almost insuperable difficulty in the computation of the percentage depletion deduction.

Nevertheless, the allowance of percentage depletion to this company is particularly appropriate because extreme difficulty has been encountered in connection with the determination of unit depletion allowances. The unique character of the deposit and of the processes necessary to its operation make it very difficult to determine the March 1, 1913, value of the deposit; the amount of the remaining recoverable tonnage; and even the amount of tonnage previously recovered. The availability of percentage depletion would, consistently with its primary purpose, eliminate these problems.

If percentage depletion is confined to the income from potash alone, however, unit depletion difficulties will be greatly multiplied. Heretofore, unit depletion has been allowed on the basis of tons of brine (rather than tons of particular minerals) and this basis has been employed in all attempts at determining the value of recovered and unrecovered content. This is the only method of determining value and content which has thus far even approached feasibility. If percentage depletion is applicable with respect to income from potash only, and not to the entire income from the mineral property, depletion with respect to the remaining minerals will be available only on a unit basis. It will then be necessary to redetermine the March 1, 1913, value, present content, and past production factors on which unit depletion depends by reference to each of the respective minerals, rather than on the basis of the brine as a whole. This would virtually be impossible at this late date.

This phase of the proposed amendment does not involve any extension of the percentage depletion allowance beyond the potash industry. It will, however, avoid possible discriminatory tax treatment in the industry itself, and put the determination of percentage depletion on a practical basis in such cases.

V. CONCLUSION

The proposed amendment with respect to percentage depletion for potash should be adopted, for the following reasons:

(1) Potash is vital to both our wartime and peacetime domestic agriculture and chemical industries.

(2) The domestic supply is limited and normally must be produced under threat of powerful and destructive foreign competition. The preservation and growth of the domestic industry should be assisted.

(3) The underlying theories of percentage depletion—simplicity, incentive, and equalized tax burdens—are especially applicable to the potash industry.

(4) Potash operations are such that the entire income "from the property" must be included in order to put the determination of the allowance on a practical basis, and to prevent unfair discrimination.

Respectfully submitted,

AMERICAN POTASH & CHEMICAL CORPORATION.
INTERNATIONAL MINERALS & CHEMICAL CORPORATION.
POTASH CO. OF AMERICA.
UNITED STATES POTASH CO.

The CHAIRMAN. Senator Maybank.

STATEMENT OF HON. BURNET R. MAYBANK, UNITED STATES SENATOR FROM THE STATE OF SOUTH CAROLINA

Senator MAYBANK. Mr. Chairman, I have a short statement that I would like to read, with your permission. I have three gentlemen here who are experts that I would like to introduce for short statements.

The CHAIRMAN. Yes, sir. Do you wish to introduce them now?

Senator MAYBANK. No. I would prefer to make this short statement and then have the privilege of introducing them.

On October 12, I introduced S. 1426, designed to suspend, for the duration, the existing 10 cents per pound tax on margarine containing yellow color, whether artificial or otherwise, and to restrict the definition of the term "manufacturer" for the duration, so that restaurants, boarding houses, hospitals, and so forth, could color margarine and serve it to their patrons, guests, and employees without incurring the $600 annual license fee now imposed upon them.

On November 3, the House Agriculture Committee, by a vote of 14 to 11 adopted a motion deferring further hearings or action on H. R. 2400 or similar legislation relative to oleomargarine for the balance of the Seventy-eighth Congress. H. R. 2400 by Representative Fulmer was designed to repeal all existing Federal taxes, license fees, and related restrictions on the manufacture, sale, and use of margarine. The House Agriculture Committee in effect declined to consider further H. R. 2400, despite the fact that over 30 witnesses, representing science, manufacturers, wholesalers, retailers, cotton, soybean, livestock, and peanut producers, labor, consumers, and hospitals, unequivocally urged the repeal of the existing discriminatory margarine taxes and license fees. Therefore, I am requesting the Senate Finance Committee to incorporate my bill in the pending Revenue Act of 1944.

The manufacture, sale, and labeling of margarine is now fully and adequately regulated by the Food and Drug Administration under the Pure Food, Drug, and Cosmetic Act, and the standard recently promulgated by that Department for margarine. That supervision is not affected, in any way, by my bill.

I firmly believe that it is in the best interest of the public during this war period for margarine to be made available at its low cost and point value to the consumers throughout this country who are unable to obtain sufficient butter for an adequate diet. We are now reduced to one tablespoon of butter per day per capita, and this, in the opinion of experts in nutrition (and certainly in the opinion of laymen who do not like dry bread and won't eat it), is not enough. The free use of margarine will tend to make up this deficiency and relieve an important wartime scarcity.

All competent nutrition authorities, including the American Medical Association, National Research Council, and our own Department of Agriculture, have established the fact that modern fortified margarine is equal nutritionally to butter. Each pound of margarine packed for consumer use contains 9,000 U. S. P. units of vitamin A, which is the average found in each pound of butter.

The average American who can afford butter and has points to buy it, if his grocer has it to sell, would rather have butter than margarine.

But, as we know, there is not now enough butter and probably will not be for the duration of the war. From the standpoint of nutrition, the deficiency between supply and demand can be supplied with fortified margarine, in a palatable form, if the existing restrictions that my bill proposes to suspend for the duration are removed as handicaps. For too long the consumer has been the "forgotten man" in the efforts of certain butter interests to "exterminate" margarine.

Now, Mr. Chairman, with your permission, I am going to ask that Mr. Carlson be heard.

Senator CLARK. Before you go into that: Your bill is designed to take off the license fee for artificially coloring margarine?

Senator MAYBANK. Taking off the $600 license fee that everyone must pay to color margarine.

Senator CLARK. It does not have anything to do with the price of margarine as such?

Senator MAYBANK. No.

Senator CLARK. The bill is designed to permit people to color the margarine so as to, in some cases, fool people into thinking that it is butter.

That is the only advantage of coloring it, is it not, to make it a more acceptable substitute for butter; not that it has anything to do with the taste, that does not have anything to do with it, except you are trying to improve the competitive position for margarine?

Senator MAYBANK. You can do it now providing you pay the $600 license fee.

Senator CLARK. I eat it myself without coloring. It tastes as well without coloring as it would with coloring.

Senator MAYBANK. That might be correct, but unfortunately in hospitals and other places people refuse to use it in an uncolored form.

Senator CLARK. The coloring matter is the whole subject of the controversy.

Senator MAYBANK. Because of the $600 license fee many small restaurants, many small places cannot afford to pay the $600 license fee.

Senator JOHNSON. Don't you think in hospitals they could serve butter?

Senator MAYBANK. They haven't the butter to serve. That is why I want the experts to testify. I have an expert here from the restaurants and one from the hospitals, and a nutrition expert, to testify to exactly what they are up against in the institutions.

Senator JOHNSON. Will they testify?

Senator MAYBANK. Yes; they are right here.

Senator JOHNSON. Will they testify to the very large volume of butter that has been recently released by the Army so that hospitals can get all the butter they want?

Senator MAYBANK. I trust they can answer any questions that you may want to put to them.

Senator JOHNSON. I hope they will give us that information.

Senator MAYBANK. They will give you all the information that you ask for.

Senator CLARK. That is only during the duration?

Senator MAYBANK. Only during the duration.

Senator GUFFEY. I like margarine, and I like it colored. I do not like to think of eating lard. That is my objection.

The CHAIRMAN. Do you wish the witnesses called now?

Senator MAYBANK. Yes.

The CHAIRMAN. Will you call your first witness?

Senator MAYBANK. Anton J. Carlson.

Senator LUCAS. May I ask one question of Senator Maybank?

The CHAIRMAN. Yes.

Senator LUCAS. You spoke of a bill before the Agricultural Committee, introduced by Mr. Fulmer of South Carolina.

Was that a bill which deals with this subject separately and is not included in the finance bill?

Senator MAYBANK. That is correct. That is a bill not for the duration and not to relieve the present situation where you have to pay 15 and 16 points for butter, whereas you can get this product for 3 points.

STATEMENT OF DR. ANTON J. CARLSON

The CHAIRMAN. All right, sir. We will hear from you on this question.

Dr. CARLSON. I do not want to bore you, but the Senator asked me to state briefly my qualifications to speak before the Senate on this subject.

The CHAIRMAN. Yes, sir.

Dr. CARLSON. Well, I received my training at the Augustanna College in Illinois, and graduate training at Stanford University, California, where I received the Ph. D. degree in 1902. I was for a short time research associate of the Carnegie Institution in Washington, and a short time on the faculty of the medical school, University of Pennsylvania. Since 1904 to 1940, I was on the faculty of the medical school in the University of Chicago, in charge of the department of physiology. During the last 10 years I held one of the 10 distinguished service professorships in that university. I am a member of nearly all the medical, biological, and scientific organizations in this country and a few abroad. Over here I am a member of the National Academy of Sciences, National Research Council, Institute of Nutrition, American Academy of Pediatrics, so forth and so on. I have served in the food and nutrition of the Army in World War I, most of the time in France, and after the armistice, in 1918, I was drafted to the American Relief Administration under Herbert Hoover and served in that capacity particularly in connection with the feeding of the starving children in the war-devastated areas in Europe. I was in that service until 1919. I have been consultant of the U. S. Food and Drug Administration for years. I have assisted the Federal Trade Commission in fields where I have competence. I am a member of the Public Advisory Committee of the U. S. Public Health Service. I think that sufficient, Mr. Chairman.

I have always opposed, I now oppose the prohibitory and discriminatory laws (Federal and State) against margarine, as good margarines are not only good foods, but also, in their class, relatively inexpensive foods. Therefore I favor the passage of Senate bill 1426 with the proposed amendments, as such legislation will void and delete, for the duration, those features of these laws most pernicious to an adequate wartime diet for our civilian population, especially for hur fellow citizens in the lowest income group. These are my reasons:

1. The 10 cents per pound Federal tax on the manufacture of colored margarines is, of course, prohibitory. The millions of pounds of margarines now manufactured for our armed forces, and

for lend-lease, are colored in the process of production, of course, without tax. The civilian population knows, or soon will know, this fact. They will ask Congress: Why deny the same privilege to us civilians who sustain all the home fronts? I am probably telling you nothing new. The State of Wisconsin is a large producer of good milk and good butter. On November 20 I received a communication from Mrs. F. A. Marshall, executive secretary of the Wisconsin League of Women Voters, stating this organization was starting out to eliminate the discriminatory State laws against margarine. The League of Women Voters is organized, I think, in every State in the Union. Our women are not idle in this war. They are also deeply concerned over adequate foods and good diets for good health. Some of the women now resent, and increasing numbers will resent, the waste of time and the waste of food involved in mixing the color into each pound of good but colorless margarine in the home. We cannot work the color into the uncolored margarine in our homes without considerable loss of fat sticking to the mixing bowl. You say: This loss is too small to be significant. At present, maybe. But don't be too flippant. Before the war is over even we may learn, the hard way, to clear our dinner plates before they are put into the dishpan. Other nations have already learned this lesson. The butter manufacturers add the same color to winter butter in the process of butter making. The housewives will ask you, "How can it be wrong to do the same in the case of good margarines? Why do you tax the latter 10 cents per pound?" Honor bright, what will be your answer, if you do not pass this bill?

2. I have heard this argument: Granted that coloring margarines in the process of manufacture eliminates unnecessary work in the kitchen as well as unnecessary food waste, the pending legislation will not yield more margarine to replace the shortage of butter, as the fats available for margarine production have been fixed by the F. D. A. Yes, for the present the F. D. A. has fixed the quantity and kinds of fats for margarine production. But the O. P. A. regulations are not immutable laws of nature. It is, obviously a question of the balance between the needs for foods, and the needs for ammunition. The production of and the efficient use of ammunition will go down, if and when the essential foods needs run short. The passage of this legislation will permit speedy adjustments of the food-ammunition ratio according to shifting needs.

3. A few weeks ago, at the public hearing on the House bill 2400, I spoke in favor of that bill, a piece of legislation essentially similar to the bill now under consideration by your committee, except that its remedial measures are not limited to the war emergency. The present prohibitive and punitive Federal legislations in regard to margarine are, in my humble judgment, bad laws in times of peace, and even worse laws in times of war. The Senators who may still be inclined to let the present Federal margarine legislation stand, even during our war emergency, are probably influenced by arguments of facts and fancy that led to the enactment of the laws we now seek to amend. These arguments were:

(*a*) Margarine as a food is inferior to good butter.

(*b*) Colored margarine may be fraudulently sold as butter.

(*c*) Margarine, as a competitor of butter, will work injury to the butter trade, if not to the more important dairy industry. May I

have your attention for a few brief minutes while I examine these alleged facts in the light of our 1943 knowledge?

4. If margarines are inferior foods, bad foods, they should be prohibited, not regulated. Margarines are not rendered more nutritious and wholesome by adding the color in the kitchen instead of in the factory.

But it is fair to state that at the time when some of the present restrictive and prohibitive laws in regard to margarine were enacted by Congress and by the several States, we did not have the amount of accurate information touching on the nutrition values for man of butter and other animal fats, or of vegetable fats, such as in margarine, now at our disposal. It will also be granted that few if any of the food industries concerned had at that time the knowledge, the experience, and the skill to produce the good margarine manufactured today. It will also be conceded that in those days individual retail dealers occasionally practiced fraud on the consumer by selling colored margarine as butter and at the then current price of butter. This factor of fraud, so far as it can be handled by Federal legislation, is now adequately taken care of by the new Food, Drug, and Cosmetic Act, and the regulations authorized by that act.

5. While it is a fact that the fat in cow's milk, that is, butter, differs chemically from other animal fats, as well as from the vegetable fats used in the production of margarine, it is now well established that the digestibility, the energy, and the over-all nutritive value of all these fats as food for man are so nearly identical that when butter or margarine made from these fats form the usual part of our American diet, no differences can be detected except possibly in content of vitamins A and D, in color, and in flavor. The apparent superiority of butterfat over vegetable fats in favoring, for a few days, the more rapid growth of weanling or pre-weanling rats reported by some investigators, has not been confirmed. In fact, it has been disproved. This is in line with history and the lesson of nature. Man is the only animal using milk as food after weaning. The domestication of the cow and the goat came very late in human evolution, and is not yet universal in all lands. It is therefore clear that the individual man has attained and can maintain his present physical and mental stature on other foods than milk or butter, after his mother's breast dries up.

6. The amounts of vitamin A (and provitamin A or carotines) and of vitamin D in butter depend on the nature of the diet of the cow, and on the amount of exposure of the cow to sunlight. The green out-of-door pasture of the summer yields milk and butter high enough in vitamin A to be significant in our national nutrition and health. The carotines (provitamin A) give the yellow color to good summer butter. Everybody knows, or should know, that winter butter is less yellow. It is gray or white, unless artificially colored. There is a common notion, only partly correct, that the yellow color of butter is an index of the vitamin A content of the butter. When the yellow color of butter is provided by nonnutritious (though noninjurious) coal-tar dye added by the butter maker, without informing the consumer, it is a means of deception. The amount of vitamin D in natural milk and butter is of less significance in our national nutrition. Our major supply of this important food element must come from other food sources, plus exposure to the sun.

7. The sciences of nutrition, chemistry, and biochemistry, as well as the industrial skills, have now reached a point where the vitamins A and D can be concentrated from natural sources (for example, fish livers) and when added to margarine rendered as stable or more stable than are these vitamins in butter. When this is done the margarine is a more uniform and dependable year around source of these important vitamins than is butter. The usual absence or low content of vitamin A in the margarine offered to the American consumer at the time some of our present Federal and State margarine legislation was enacted was the chief scientific argument advanced in favor of this legislation. That argument is invalid today.

8. So far as we know now (apart from carotine), color and flavor in butter and in margarine play no essential role in digestion, nutrition, and metabolism, except as related to food habits. But food habits, food flavor, and the esthetic aspect of foods cannot be entirely ignored in national nutrition. As stated before, the yellow color of summer butter can be duplicated in winter butter and in margarine by coal tar dyes, proven harmless to man. The chemicals responsible for the essential flavor of typical good fresh butter are known in part. Some of them can be made, and added to margarine just as they are now made and added to butter. So far as we know such color and flavor in butter or in margarine give these foods no increased nutritional value, but to our fellow citizens of today, on account of our past and present food habits, they do contribute to the pleasure of eating, and this, in turn, acts favorably on the digestion and the absorption of foods.

9. What I have said so far I think is true and I think it can be, it has been substantiated by others, by such competent authorities as the National Research Council and the New York Academy of Medicine. That I am dealing with established facts is probably within the knowledge of the honorable members of this committee. I have no personal financial interest in this bill. It is not my desire to advise you to take an unwise step. I think it is a fact that our present restrictive and prohibitive margarine laws were enacted under pressure from the fear that the growing production of margarine for human food would work injury to the dairy industry. If I saw any truth or sense in this argument I would oppose this bill, for cow's milk, when clean, is such a good human food, that I want its production and consumption expanded, not curtailed. I will oppose any and all legislation that will or that might restrict milk production, milk distribution, and milk consumption, or in any way add financial hazards to that important food industry. But butter is not milk. The dairy industry is bigger than the butter trade. I said I had no personal economic interest in this bill. But I have a profound public interest in it, because it touches—through the pocketbook—the state of health of our financially less fortunate fellow citizens, and if enacted into law it may lead to a better state of health—through better nutrition—of our Nation as a whole, by increasing the consumption of whole milk, instead of merely the fat in the milk.

10. I have elsewhere discussed the several obstacles in the path toward an optimum diet for all people in our land with its abundance of good foods. These obstacles are many. There is neither time nor occasion to discuss all of them here. I brought with me for the members of this committee copies of my recent paper on this aspect of our national nutrition problem, should you want them. One of

these obstacles is poverty. There is no question but that poverty is one factor in the malnutrition found among our financially less fortunate fellow citizens. These people would be better off in health did they buy and eat 2 pounds of good margarine in the place of 1 pound of good butter, or 1 pound of good margarine and 2 quarts of fresh whole milk, as may be done at approximately the same cost. All special taxes on foods are by economic necessity added to the basic cost of production and distribution of these foods, and hence finally to the retail cost of the food to the consumer. I have said elsewhere publicly, and I say to you now: The present special taxes—national and State—on margarine so far as they are not actually prohibitory, are taxes on an important food item of our less fortunate fellow men. They are special taxes on the poor, on "the forgotten man," and contribute to whatever poor state of health from poor diets may be present among these people.

11. The production and consumption of butter and of liquid or frozen cream in this country leaves an enormous quantity of skim milk and buttermilk as byproducts. Because of the common notion that the main food value of milk for man is in the cream and the butter, the notion that skim milk is good food only for chickens, hogs, and calves, huge quantities of this precious food do not reach the human stomach. It is now proved beyond the shadow of a doubt, that skim milk and buttermilk, because of their contents of proteins, inorganic salts, and vitamins—other than A and D—are just as valuable, of high biologic value, if not more valuable, in man's dietary, than is butter, and cream. The consumption of butter—butter being 80 percent fat—contributes more to the production and waste of skim milk than does the production and consumption of cream—cream being only 20 percent fat. On the basis of our present knowledge of foods and human nutrition, my assertion that—under present conditions—the consumption of all the milk we produce or can produce as whole milk—fresh, evaporated, condensed, or powdered—would add to our reserves and safety in national nutrition and national health, cannot be controverted. To be sure, all milk is not clean and wholesome. To be sure, a few people cannot eat cow's milk in any form without becoming sick. But such difficulties and exceptions apply also to many of our other good and natural foods. Therefore, if the production and consumption of more good margarine should decrease the production and consumption of butter, decrease the waste of skim milk, and increase the consumption of whole milk, national nutrition would be the gainer, and the dairy farmer would suffer no loss.

In an editorial in the Dairy Record of November 10, 1943, commenting on the public hearing on House bill 2400, that trade journal charges me with advocating that the dairy industry breed cows that will give only skim milk. Bad laws are not improved by feeble jokes. The few grains of gray matter inside our skulls, provided by a generous nature, could render more farsighted leadership, even in the butter trade. On my statements of facts, at that hearing, and today: That good margarines are nutritionally equivalent to good butters; that skim milk contains important nutrients not present in butter; that there is greater health assurance for our Nation in consuming all the nutrients in all the cow's milk we can produce, instead of just the cream and the butter and feeding the skim milk to animals. On these statements of facts I challenge to public debate any butter

maker, any farmer, any Member of Congress, in fact, any man or woman.

12. In brief: Good butter and good margarine are both good foods. They are not chemically identical, but they are nutritionally equivalent. Each can and should stand on its own merit. The facts that these two good foods are chemically different provides no sound basis for legal discrimination against one in favor of the other. Meat is a good food, oatmeal is a good food. But these two good foods differ in chemical composition. Lard, olive oil, beef fat and butter differ chemically. But they are good foods for man. It would be absurd to pass or retain discriminatory laws against olive oil, beef fat, and lard, on the basis that these three fats differ chemically from butter. The present discriminatory laws against margarine are equally absurd and myopic, in war and in peace.

I am through. If I seem to have exaggerated and said something which you doubt, I am here to answer such questions as you may wish to ask me.

The CHAIRMAN. Are there any questions that anyone would like to ask the doctor?

Senator LUCAS. Dr. Carlson, what are the chemical ingredients of oleomargarine?

Dr. CARLSON. Well, that depends, of course, on what fats are used. I worked somewhat on oleomargarine 25 years ago. They got their name from beef fat. Beef fat was used in oleomargarine in those days.

Senator LUCAS. What are the major ingredients?

Dr. CARLSON. The major ingredients now I think are vegetable oils such as cottonseed oils, refined cottonseed oil, soybean oil. In the past coconut oil was used. In Europe, for example, a great many fats include oleo or beef fats. That is the major ingredient. In addition, vitamin A and in some cases vitamin D are added. Then, a good many churn or make their margarine in skim milk, so that there is more of the milk proteins retained in margarines made in that way than in butter where we wash most of it out. But the specific chemistry, that is the type and kind of fatty acids in margarine will differ, you see, depending on the fat used. Have I answered your question?

Senator LUCAS. That is an answer.

The CHAIRMAN. Are there any other questions?

Senator CLARK. Doctor, in normal times the bulk of the oleomargarine industry is a byproduct of the soap industry, is it not? In other words, from an economic standpoint you can absolutely undersell any other oil used for oleomargarine with the coconut oils. I do not mean there is anything impure in oleomargarine, but from an economic standpoint in normal times the coconut derivatives can undersell any cottonseed oil or any other oil, and even if they use soybean oil?

Dr. CARLSON. What do you meau by coconut derivatives?

Senator CLARK. I mean the coconut oils imported in this country that largely we make soap out of.

Dr. CARLSON. I am not a soap manufacturer nor a soap chemist.

Senator CLARK. Neither am I, but you are an expert, and I am asking you a question.

Dr. CARLSON. I am an expert in food and nutrition, but not in soap. When fats are used for soap there will be no remnants in that fat used for human food.

Senator CLARK. Coconut and coconut oil was introduced into this country largely for the purpose of making soap. They use some of it for soap and some of it for oleomargarine. The point I am making is those fats can, in normal times, undersell cottonseed oil or soybean oil or any of the other generally used oils as a basis for oleomargarine.

Dr. CARLSON. That is possible. I am not an expert on soap; I do not know.

Senator CLARK. It is a very important question.

Dr. CARLSON. If you mean, Senator, of the imported copra or coconut fat, that part of it was used for soap and another part was used for margarine; that is probably true.

Senator CLARK. That is what I mean.

Dr. CARLSON. I understood you to ask me whether the refuse, after you made the soap, was used for making margarine.

Senator CLARK. I was not speaking of the refuse after you make the soap. I was speaking of it in an economic sense. The fact I am trying to establish is in normal times they have imported coconut oil and that would ordinarily undersell domestic oil, and coconut oil is the principal base, in normal times, for manufacturing margarine; is that not correct?

Dr. CARLSON. No; that is not the principal base. I do not know of any margarine now that is made from coconut oil.

Senator CLARK. There is no coconut oil coming in now because of war conditions.

Dr. Carlson. Even before that, for a long, long time. In the past, yes, it was used, but now it is largely cottonseed oil and soybean oil. I know of one big manufacturer 20 years ago that used nothing but oleo oil, the fat from our excessively fat steers which we would normally waste anyway, you know. Have I answered your question?

Senator CLARK. Yes. I expect to have some other witnesses who will claim contrary to your views.

The CHAIRMAN. Thank you very much, Doctor.

Senator MAYBANK. I will ask Dr. John G. Martin to make a brief statement. I know you have got many other matters before you here.

The CHAIRMAN. Yes.

Senator MAYBANK. I would like to ask Dr. Martin to make himself known.

The CHAIRMAN. Yes, sir; Doctor, if you will come around.

Is there another witness here also?

Senator MAYBANK. Yes; but he will be very short.

STATEMENT OF REV. JOHN GOODRICH MARTIN

The CHAIRMAN. Doctor, will you identify yourself to the reporter?

Dr. MARTIN. Mr. James Russell Clark, director of the wartime service bureau of the American Hospital Association, with offices at 1705 K Street NW., in Washington, was not able to be present at this hearing and requested me to present the position of the hospitals of the Nation with regard to Senate 1426.

The American Hospital Association was organized in 1899 with 9 members and now has 3,250 institutional and 2,500 personal members—a total of 5,750.

My name is John Goodridge Martin. I am a personal member and my hospital is an institutional member of the American Hospital Association. I am the administrator of the Hospital of St. Barnabas and for Women and Children, Newark, N. J.; the vice chairman of the joint committee of the American, the Catholic, and the American Protestant Hospital Associations; and I am the president of the American Protestant Hospital Association.

The hospital associations are primarily interested in the health of our people and work to promote approved programs of activity leading to the welfare of the men, women, and children who become patients in hospitals. The care of the sick is not only an important obligation. It is an extremely complex one, involving the professional services of physicians, nurses, medical technicians, and specialists of several kinds. One most vital consideration in the care of the sick is nutrition. Specially trained dietitians are engaged to plan and supervise the preparation and serving of foods with the aim of accelerating the physical recovery of the patients.

A large body of nurses and other personnel live at the hospital and must be provided with maintenance.

The hospitals do not get enough butter to supply the ordinary dietary requirements to which they have been accustomed. They are denied butter, and therefore, seek substitutes for it. A favorite substitute is oleomargarine. This product is credibly stated to contain nutritional values comparable to those of butter. But the legal restrictions to the use of this product in voluntary hospitals deter them from taking advantage of it. I say "voluntary hospitals" for the law expressly permits governmental hospitals to make full use of oleomargarine without any license fee or tax upon the coloring process. The law, section III of the act of August 2, 1896, reads:

> And any person that * * * furnished oleomargarine * * *, except to his own family table without compensation, who shall add to * * * such oleomargarine any substance which causes such oleomargarine to be yellow in color, * * * shall also be held to be a manufacturer * * *.

The regulations of the Bureau of Internal Revenue, under this section, provides:

> ART. 21. COLORATION.—(a) TAXABLE SITUATIONS.—Liability to special tax as a manufacturer and to commodity tax is incurred in the following situations:
>
> * * * * * * *
>
> (3) *Institutions.*—Where a sanatorium, hospital, or any charitable, religious, educational, or other institution colors oleomargarine for the use of inmates or employees of the institution; but see (b) (2) below.
>
> (b) NONTAXABLE SITUATIONS.—Liability is not incurred in the following situations:
>
> * * * * * * *
>
> (2) *Governmental institutions.*—Where an institution under the complete control of the United States, or a State or political subdivision thereof, in the exercise of an essential governmental function, colors oleomargarine for use of inmates or employees of the institution.

It is manifestly unfair to require a license fee and tax of voluntary hospitals which give medical service in large measures to the same types of patients as those served by the governmental hospitals which are exempt from the fees and tax.

The second section of the bill before the Senate Finance Committee, Senate 1426, restricts the definition of the term "manufacturer" so that

hospitals coloring margarine would not be required to pay the manufacturer's license fee of $600 for the duration. The first section suspends, for the duration, the 10-cent-per-pound tax on colored margarine.

A report on butter substitutes by the committee on public health relations of the New York Academy of Medicine states that—

from a nutritional viewpoint, when it is fortified with vitamin A in the required amount, oleomargarine is the equal of butter, containing the same amounts of protein, fat, carbohydrates, and calories per unit of weight. Moreover, since the minimum vitamin A content of "enriched" oleomargarine is fixed and the amount of this vitamin in butter may range from 500 to 20,000 units per pound, "enriched" oleomargarine is a more dependable source of vitamin A than is butter. Since it is a cheaper product than butter, fortified oleomargarine constitutes a good vehicle for the distribution of vitamin A and fats to low-income groups and should, therefore, be made available to them.

Butter is almost impossible to obtain in large quantities for use in hospitals because of the shortage and because maximum price regulations encourage dealers to sell small consumers, being permitted to charge up to 2 cents per pound more in these cases. Butter costs 16 points per pound under the point rationing system, while oleomargarine costs 6 points per pound. The cost of oleomargarine on a cash basis tax-free would be about one-half the cost of butter. We have been advised through the War Food Administration sources that butter will be 20 percent short of supply compared with last year for civilians, whereas the supply of oleomargarine will be 27 percent greater. Therefore, we urge the passage of Senate 1426 so that the tax restrictions on oleomargarine may be lifted and afford hospitals a better opportunity adequately to meet the dietary needs of their patients.

The CHAIRMAN. Thank you very much for your appearance, Doctor. Is there any other witness, Senator Maybank?

Senator MAYBANK. I will ask Mr. Robert J. Wilson if he will come up and explain it from the standpoint of restaurants.

The CHAIRMAN. All right, Mr. Wilson.

STATEMENT OF ROBERT J. WILSON, WASHINGTON SECRETARY, NATIONAL RESTAURANT ASSOCIATION

Mr. WILSON. My name is Robert J. Wilson. I am the Washington secretary of the National Restaurant Association.

This statement is prepared and submitted by the war committee of the National Restaurant Association, representing 58 affiliated States and local associations. These organizations in turn represent approximately 70 percent of the volume of business in the restaurant industry. There is likewise here represented the equivalent of 30,000,000 meals per day. Approximately 90 percent of the establishments so represented can be classified as small, individually owned operations. Included in our representation is that vast feeding operation now conducted in many industrial plants, all of which are devoted exclusively to war work.

The committee entered the picture when the allocation of food was under the War Production Board and followed through when it was transferred to the Office of Price Administration. This committee has to the best of its ability, from the beginning, cooperated with all departments in the Government concerned with food conservation.

The restaurant industry has an ever-present obligation to the public which it must fulfill. As we visualize this obligation, it is to serve adequate, wholesome, nutritious food under clean and sanitary circumstances. This obligation becomes more apparent in wartime.

It has been repeatedly stated by representatives of the Government that equality in the rationing of food must prevail; that there must be no discrimination against persons in one category as contrasted to those in another category. Specifically, it has always been stated that no bias should be shown in favor of the restaurant industry as contrasted with household consumers, nor should any bias be shown in favor of the houshold consumers in contrast to the restaurants.

Margarine. Our committee is in favor of Senate bill No. 1426. The second section thereof restricts the definition of the term "manufacturer" so that restaurants coloring margarine would not be required to pay the manufacturer's license fee of $600 for the duration. The first section suspends, for the duration, the 10-cent per pound tax on colored margarine.

The law is section III of the act of August 2, 1886, as amended, reading:

> And any person that * * * furnishes oleomargarine * * * except to his own family table without compensation who shall add to * * * such margarine any substance which causes such oleomargarine to be yellow in color, * * * shall also be held to be a manufacturer * * *.

The Regulations of the Bureau of Internal Revenue, under this section, provides:

> ART. 21. COLORATION—(a) TAXABLE SITUATIONS.—Liability to special tax as a manufacturer and to commodity tax is incurred in the following situations:
>
> * * * * * * *
>
> (2) *Eating Places.*—Where the proprietor of a hotel, boarding house, restaurant, or other eating place colors and serves oleomargarine to paying guests or employees; * * *.

Senator JOHNSON. Mr. Chairman, may I interrupt to ask the witness what bill he is discussing, if he is discussing a bill before the committee or some bill introduced some place else?

Mr. WILSON. Senate bill 1426.

Senator CLARK. That was a bill rejected by the House committee.

Senator JOHNSON. That is not before us.

Senator MAYBANK. I introduced the bill and asked it be made an amendment to the tax bill.

The CHAIRMAN. Senator Maybank introduced it and referred it to the committee.

Senator JOHNSON. That is not the House bill?

Senator CLARK. No.

Senator JOHNSON. I want to know what the witness is talking about.

Senator WALSH. He asked that the amendment be attached to the tax bill.

Senator JOHNSON. That is all right.

Senator MAYBANK. I asked it to be made an amendment to this bill.

Senator WALSH. Yes.

Mr. WILSON. The following is a copy of a resolution adopted at our National Wartime Conference in Cleveland, Ohio, October 21, 1943:

> Whereas margarine, fortified with vitamin A, is recognized as a wholesome and nutritious food suitable for use as a table spread, seasoning and baking; but

Whereas existing Federal laws and regulations class restaurant coloring and serving colored margarine to the public as manufacturers and impose upon them an annual license fee of $600 per year and 10 cents per pound tax, and the present high point value, cost, and scarcity of butter further aggravate this burden: Therefore be it

Resolved by the National Restaurant Association, in convention assembled, That legislation be enacted, effective for the duration of the war, eliminating all Federal taxes, license fees, and related restrictions on the manufacture, sale, and use of margarine having the approval of the appropriate health authorities of the Federal Government; be it further

Resolved, That the officers of this association be authorized to act accordingly.

There has been some question raised that the service of margarine in restaurants would be deceptive. Under most State laws restaurants are required to post signs to the effect that margarine is being served. There is no disposition on the part of restaurants to deceive their patrons and all necessary steps will be taken by the restaurants themselves to advise the patron that he is obtaining margarine.

We urge that this committee recommend that Senate bill No. 1426 do pass.

The CHAIRMAN. Are there any questions?

If not, thank you very much, Mr. Wilson.

Are there any other witnesses?

Senator MAYBANK. Nothing further, except to express my appreciation for giving me this opportunity to have our matter heard.

Senator CLARK. Now, Mr. Chairman, may I inquire when the opponents to this amendment will be given an opportunity to be heard?

The CHAIRMAN. Today or tomorrow, Senator; any time you can get them in here.

Senator CLARK. Senator, it was not generally known that entirely extraneous amendment, having nothing to do with the raising of revenue, was to be presented until yesterday. I am told there are many people greatly interested in this matter that are at such distances that they will not be able to be here until next week. Senator Thomas told me a few minutes ago he had some constituents that would like to be heard.

The CHAIRMAN. We will have to decide that matter later.

Senator CLARK. It seems to me that it is important that they be notified at the earliest possible moment.

The CHAIRMAN. I do not want to run this committee over next week on a hearing in this oleomargarine matter.

Senator CLARK. I am very reluctant to do it, but since this extraneous of the oleomargarine industry has been injected here I think the industry and the people who are interested in opposition to this ought to be given a fair opportunity to be heard.

The CHAIRMAN. I asked Senator Gillette to have his witnesses here the early part of the week. He said he could not get them here until next week. That means we will have public hearings next week. If that becomes known there will be at least another 100 witnesses who will want to come. I was hoping that we could get them here at least by Friday night and be heard on this question. But then we will hear them. If they cannot come before Monday we will simply have to break into the executive considerations on the bill and let them put in their testimony.

Senator MAYBANK. I only want to say I am rather sorry that such a situation arises, because I am deeply appreciative of the necessity of time.

The CHAIRMAN. We will have hearings, of course. I should frankly state my own view. There isn't any reason, in my judgment, why they could not be here this week. I do not want to exclude them. I imagine there are hundreds of them right around town now.

Senator THOMAS. Mr. Chairman, may I say something on that point?

The CHAIRMAN. Yes, sir.

Senator THOMAS. I haven't any desire whatever to prolong these hearings, because, as a matter of fact, I realize the stress under which the committee is working, but, on the other hand, the representatives from the Northwest live a long ways from here. This matter is something that they knew nothing about.

The CHAIRMAN. I realize that, Senator Thomas. We will not close the hearings until they have had the opportunity of a hearing, but it is simply impossible to say what time at the moment.

Senator CLARK. I will say, Mr. Chairman, my witnesses will be here as soon as they can come. The transportation situation being what it is, it is doubtful when they can get here.

The CHAIRMAN. We will hear them when they come, Senator. We will have to reopen the hearings, of course, or hear them in executive session. We will give them an opportunity to be heard.

Senator THOMAS. I am sure our people from the Northwest will be able to be here by next Monday.

The CHAIRMAN. Senator Gillette advised me that he had some witnesses in charge and he did not think they could get here before Monday. However, he wanted as much time to present witnesses in opposition as was given in favor of the proponents of the matter.

Senator LUCAS. Mr. Chairman, as a matter of information, how long has this tax been on?

Senator CLARK. Since 1902, in the present form.

The CHAIRMAN. Well, a long time. It is a matter which, in the House, is under the jurisdiction of Agriculture. After a prolonged fight, Senator Clark advised me yesterday, and it is a fact, it is under the jurisdiction of the Agricultural Committee. It is a tax, however, and there is a technical jurisdiction in this committee because of the tax feature, otherwise the merits or demerits of the proposal really ought to be considered by other committees, but that is the situation with us.

Is Senator Nye present?

Senator Nye was listed.

(No response.)

The CHAIRMAN. Mr. Lincoln.

Mr. LINCOLN. Yes, sir.

The CHAIRMAN. Senator Clark, suppose you ask the witnesses to come down as soon as they can.

Senator CLARK. Very well, Senator.

How much time will you want, Mr. Lincoln?

Mr. LINCOLN. About 10 or 15 minutes.

Senator WALSH. You came down to talk on the renegotiation?

Mr. LINCOLN. The renegotiation and also the matter of incentive payments.

Senator WALSH. I would like to insert a letter in the record that I received this morning from Representative Carl Vinson, chairman of the Naval Affairs Committee in the House, in which he recommends

certain changes in the renegotiation agreements, and I will ask that it be inserted in the record.

The CHAIRMAN. It may be inserted in the record.

(The matter referred to is as follows:)

COMMITTEE ON NAVAL AFFAIRS,
Washington, D. C., December 1, 1943.

Hon. DAVID I. WALSH,
United States Senate, Washington, D. C.

MY DEAR SENATOR: I herewith enclose a memorandum setting forth certain changes I hope can be made in the renegotiation provisions of H. R. 3687.

This bill, as you know, passed the House under a closed rule and therefore was not open to amendment. I respectfully invite your attention to the criticisms I have made of certain sections of the renegotiation provisions of the tax bill and hope they will be looked into by your committee.

With highest personal regards, I am,

Yours very truly,

CARL VINSON, *Chairman.*

COMMENTS OF REPRESENTATIVE CARL VINSON, CHAIRMAN OF THE COMMITTEE ON NAVAL AFFAIRS OF THE HOUSE OF REPRESENTATIVES, ON THE RENEGOTIATION PROVISIONS (TITLE VII) OF THE REVENUE ACT OF 1943 (H. R. 3687)

(1) PROVISION FOR RECONVERSION ALLOWANCE IMPROPERLY MADE IN RENEGOTIATION

Section 403 (a) (1), on page 102 of the bill, sets up standards to be applied by the departments in determining the existence of excessive profits under the act.

In addition to factors specifically stated, as required to be considered, paragraph (vii) of this subsection provides that there shall be considered—

"such other factors the consideration of which the public interest and equitable dealing may require."

In connection with this paragraph, a disturbing note is sounded by the Ways and Means Committee on page 34 of its report where it is said that in applying this particular paragraph—

"Your committee believes that in computing excessive profits, consideration should be given to the financial problems in connection with reconversion in applying factor g."

Throughout the study which this committee made of renegotiation, arguments were advanced by representatives of industry, urging that special profit allowances be made in renegotiation for reserves to protect contractors in the period of post-war reconversion. This was carefully gone into by the committee and, as indicated on pages 45–57 of the committee's report, it was felt that although industry faced serious problems in connection with the post-war period, such problems were not susceptible of solution through renegotiation. It was evident that many contractors would not require such reserves, and that allowance of reserves would in some cases result in windfalls, and so add unnecessarily to the expense of the war. It also seemed unfair that, although many contractors would have such problems, the only ones who would receive assistance under the act were those who had realized excessive profits on war contracts; since the contractor who charged a reasonable price only had no excessive profits, he could not have the benefit of such an allowance. It was also obvious that in most cases it is impossible to determine at the time of renegotiation what in the way of such reserve a given company will require. There is nothing in the bill which provides for such a reconversion allowance. If one is to be provided, it should be done by clear and specific language, and not by the back-door approach which appears to have been taken. The Senate Finance Committee should make clear in its report that it is not intended to authorize the making of such allowances by this subsection.

(2) EXEMPTION OF CONTRACTS FOR MACHINE TOOLS FROM RENEGOTIATION

Section 403 (a) (5), on page 104, lines 21–23, of the bill, containing the definition of the term "subcontract" for the purpose of the act, excludes from renegotiation all subcontracts not coming within this definition. By restricting the meaning of "subcontract" to contracts for the contract item and component articles, it excludes from renegotiation contracts for the purchase of machine tools necessary

to manufacture the article. The record of testimony before the Naval Affairs Committee (see pp. 1151–1156, 1160) contains convincing evidence that some of the largest and most excessive profits made on war contracts are made by machine-tool companies selling machine tools for use on war contracts. Thus, 19 leading companies in the industry, whose total net worth at the beginning of 1942 was $103,900,000, had net earnings after payment of all income taxes of $45,000,000 in 1942. In the case of the Warner & Swasey Co., profits in 1942, before taxes, were $20,000,000 in comparison with average annual profits before taxes in the years 1936 to 1939 of $1,900,000. This company's profits in 1942 after taxes amounted to $5,460,000, as contrasted with after taxes profits of $1,400,000 in the base years. The company's net worth in 1940 was only $6,027,000. Under the proposed bill a contractor purchasing from a machine-tool manufacturer such tools at a price permitting an excessive—and even an unconscionable profit—can pass the cost of the article on to the Government, and the Government is not permitted to renegotiate the contract with the machine-tool manufacturer so as to eliminate the excessive profit. It seems inequitable that where an airframe manufacturer enters into a contract with one subcontractor to provide aluminum sheets necessary for war planes, and with another subcontractor to provide the presses with which to fabricate those aluminum sheets, the Government should be able to eliminate the excessive profits on the subcontract for the sheets and not be able to eliminate the excessive profits on the subcontract for the presses. This can be rectified by having section 403 (a) (5) read as follows:

"(5) The term 'subcontract' means—

"(A) any purchase order or agreement (other than a contract with a department) to *perform all or any part of the work, or to make or furnish any article, required for the performance of any contract or subcontract or* * * *"

(3) JUDICIAL REVIEW OF RENEGOTIATION DECISIONS

Section 403 (e) (1), on page 119, line 17, to page 121, line 10, provides for judicial review of the administrative determinations of the renegotiating agency. One of the defects of the present law, as discussed on pages 33 and 34 of the House Naval Affairs Committee report, is the lack of specific provision for judicial review of unilateral decisions of the administrative agency. Both the Naval Affairs Committee and the Ways and Means Committee were in unanimous agreement that some form of judicial review should be provided. It was the view of the Naval Affairs Committee that this should be a review by the United States district courts of the administrative decision, and the administrative decision should stand unless the findings of fact of the administrative agency furnished no reasonable basis, for the determination with respect to the existence of excessive profits, or if the administrative action was otherwise arbitrary or capricious, or not in accordance with law. The House bill as passed took an entirely different approach. The judicial review is placed in the Tax Court, but it is not in any sense a review. The court is prohibited by section 403 (c) (1), page 111, lines 3–6, from considering at all the administrative decision. The Tax Court is directed instead to re-try the entire matter de novo, and to ignore completely, all that has gone before. This is wasteful of both time and manpower, and is an entirely new innovation in judicial procedure.

(4) RETROACTIVE FEATURES OF JUDICIAL REVIEW PROVISION

Section 403 (e) (2), page 121, line 11, to page 122, line 18, of the bill would permit every contractor who has signed an agreement refunding excessive profits on war contracts to the Government since the passage of the original Renegotiation Act on April 28, 1942, to reopen the renegotiation proceeding and retry the entire case before The Tax Court de novo. Amazingly enough, under the bill The Tax Court is prohibited from considering the fact that the contractor has entered into a voluntary agreement to refund excessive profits, or the amount of profits which he has voluntarily admitted to be excessive (p. 122, lines 13–18). It is inconsistent to include in a tax bill, whose main purpose is to raise two and a half billion dollars in additional revenue, a provision which will subject the Government to the loss of the more than $5,000,000,000 which have already been saved to the Government through renegotiation. It will justly invoke public criticism of Congress. It also frustrates one of the most important features of the Renegotiation Act—the keeping of procurement on a current basis and the avoidance of conditions such as those that resulted from the last war, where litigation between the Government and contractors continued for more than 20

years after the end of the war. To reopen all of these cases will set the clock back several years. This subsection should be eliminated in its entirety from the bill.

(5) FAILURE TO INCLUDE CERTAIN LEND-LEASE CONTRACTS IN RENEGOTIATION

As set forth on pages 25 and 26 of the Naval Affairs Committee report, the committee's investigation showed that a substantial number of contracts, originally entered into with foreign Governments and then taken over by the United States Government under Lendd-Lease, were not subject to renegotiation, since only contracts directly entered into by the War, Navy, and Treasury Departments and the Maritime Commission for Lend-Lease account are renegotiable. These contracts should be brought within the Renegotiation Act. This can be accomplished by having section 403 (i) (1) (A), page 124, line 19, of the bill read as follows:

"(i) (1) The provisions of this section shall not apply to—

"(A) any contract by a department with any other department, bureau, agency, or governmental corporation of the United States or with any Territory, possession, or State or any agency thereof or with any foreign government or any agency thereof, *except that where any department or any other agency of the United States acquires the interest of any foreign government or any agency thereof, in a contract entered into by such foreign government or any agency thereof with a contractor doing business in the United States, or in a territory or possession thereof, or where any department or any other agency of the United States acquires the right of any foreign government or any agency thereof to the goods, materials, articles, or services to be delivered under such contract, such contract shall be subject to the provisions of this Act just as if the contract had been originally entered into between a department and the contractor, or* * * *."

(6) WAR BROKERS

Public Law 149 (78th Cong.), approved July 14, 1943, effectively regulates the exorbitant fees of the so-called "war brokers" and "influence boys" by defining them "subcontractors" under the Renegotiation Act. One of the principal sources of excessive commissions to these "war brokers" has been their machine-tool contracts. Section 403 (i) (1) (E) of the bill, on page 126, lines 3–6, exempts—

"any subcontract, directly or indirectly under a contract or subcontract exempted from the provisions of this section, or to which this section does not apply, by reason of this paragraph."

The effect of this provision is to make the departments powerless to control these unconscionable commissions on war business. The war brokers who obtain excessive commissions on machine-tool contracts are permitted to retain those commissions without governmental control. This provision should be deleted from the bill.

(7) PROVISIONS FOR AMORTIZATION ALLOWANCE

Section 403 (a) (4) (B), page 102, line 24, to page 104, line 11, provides that in determining profits—"all items of the character allowed as deductions and exclusions under chapters 1 and 2 E of the Internal Revenue Code (excluding taxes measured by income) shall, to the extent allocable to such contracts and subcontracts, be allowed as items of cost."

On page 37 of the report of the Ways and Means Committee, explaining this provision, it is stated that it is intended thereby to include as an allowable item of cost the currently deductible annual amortization allowance. Allowing this as an item of cost in the price of the article purchased, as well as for tax purposes, provides for a double contribution by the Government toward the cost of the emergency facilities acquired by the contractor. This cannot be justified on any basis of logic. Thus, in all departmental cost manuals only normal depreciation is allowed in determining costs for cost-plus-fixed-fee contracts, and estimating costs and prices for fixed-price contracts. This can be corrected by changing the language of this subsection, commencing at line 1, of page 104, to read:

"Except as otherwise provided in the foregoing provisions of this paragraph, all items of the character allowed as deductions and exclusions under chapters 1 and 2 E of the Internal Revenue Code (excluding taxes measured by income,

and that portion of emergency facilities amortization in excess of normal depreciation after giving consideration to the residual value of the facilities) shall, to the extent allocable to such contracts and subcontracts, be allowed as items of cost, but in determining the amount of excessive profits to be eliminated proper adjustment shall be made on account of the taxes so excluded, other than Federal taxes, which are attributable to the portion of the profits which are not excessive."

STATEMENT OF JAMES F. LINCOLN, PRESIDENT, THE LINCOLN ELECTRIC CO., CLEVELAND, OHIO

The CHAIRMAN. Will you identify yourself to the reporter?

Mr. LINCOLN. My name is James F. Lincoln. I am president of the Lincoln Electric Co., Cleveland, Ohio. I am an industrialist and if my testimony is going to be of any advantage it is because of the fact that I am an industrialist and see it from the point of view of industry.

There are two things wrong, from the point of view of the industrialist, with the present proposed tax law as we see it. The first is that it eliminates or penalizes incentive payment of wages. Incentive payment of wages of itself is a tremendously helpful thing in the production of war products.

The second thing, by renegotiation it penalizes the efficiency of operation. I doubt very much if at the time the law was passed either of those was understood by the House that passed them. We have here the development of laws or regulations by the administrators of the law, which makes it, I believe, radically different than the law first intended. The result of this has been that there is a higher cost of war goods by many billions of dollars, in spite of the fact that it had been claimed at some times that there had been a saving by this renegotiation.

The second thing is there is a very much longer delivery, and we have a manpower shortage because of that fact.

I think one of the things that is of considerably more importance than that is the fact that the post-war condition of industry in which they have to meet world competition is tremendously handicapped because inffiecient methods are being developed during the present time which will stand us in bad stead at the end of the war.

I would like now to just dwell briefly on the two penalties I mentioned. In the case of incentives the law has been translated this way: If an amount of money is paid to a man above a certain amount, then that is disallowed as a deduction in the cost of production. We have a situation of this kind. It is on an hourly basis. And hourly measure of production has nothing to do with reality. If a man sits down during the hour, he will be paid equally as much as if he does as much as he can during that hour. The net result is you have an entirely false basis of measurement of production. It is a good deal like measuring distance by bushels or tons. It has no relation to the actual thing which production is. However, when you go from the hourly basis to the basis of the number of pieces the man produces, then you get away entirely from the fact that the amount of money that the man will get will be measured by the amount of time that he is in the factory, and you come to the place where what he actually produces is the thing that measures the amount of money that he is going to be paid. As soon as you do that, as has been done in many cases, and which I believe you admit is a very necessary thing if high production is to be achieved, then you have the condition where the

department steps in and says, "You cannot go above a certain dead level of price per hour," not a dead level of so much per piece.

I would like to illustrate to you just how this works out in our own particular case, because I think our case is a very good example. It happens that we are producing a product which is manufactured by some 15 or 20 other manufacturers. In our case, because of an incentive arrangement we have been able to enormously increase the production per hour compared to any other of our competitors. Because of the fact that we have done that and because of the fact this incentive method has been able to do that it has meant that the amount of pay per hour of our men is relatively high. The pay per piece is very low. I can say to you, in general, that this is a fact, that our actual labor cost per piece is less than half of our competitors, and the amount of money per hour that our men get is, I would say, from 50 percent to 100 percent above our competitors, because we are getting a production about four times that of the average of the industry.

Senator BYRD. What is the amount per hour?

Mr. LINCOLN. The amount per hour will run close to $2.

Senator BYRD. Do incentive payments have to be approved by the War Labor Board?

Mr. LINCOLN. It has been, in fact.

Senator GUGGEY. What do you manufacture?

Mr. LINCOLN. We manufacture arc-welding equipment and electrodes.

As long as a situation of that kind exists where you increase production and pay the men for production, you are going to be limited as to how far you can go, and you can well imagine what is going to happen to the efficiency which you can get under those conditions.

We are in a position of this kind, that we have been penalized $1,600,000 because of the incentive arrangement which we have, in spite of the fact that the Department admits that our labor cost per piece is less than that of any of our competitors.

There is one thing also to think of in a problem of this kind. Supposing we pay the same rate per piece as our competitors, in which our men would be paid twice as much as they are being paid now, what would be the reaction? They say immediately, "We will increase the amount we charge you or eliminate as a deduction by twice the amount we have now." In other words, their point is you cannot go above a certain dead level of efficiency. That, particularly at a time of war, is a thing that cannot be countenanced.

Senator VANDENBERG. Whom do you mean by "they"? The renegotiation board?

Mr. LINCOLN. I am talking of the Treasury Department who have assessed this amount because of the fact that they say we are paying our men too much.

Senator DAVIS. How many employees have you now?

Mr. LINCOLN. About 1,300. I might say in connection with that—this may be of interest—we are getting a production per man per year which is four times that of the average of other companies in the same line of business. So I am merely illustrating the fact that this incentive arrangement is tremendously valuable in the war effort and in the post-war effort.

Senator DAVIS. In other words, your 1,300 employees are doing the work of 6,000 practically.

Mr. LINCOLN. That is correct.

Senator BYRD. How many hours do you work a week?

Mr. LINCOLN. They will average approximately 48 hours. It depends on various production departments. Some departments are a little higher than in other cases.

We therefore make the suggestion to you in connection with this law, this tax law, that incentive pay and that lower cost be allowed as a prima facie deduction. If that is done, it will then put the shoe on the other foot, so that a lower cost producer is able to get the deductions which he should in order to get that lower cost.

The CHAIRMAN. In other words, the burden will be over on the Treasury.

Mr. LINCOLN. That is it. In the case of payments of incentive only

The CHAIRMAN. That is right.

Mr. LINCOLN. That is all I am speaking of.

I want to talk to you on this matter of renegotiation, because again I think the point of view of industry is radically different, perhaps, than that of many people outside the industry.

Let me, first of all, say that to get high efficiency of manufacture is not a simple thing to do. It takes tremendous ability on the part of management in order to do it. Therefore, when high efficiency is obtained, that is something that is very difficult to obtain and is very easy to lose, and all that is necessary to do to reduce efficiency is to allow things to go at loose ends, but when you put enough incentive on allowing it to go, with a penalty on doing the job, you have got a very, very difficult and a very dangerous precedent.

Let me just illustrate the point this way: This happens to be a product we make that sells for 4.8 cents a pound [indicating an electrode]. This is a product made by another industry that sells for 14.4 cents a pound [indicating another electrode]. This one cost about 30 percent more to make than this other one did. Let me show you what happens in connection with that. Because we have reduced the price of this from 15 cents a pound, we will say, down to 4.8 cents a pound, our total sales for the year have been reduced by two-thirds which automatically, because of renegotiation, reduces all profit which we are allowed by two-thirds. If we had not been efficient and kept the price of that up to the place where the competing electrode is now, we would have been allowed by the Renegotiation Board three times as much as we were, since we brought the efficiency up and the price down.

Let me also say one other thing in connection with that.

Senatur LUCAS. Under your theory it pays to be inefficient.

Mr. LINCOLN. Beg pardon?

Senator LUCAS. Under your demonstration it pays to be inefficient.

Mr. LINCOLN. That is exactly the point, and I want to carry that one step further in connection with this.

The inefficient manufacturer who is renegotiated under the present law and who manufactures a number of other things besides this—and I say to you that they do not make money on that—what happens? They renegotiate his profits on this up to the dead level of all the rest, or take the profits off the high profit item and put them on to this so as to bring the price on that, or the profit on that, up to the dead level. Therefore, the efficient manufacturer is, first of all, penalized, while the inefficient manufacturer is encouraged by having his profit

increased. Could anything at a time of war be more deadening on the war effort?

I will go a step further, which is a very, very important thing, and that is this: I can say to you that the operating of an industry is not an easy thing. There are many problems which are before us at the present time, with the rapid turn-over, with the tremendous amount of regulation, which is probably essential at wartimes, but when you add to that the industry being in doubt as to what is wanted, as to what direction they should go, by penalizing a good job and rewarding a bad job which renegotiation does, what would you do if you were in a responsible position in an industry? That is the difficulty which industry is facing in connection with that, not knowing what the future holds, and that is a tremendously difficult question because the job of the industrialist is to take the conditions as they exist and be able by themselves to get the answer they want.

Senator DAVIS. What is your labor turn-over?

Mr. LINCOLN. It is practically nonexistent. We have three recommendations to make:

1. In the law as it has come to you from the House, the elimination of renegotiation on standard commercial products is made discretionary. It is our belief it should be made mandatory. By that I mean if the price of the product is to be settled by competition then, in those cases, it should be eliminated in all cases, renegotiation should be eliminated in all cases.

The second thing is we think profit should be determined after taxes, because that is the only money that the industrialist is going to have when he is all through, and it is on that that you are depending for him to employ labor after the war is over.

Senator WALSH. Is it your point where the Government makes a contract in a case where there is competitive bidding, there should be no renegotiation?

Mr. LINCOLN. That is correct.

Senator WALSH. I do not think it was originally intended it should apply in those cases, except in the case of a negotiated contract.

Mr. LINCOLN. That is my belief, sir.

The third thing is profits after taxes.

Let me again say that this matter of renegotiation is doing more to increase the cost of production than any other single thing which is occurring, because you are penalizing efficiency and you are rewarding inefficiency.

The CHAIRMAN. Thank you very much, Mr. Lincoln.

Are there any questions?

Senator GUFFEY. Who renegotiates your contract? The Army or the Navy?

Mr. LINCOLN. The Navy, Mr. Rock and his committee.

Senator GUFFEY. In Cleveland?

Mr. LINCOLN. That is in Washington.

Senator GUFFEY. Does he have a subcommittee in Cleveland?

Mr. LINCOLN. No.

Senator GUFFEY. Everything is done here?

Mr. LINCOLN. Everything is done here.

Senator GUFFEY. I understood you had a very good committee in Cleveland.

Mr. LINCOLN. I do not think there is a Navy committee in Cleveland. I think there is the Ordnance committee there.

Senator GUFFEY. Have you finally appealed to the Under Secretary who appointed the committee?

Mr. LINCOLN. We are at the present time questioning the validity of the law.

Senator GUFFEY. All right.

Senator LUCAS. Have your contracts all been competitive?

Mr. LINCOLN. Entirely so, they have all been competitive. There are, as I say, about 15 manufacturers making identically the same thing. This is the cheapest manufactured steel product which is being sold on the market today, the cheapest manufactured steel product.

Senator WALSH. What is the amount of contracts that have been renegotiated by your company?

Mr. LINCOLN. They run about $21,000,000.

Senator WALSH. How much has been turned back into the Public Treasury?

Mr. LINCOLN. After renegotiation?

Senator WALSH. Yes.

Mr. LINCOLN. Nothing at the present time.

Senator WALSH. How much has the Renegotiation Board said you ought to pay back?

Mr. LINCOLN. $3,250,000.

Senator WALSH. You are protesting that; that is, you are raising legal questions over it?

Mr. LINCOLN. Yes.

I have some matter here that I would like to leave with you for your record.

The CHAIRMAN. Yes, you may submit anything you wish.

(The matter referred to is as follows:)

INTELLIGENT SELFISHNESS AND MANUFACTURING

By James F. Lincoln, President, The Lincoln Electric Co., Cleveland, Ohio

Great as American industry is, it leaves largely untapped its greatest resource, the productive power, initiative, and intelligence latent in every person. The prophet states it, "Thou madest him to have dominion over the works of Thy hand." That conception is a far cry from the normal evaluation of man by his contemporaries. Truly man is so made but our industrial system does not now fully develop these abilities.

There have been many who have guessed what the result would be if a large, intelligently led, enthusiastic organization should use the powers latent in all the individuals to a common end. What would happen when all are equally anxious to produce a product at the lowest possible cost? What would happen when all want to make the wages of all workers, from sweeper to manager, a maximum? What would happen when all want to make the company profitable since it is largely owned by the workers in it?

This cannot be done by human beings except by the exploitation of the driving force fundamental in all of us, namely, selfishness. Selfishness has a bad reputation but that is because of a narrow conception as to what it really is. No program involving the human race developed as it has been through the ages on the concept of the survival of the fittest can be founded on any other principle than selfishness. The only necessary corollary to this principle to make it attractive, helpful, and satisfying to all concerned is to make this selfishness intelligent. The greatest heights we attain as humans—patriotism, parenthood, and friendship, are all based on this same human trait—selfishness. The results which can occur when this incentive is tapped can be illustrated by the following example:

The Lincoln Electric Co. of Cleveland was started by one man with a capital of $150 of borrowed money in 1896 and has had no outside capital since. The company has tried to follow the principle of appealing to the intelligent selfishness of the worker, the manager and the investor. It has gone along its unique path for a long enough time so that its results are proven. There is sufficient history back of the facts so that no error can be made in appraising the outcome.

The results are:

(a) Lincoln workers, at least in the factory, are the highest paid employees in industry anywhere in the world.

(b) Lincoln workers produce more per hour than any organization making a comparable product in the world.

(c) Lincoln selling prices are less than those of any company making a comparable product. Obviously, companies making specifically competing products must sell at the same price if they are to remain competitors.

(d) Lincoln stockholders have never missed a dividend since the first payment was made in 1918.

(e) The Lincoln Electric Co. does approximately half of the total arc-welding business of the United States and more than a quarter of all the arc-welding business of the world.

(f) Practically speaking there is no labor turn-over.

(g) There is no labor union.

Following is the story of this company's methods used to produce these results:

1914.—An advisory board was formed. The basic job of this board is the developing of the normally unused abilities inherent in the organization. In order to bring the intelligence of all people in the organization to bear on the subject this board was chosen from the entire personnel of the plant. This was done by electing one man from each department by the vote of all the people in such department. The foremen in the plant also elected a representative foreman from their group. These men with the plant superintendent and president (who acts as chairman) constitute the advisory board. This board has authority over all matters affecting the man and shop operations. They are the board of directors for the plant.

This is what that board did from 1914 when formed, to date:

1914.—Decreased the hours of work from 55 (then standard) to 50, with a 10 percent increase in wage rates. The result of this action was to increase efficiency so that the cost per piece was definitely reduced.

1914.—Installed a piecework plan which has been satisfactory to all concerned (both workers and management), without change of this plan to date. The rates are guaranteed by the company after being set by an expert timestudy man who has been trained in that department. The worker, however, has a right to eliminate the price by challenge. When this is done the time-study man runs the job himself for a day. Whatever his earnings are, whether higher or lower, is the new price. This price is subject to the same rules as the first one, however. The company can change the price only by changing the method, design or tooling, thus making it a new job.

1915.—Insured the lives of all workers for the equivalent of a year's wages at no cost to the worker.

1918.—Tried bonus payment which was not successful at that time. This was the "silk shirt era." The amount of this bonus was not a large percentage of the year's wages although it was half of the dividend declared that year. Also, the mutual understanding between management and men which longer experience developed was not then present.

1923.—Adopted the policy of vacation of all workers with pay, shutting down the entire factory for this purpose the second and third weeks of August each year. This was a radical departure at that time although it has become more common in recent years.

1925.—Sold stock of the company to the employees who desired it, providing the workers had been continuously employed for 1 year. More than half of the normal workers are stockholders. They largely own their own plant.

1929.—Established a suggestion system. Suggestions which were accepted, made by any man outside of engineers, time-study men, and others who from the nature of their jobs were responsible for improvement in methods or design, were rewarded in cash. The amount of this award was half of the net estimated saving for the first year of use after acceptance. This plan not only resulted in many good ideas, but it also kept those executives primarily responsible for such progress on their toes.

1934.—Paid the second bonus which started the present bonus plan. This new plan was more workable than that of 1918 and has thoroughly succeeded. This second bonus was paid after the slump of 1929 to 1934 and was perhaps much more attractive because of that. In any case, it had a profound effect and resulted in greatly increased production, interest, and cooperation. These bonuses are based on the success of the company and are distributed on the basis of value of the man to the company for that year. The decision as to division of bonus is made by the president who alone, of all the personnel, gets no part of the money.

1936.—Installed an annuity plan so that all faithful workers may be retired with pay when their working life is over. This results in not only rewarding the faithful employee but eliminates him from the possibility of accident which his failing powers may introduce.

1941.—Installed a trust-fund plan for the workers.

1914 to 1942.—Handled the countless problems which arise in any operation as involved as a large manufacturing plant.

The results of these acts in total are manifold. If they did not increase production at least as much as their cost they would have been impossible. It must be seen in action to believe how great the result can be. No one otherwise can understand the advance that can be made when a man works in his own company, for his own benefit, and with his full enthusiasm.

The following graphs will show what the results of these policies have been:

CHART I

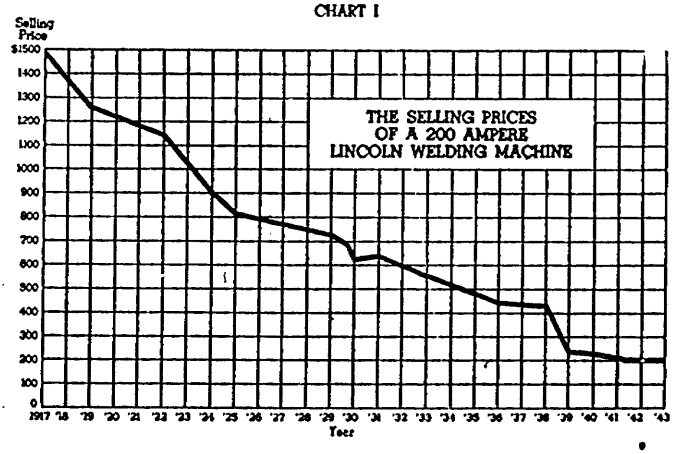


CHART II

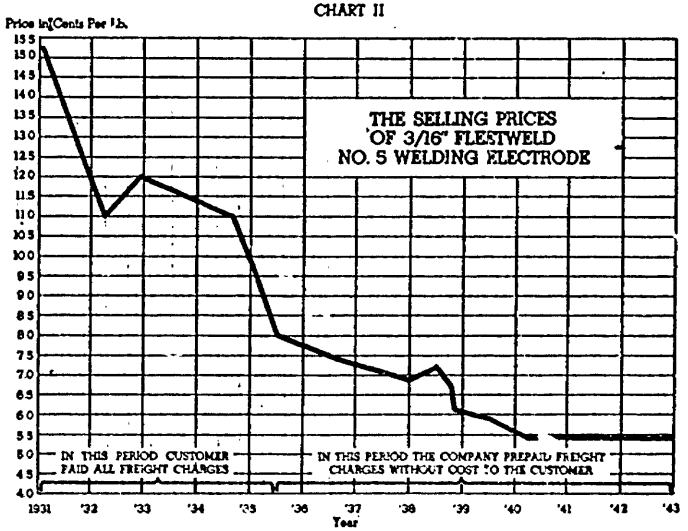
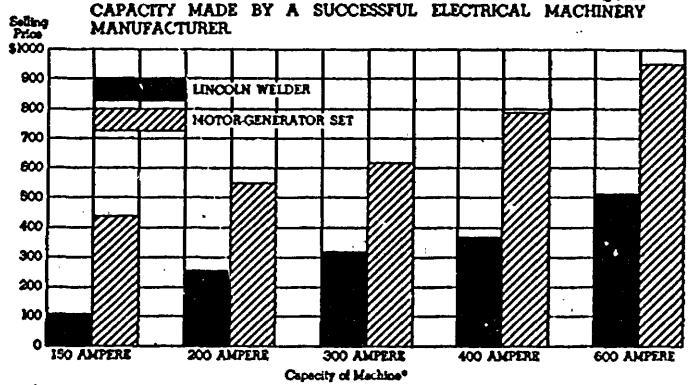


CHART III.

SELLING PRICES OF LINCOLN WELDERS COMPARED WITH THE SELLING PRICES OF STANDARD MOTOR-GENERATOR SETS OF EQUAL CAPACITY MADE BY A SUCCESSFUL ELECTRICAL MACHINERY MANUFACTURER.



*Ratings are welder ampere ratings. Motor generator sets have equivalent current output at similar voltage.

Welders have special controls which are not ordinarily used on motor generator sets. To obtain accurate comparisons of similar equipment the proportional cost of the controls has been removed from the selling price of the welder.
Source: A Certified Public Accountant in the City of Cleveland.

CHART IV

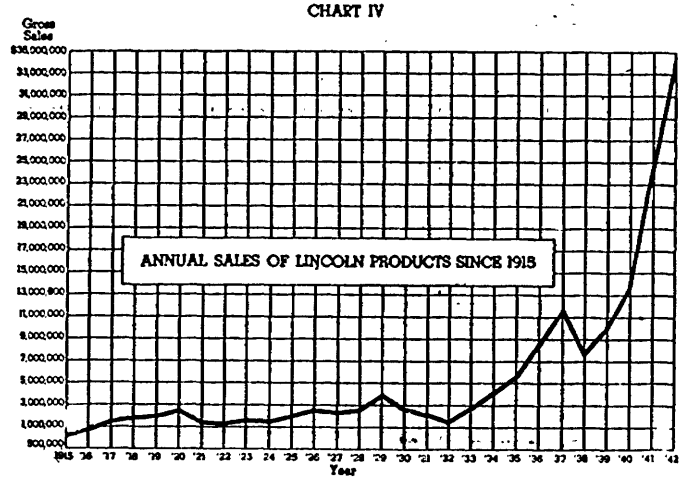
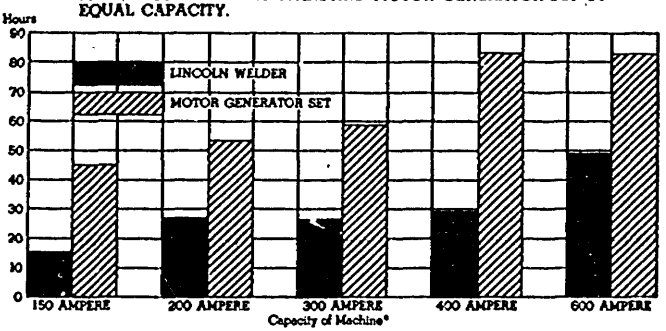


CHART V

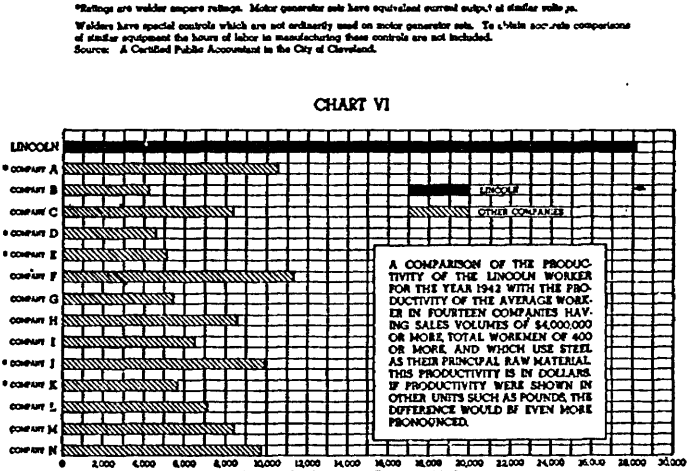
HOURS OF DIRECT LABOR ON VARIOUS TYPES OF WELDING MACHINES COMPARED WITH THE HOURS OF A SUCCESSFUL MANUFACTURER OF A STANDARD MOTOR GENERATOR SET OF EQUAL CAPACITY.



*Ratings are welder ampere ratings. Motor generator sets have equivalent current output at similar volts ps.

Welders have special controls which are not ordinarily used on motor generator sets. To obtain accurate comparisons of similar equipment the hours of labor in manufacturing these controls are not included.
Source: A Certified Public Accountant in the City of Cleveland.

CHART VI

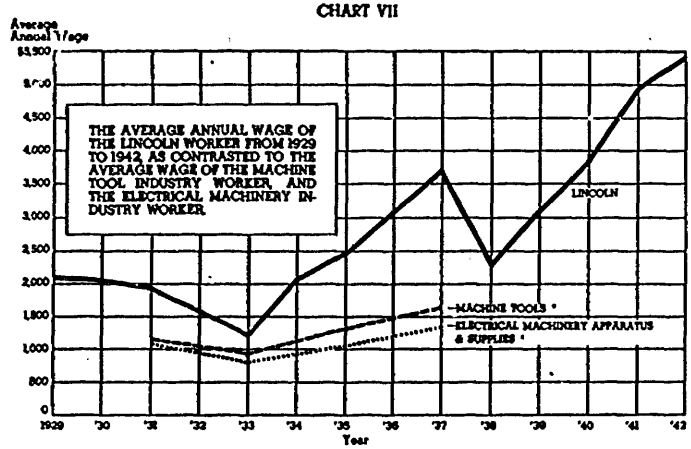


*Worker productivity equals total sales in dollars divided by average number of employees.

COMPANY A: Machine Tool Mfr.
COMPANY B: Auto and Aircraft Parts Mfr.
COMPANY C: Gas Welding Supplies Mfr.
COMPANY D: Electrical Equipment Mfr.
COMPANY E: Electrical Equipment Mfr.
COMPANY F: Auto Mfr.
COMPANY G: Auto Part Mfr.
COMPANY H: Auto Part Mfr.
COMPANY I: Electrical Equipment Mfr.
COMPANY J: Machine Tool Mfr.
COMPANY K: Domestic Furnaces Mfr
COMPANY L: Auto Mfr.
COMPANY M: Machine Tool Mfr.
COMPANY N: Gas Welding Supplies Mfr.

*1942 figures not available. Latest figures (1940 or 1941) used. Source: "Moody's Industrials," 1942.

CHART VII



*Source: "Statistical Abstract of the United States" and "Census of Manufactures," U. S. Dept. of Commerce. Industry figures available only for the years shown.

CHART VIII

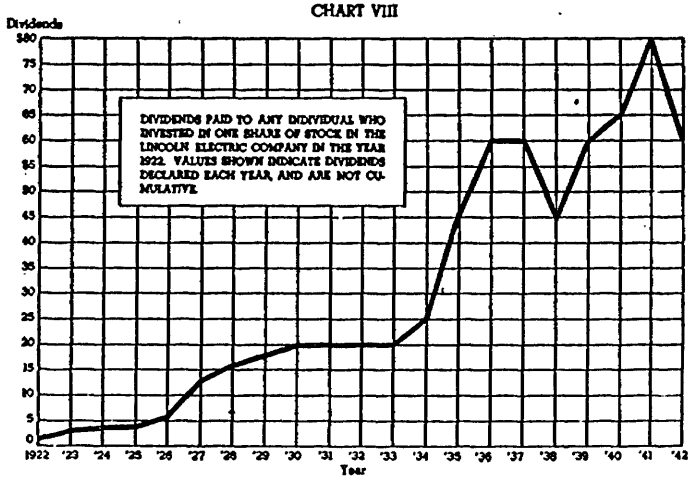


CHART IX

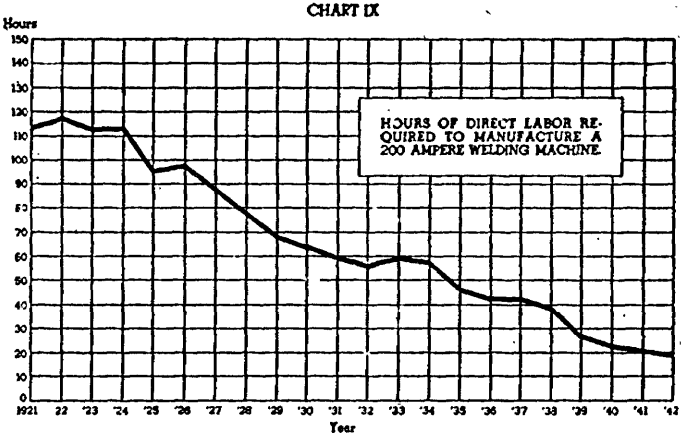
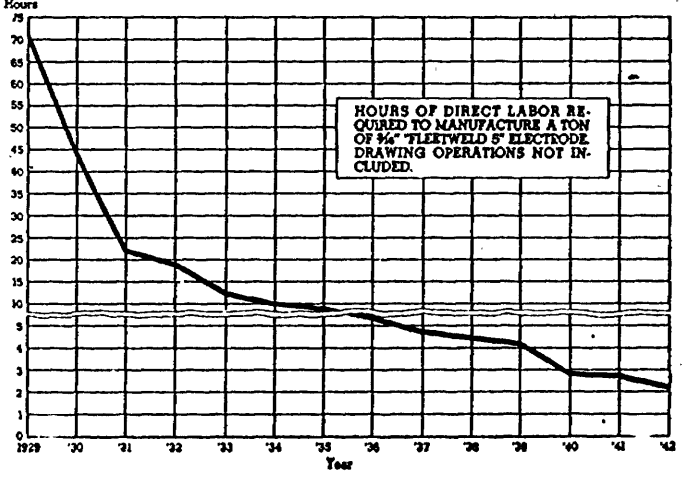


CHART X



SUGGESTIONS

Perhaps the following comments may be valuable in helping others to put in the same or a better method of arousing the intelligent selfishness of their own workers:

(1) Management must be able to lead the organization in the direction of more efficient methods as fast as the method can be absorbed by the organization. This will be found to be the chief difficulty in most plants.

(2) Management and men are "fellow workers." Neither is superior but each is responsible for their part in the result. Of course, management's direction is unquestioned and enthusiastically followed. Consequently, management must be made up of the best managerial ability in the organization. When a man with new managerial ability arises he is recognized. When one who is a manager slips he is eliminated. Accomplishing the elimination may give some trouble both in understanding and in doing in some organizations. Management must be able to stand on its record and be accepted by all the workers as being fair, able, and intelligent.

(3) A factory worker cannot express his ideas as well as a trained man of the world but he has them just the same. Management must be able to see, select, grade, and apply these ideas accurately and fairly.

(4) The goal of the organization must be this—to make a better and better product to be sold at a lower and lower price. Profit cannot be the goal. Profit must be a byproduct. That is a state of mind and a philosophy. Actually an organization doing this job as it can be done will make large profits which must be properly divided between user, worker, and stockholder. That takes ability and character.

(5) It must be kept in mind at all times that this is a natural working out of our inherent selfishness. The only difference between the Lincoln Electric Co. and the usual industry is that in this case the selfishness is more nearly intelligent. A sneak thief is selfish but not intelligent. The civil war called collective bargaining is selfish but not intelligent. The exploiting of workmen is selfish but not intelligent. The practice of raising prices in a seller's market is selfish but not intelligent. The charging of "all the traffic will bear" is selfish but not intelligent. War is selfish but not intelligent. The only difference between these acts and the program explained herein is that these acts are stupidly selfish and the activities outlined herein are intelligently selfish. When we as a Nation adopt this principle of intelligent selfishness into our philosophy of life and industry we will have stopped unemployment of the employable, stopped poverty for the able-bodied, and, what is more, we will have gone far toward the elimination of misery no matter how caused.

NAVY DEPARTMENT,
BUREAU OF SHIPS,
Washington, D. C., March 20, 1943.

Mr. K. H. ROCKEY,
Chairman, Navy Price Adjustment Board,
Washington, D. C.

DEAR SIR: I understand that you wish to know the results of a survey of the electrode industry, which the Bureau of Ships conducted during the months of August, September, and October, 1942, in order to assist you in determining the necessity of price adjustments of contracts for shielded arc welding electrodes.

This survey was made under my direction for the purpose of ascertaining the relationship between the demand for welding electrodes and the capacity of the welding electrode industry to produce. If the capacity of the industry was less than the need, the Navy Department was to finance an immediate expansion of facilities.

In making the survey to determine the capacity of the industry, the problem was not to find out how much they were producing but to find out how much they could produce with their existing equipment.

After visiting all of the major welding rod producers, it was decided to evaluate the efficiency of their individual production for two reasons:

(a) To determine the ultimate capacity of the industry if all companies were producing at the rate of the most efficient.

(b) To determine where the Navy Department could most expeditously, efficiently and economically finance an expansion if and when an expansion was needed.

The ratings of the welding rod manufacturers were determined on the basis of welding rod output per dollar of equipment investment and were as follows:

Arcrods:	
Sparrows Point	19
Cleveland	15
Champion Rivet: Cleveland	12
Hobart Bros., Troy, Ohio	6
Hellup:	
Stockton, Calif	15
Chicago	16
Harnischfeger, Milwaukee	19
Lincoln Electric, Cleveland	[1] 37
Metal & Thermit:	
New Jersey	17
Chicago	15
Reed Avery, Baltimore	13
A. O. Smith, Milwaukee	16
McKay, York, Pa	7
Westinghouse, Pittsubrgh	20

[1] To make this value comparable with the others, it is necessary to discount the increased production obtained from the wire drawing operation not present at the other plants. Subtract 11 points

From the foregoing it is obvious that if all companies could produce at an efficiency rating of approxmately 20, a tremendous increase in welding rod could be obtained.

The supply-demand data showed a deficit of 25,000,000 pounds per month in October. To expand the manufacturing facilities sufficiently to obtain this increase in output would cost an estimated $1,900,000 and would require from 8 to 12 months for completion even with emergency priority ratings.

At this time the Lincoln Electric Co. proposed that since it was able to produce approximately two and one-half times more per unit of equipment than the average of the industry, some effort should be made to increase the production of the industry as a whole through more efficient use of their facilities. It was apparent that if the average efficiency of the industry could be raised most if not all of the production would be immediately available without additional investment in facilities.

It was decided that a delay was justified in order to enable the Lincoln Electric Co. to assist the other members of the industry to improve their output. The results of the efforts of the industry to improve their efficiency and output per extruder during October, November and December, were so promising that the Navy expansion program was postponed. The total production of electrodes increased 33⅓ percent during the last quarter of 1942, as indicated by the following production figures:

	Pounds
October	63,000,000
November	77,000,000
December	84,000,000

Although this increase in productivity and efficiency in the industry may make it possible to permanently abandon the Navy expansion program (some time in the future) that decision must be held in abeyance until the industry increases its efficiency still further and proves that step unnecessary.

Respectfully,

R. E. JONES,
Commander, Bureau of Ships,
Navy Department, Washington, D. C.

THE UNDER SECRETARY OF THE NAVY,
Washington, February 19, 1943.

WELDING WIRE SECTION, WELDING DIVISION,
National Electrical Manufacturers Association, New York, N. Y.

GENTLEMEN: In August 1942 the coated electrode situation throughout the country was most critical. During the first week of September, you were called upon to pool all your technique in an attempt to meet the growing demand.

How well you have met that challenge is evidenced by the fact that with about 6 percent additional equipment over August, you produced in January 1943, 42 percent more electrode tonnage or 88,000,000 pounds as against 62,000,000

pounds in August. This tonnage in January met, for the first time since the emergency, the full requirements of the industry.

In September it was also stated that 100,000,000 pounds would be expected in March. There is every evidence that that figure will be exceeded.

May I thank you for an exceptional performance and congratulate you on such a wholehearted cooperation of an entire industry as is seldom witnessed in our competitive system.

"Well done."

Sincerely,

JAMES FORRESTAL.

The CHAIRMAN. Colonel Rockwell.

STATEMENT OF COL. WILLARD F. ROCKWELL, CHAIRMAN OF THE BOARD, TIMKEN-DETROIT AXLE CO., DETROIT, MICH.

Colonel ROCKWELL. My name is William F. Rockwell. I am chairman of the board of Timken-Detroit Axle Co., Detroit, Mich.

I want to tell you what we have gone through on renegotiation. I am very glad Mr. Lincoln appeared first because I know you heard his story, and I can verify certain parts of that story.

In August 1942 the Timken-Detroit Axle Co. was asked to prepare figures for the renegotiation board of the Detroit ordnance office of the War Department for the fiscal year ending June 30, 1942. We carefully prepared figures, data, statistical charts, and comparative statements and proceeded with a series of conferences, at the end of which time we were asked to refund 10 million dollars, and we were definitely told that we had been allowed the highest percentage of profit before taxes, because we had done such an excellent job. We had increased our output from 20 million dollars a year to 150 million a year without borrowing a cent from the Government, or asking the Government for machine tools or other aid. We had given up the manufacture of our profitable oil-burner business; we had taken over the money used to finance installment sales in order to protect the axle business; we had sold a very profitable subsidiary for over a million dollars cash; and were out borrowing 10 million dollars to further protect deliveries to the Army. In June 1941, at the request and in the presence of Army officers, we offered our two largest competitors the use of our patents and our designs, but they refused to accept Army orders for standard military axles so that we had to carry the entire load.

With the understanding that we were allowed the highest rate, which was approximately 13 percent before taxes, we sent a check, making a refund equal to $10,000,000. We know now that other companies were allowed much higher rates, and we have learned that deception is practiced on the unwary.

Some time later our check was returned and we were informed that an impasse had been reached because the Washington board decided that we should pay twelve and one-half million dollars. We were then called before the Washington board, known as panel A. They refused to give us any information as to the reason for higher refund, but told us that if we did not immediately agree to pay the twelve and one-half million dollars we might be called upon to pay more. We were amazed to learn that panel A had never received the data showing the sacrifices we had made in order to maintain prompt deliveries—these data required months to prepare. We were then called before the Under Secretary who was very cordial and who told us that we did not

need to tell of our achievements because he knew of them. He agreed to give the case full consideration and advise us. He subsequently advised us that he expected us to pay the twelve and one-half million dollars. We still had heard no complaint but we had learned that other manufacturers who had contributed far less to the war effort had been allowed 22 percent before taxes, so we notified the Under Secretary we would not agree. We then received notice of the unilateral agreement which is an imported European practice, which means that all the deciding is done by one party as dictator and all the agreeing is done by the other as victim. We were told that our payments would be held up and we learned that efforts were being made to have a truck company withhold payments. I then notified the Under Secretary that we would ask legal redress if payments were withheld. He then wrote his letter of November 16, which was the first time we learned that he disapproved of several things. I assumed that the Board furnished him the misinformation which is contained in his letter and I am sorry that I have to bring these facts before Congress but it appears to be the only way we can obtain justice.

The Under Secretary said that we paid three and one-half times as much in dividends in 1942 as we did in 1940. Our company is publicly owned, with 11,000 stockholders and 9,000 employees. The public records show that we paid $3.25 in dividends in 1940 and exactly the same amount in dividends in 1942. The Under Secretary states that we paid our executives five times as much in 1942 as we paid in 1940. The record shows that we paid only 25 percent more, which was based on a legal contract of many years' standing, approved by the stockholders and by the board of directors, and no officer or executive received as much as 100 percent increase, although the company's output had increased to 425 percent. In 1942 this incentive contract was unjustly made inoperative for several officers by order of the Commissioner of Internal Revenue. New war contracting companies, obviously unhampered by ceiling on salaries would have employed all of them at higher wages.

The Under Secretary makes the comment that the nonrenegotiable business was extremely profitable but there is nothing in the law that requires Government officers to make any such criticism and it certainly has no application to the price-adjustment law. We would like it clearly understood that we sold our axles, as subcontractors, to the largest automobile truck manufacturers and any comments to the effect that we were taking advantage of the automotive industry are absurd, because the automobile companies can produce their own axles whenever they wish to do so and would certainly do so if they felt our prices were not entirely fair. When war agencies arrive at automotive-industry efficiency in purchasing, they won't need price-adjustment laws to cover any incompetency.

As far as salaries are concerned, we wish to point out that the compensation of the 22 executives who receive over $10,000 a year is less than $500,000, or less than one-third of 1 percent of our sales. We doubt whether any company in the country can show such a low administrative cost. On the other hand, I have a press clipping which shows that a company which is held up as a model of efficiency received a contract of $46,000,000 on which they were subsequently renegotiated down to $22,000,000, and this machine-gun manufacturer received over 20 percent profit before taxes after renegotiation. According to the newspapers there are seven men in that company who fur-

nish engineering and management talent through a subsidiary and the highest paid man receives over $630,000 a year while the lowest-paid executive in the company receives $200,000 a year, and we are told that they are entitled to it, because of their efficiency. Praise is given for saving $24,000,000 on this $46,000,000 contract. Is it possible that if the contract had been given at one hundred and forty-six million, the saving would then be $124,000,000 on this $46,000,000 contract. Is it possible that if the contract had been given at one hundred and forty-six million, the saving would then be one hundred and twenty-four million? You will note in this case that one man receives more than our entire group of 22 executives and his business runs $22,000,000 a year while ours is approximately one hundred and fifty million. We do not have a man in our plant that receives $100,000 a year. I am told these people are entitled to it because of their efficiency.

Senator BYRD. What is the highest salary you pay?

Colonel ROCKWELL. Our highest pay runs about $95,000. It would run slightly higher than that if the Internal Revenue had not made this bonus contract inoperative.

Senator BYRD. How many receive that salary?

Colonel ROCKWELL. Only 22 receive over $10,000 a year.

Senator WALSH. Your contracts are all subcontracts?

Colonel ROCKWELL. We have some truck contracts, Senator, for transmissions for the tanks, the first of which we built many years ago.

Senator WALSH. Was the main contract a competitive one or a negotiated one?

Colonel ROCKWELL. It was competitive.

Senator WALSH. I am speaking about the main contract.

Colonel ROCKWELL. There is not any main contract, Senator. We have a large number of subcontracts.

Senator WALSH. Do you contract direct with the Army?

Colonel ROCKWELL. No, sir; we contract principally with the truck manufacturers who obtain their contract as prime contractors from the Army.

Senator WALSH. Was that prime contract a negotiated contract or was it a competitive contract?

Colonel ROCKWELL. Those are distinctly competitive contracts, Senator, and you can be awfully sure that the truck companies do not pay us more for those axles than they can buy them elsewhere.

Senator WALSH. That answers my question.

Colonel ROCKWELL. You will note in this one case that 1 man receives more than our entire group of 22 executives, and his business runs $22,000,000 a year, while ours is approximately $150,000,000 a year.

Senator WALSH. Would you mind telling the name of that company?

Colonel ROCKWELL. The name is given in the press as the High Standard Manufacturing Co., which we were told was formed in 1940, and they have a subsidiary which handles the management and engineering.

Senator WALSH. Apparently a war baby.

Colonel ROCKWELL. It might be; I would not be able to answer that. I can give you the press clipping from the Pittsburgh Press of November 3, 1943, entitled: "Efficient Firms Granted Higher Profits by Army."

Now, we cannot learn the name of the genius on those boards who is able to show that one man is worth such a large sum, and we are worth so little.

We have been the largest commercial truck axle producers in the world. Our facilities are now almost 100 percent in Government use. We are told that the War Production Board is about to permit the production of commercial trucks but they have advised our customers to buy their axles from our competitors who refused to manufacture the standardized Army axles in June 1941. Our two competitors, according to press reports, were permitted to receive a much larger percentage of profit on their business. We ask you if that is fair, and if we are not being threatened with confiscation of our business, as well as our profits? A few weeks ago, the Detroit Ordnance office signed a contract with us and with a subcontractor to produce $90,000,000 of axles. After this contract was legally signed with us in Detroit we were advised in Washington that it was illegal and that our profit was too great. Inasmuch as we were forced to adopt a renegotiation clause we cannot be sure of any profit. The very low profit allowed us on the 1942 business means that we will do approximately 20 percent more business in 1943 and the stockholders will receive 20 percent less money, while our competitors will take the more profitable commercial business which we are forced to relinquish, and they will not be subject to renegotiation on this new commercial business.

Our company cannot publish its sales for the year ending June 30, 1943, until renegotiation is accomplished. We cannot tell our stockholders what our sales are nor what our profits are, because the renegotiation amount is deducted from the sales. We have been tied up for 16 months on the renegotiation for the year ending June 30, 1942. Is it fair to withhold such direct settlements for 2 years? We have had to reduce our dividends and do what we can to protect our company from financial disaster. I think the Under Secretary will be glad to know the stockholders will be only able to receive $2 this year, after doing 400 or 500 percent more business.

Senator WALSH. What did you pay last year?

Colonel ROCKWELL. I do not know, Senator. It is all in the public record, though. I will be glad to furnish that to you.

Heavy-duty trucks are being produced in approximately 10 times the rate of the best peacetime year so that if only 20 percent of them are thrown back on the market at the end of the war we cannot expect any heavy truck-axle business for 2 years. We do not manufacture passenger-car axles so we cannot benefit from that business. If we were so lucky as to return to a normal business we still would be forced to release 6,000 men, and certainly you want us to reemploy thousands of others now in the armed services. If we were given proper consideration we could bring out new products and keep some of these men employed and we might be able to pay a small dividend to some of our 11,000 stockholders. These stockholders will only receive $2 this year and their stock has shrunk 20 percent in value, which is far more than the actual recovery if the proposed renegotiation does not fail in the legal test which we intend to apply for. We believe the act is unconstitutional, because the power to renegotiate has been an example of delegation run riot, as Justice Cardozo said, and there is obviously no standard, nor set of standards, being used to decide the relative efficiency of various contractors.

We believe that excessive profits can be taken care of by taxes. No tax takes 100 percent of our savings and earnings but we claim that renegotiation has taken more than 100 percent of our savings.

We call your attention to the statement of the Under Secretary that we only reduced prices 1¼ percent. If we produced $20,000,000 worth of axles in a 40-hour week in peacetimes, how did we produce seven times as many axles in a 160-hour week? The answer is that in accordance with the instructions of the Army and in accordance with the will of Congress we subcontracted and we had parts made by any small company which had any available equipment. We paid for the special tools and we paid as much as 65 percent over our own costs. All of these extra costs were absorbed by us and therefore represent great reductions to the Government. We also wish to point out that enormous quantities of service and repair parts have been ordered by Government agencies far beyond any normal requirements and that these parts will eventually find their way back into the markets and cut off our future service business which we usually rely upon to provide us with work, and which provides our workmen and stockholders with subsistence in bad business years. It is impossible to discuss such matters with people who withhold their criticism and therefore give us no opportunity to point out their errors.

The Under Secretary states in his letter that these matters were fully discussed with us but it must be obvious to anyone that if these statements had been made to us we would have corrected them immediately. Now that the injustice has been done it appears that we are to be subjected to persecution and our only hope is that Congress or the courts will correct this situation. In closing, I would like to say that we have always had the best treatment from the Regular Army officers, many of whom have given us the highest praise for the quality and quantity of our production. They know that we furnished free service to the Army for 25 years, most of the time with no hope of profit and that when we were asked to produce for war we spared no effort. Our executives worked 12 and 14 hours a day and gave up their vacations. When the determination of our efficiency is to be made we find the job delegated to men in Washington who have had no practical industrial experience and who have never visited our shops or factories or even seen our products in action. If a company as large as ours cannot receive justice, what hope is there for the little manufacturer who does not have the staff to compile data, nor the resources to fight against such injustice?

In closing, I would like to say we earnestly beg Congress to eliminate the Renegotiation Act and take excessive profits by means of taxes, leaving us enough reserves so that we can design new products to carry on our business, and reconvert and rehabilitate when peace returns. If this is not done we cannot provide jobs for the 8,000 employees now at work and the several thousand employees who are now in the armed services.

Senator GUFFEY. Colonel Rockwell, were you renegotiated by the Detroit subcommittee?

Colonel ROCKWELL. Yes, sir.

Senator GUFFEY. How much did they ask you to refund?

Colonel ROCKWELL. $10,000,000. We actually made out the check and we signed an agreement, Senator.

Senator GUFFEY. That was returned?

Colonel ROCKWELL. That was returned.

Senator GUFFEY. And the headquarters increased it to $12,500,000?

Colonel ROCKWELL. The headquarters increased it to $12,500,000, a good flat 25 percent.

They told us if we did not agree to pay $12,500,000 there would be more. Incidentially, they charged us $6,000 more since that time.

Senator GUFFEY. Did they threaten to cancel the contract or break it if you did not accept it?

Colonel ROCKWELL. They told us if we did not change the contract with them they were going to give the business to our competitors, who refused the business before the war.

Senator GUFFEY. Thank you very much.

Senator VANDENBERG. Colonel, short of repeal of the Renegotiation Act, are there any changes in the act which would at least partially correct the situation?

Colonel ROCKWELL. One change would be to have somebody down here on the board that knew something about the industry, Senator.

Senator VANDENBERG. If you had a right of appeal to an independent tribunal, it would help you; would it not?

Colonel ROCKWELL. I think that would correct the situation, of course, if we can only go to The Tax Court they would just as likely as not say these things are competent.

I do not think the Under Secretary ever had a chance to look into this case. He delegated it to people who may be very good tea merchants and they may be very good wallpaper salesmen, and they may be very good at many other things, but I have looked through the list as they presented it to the House Ways and Means Committee, and I failed to find any industrialist on there that had any real experience building up a business.

Senator VANDENBERG. My experience with the Under Secretary leads me to feel that he wants to be fair, in spite of the difficulties which he confronts, in the administration of law, which I agree with you is undoubtedly unconstitutional. I am going to take the liberty of presenting your testimony to the Under Secretary and ask him what his answer is, because I am unable to believe that he would permit you to suffer the situation you described.

Colonel ROCKWELL. I would like to submit a statement by a good attorney on the constitutionality of the law.

I also received a letter here this morning by messenger from the Under Secretary of War. He still reiterates that all these matters were discussed with us. I say they were not or we would have corrected them, and I will stand up anywhere and say that. I think anybody that has good common sense will know we would not have permitted the errors to appear in the statement if they had been brought to our attention. In his letter he says that they made some very fine reductions, $50,000,000, or $60,000,000 now, and he says the next time they review our case they will probably give us credit for that, but you cannot tell me that should they think they can screw us down to 2.7 percent this time that they will hold us down to that or less the next time.

Senator GUFFEY. What did they allow you?

Colonel ROCKWELL. We figure less than 3 percent after taxes on our sales. Senator, in the automotive business we have lost money 1 out of every 5 years. We know we have to have reserves. We have had to cut down our dividends. We have had to go out and borrow money.

Now, the Army has given us plenty of money, and given subcontractors plenty of money. They tell us now they would be willing to pay twice as much for these axles if they had them. When I told them a year ago that they better do certain things about getting forgings they brought in a professor from Harvard, who was a lieutenant colonel, and he told us there was no need of having additional forging facilities. He was very positive about it. Yet every bit of work that you are talking about now that is critical, like ball bearings, like valves, you find they do not have enough forging capacity for that. That is the kind of people we have to fight against. It is rather difficult for a manufacturer to try to bring up his production, as we are trying to do, and all the time be shot at by people who do not know what it is all about but who insist on penalizing us and setting themselves up as experts in branches of business which they know very little about. Certainly anybody who says we paid three and a half times as much dividends in 1942 and 1940 does not know there is such a thing as a stock exchange. We are listed on the New York Stock Exchange and anybody can refer to that.

Senator DAVIS. Would you care to make the Under Secretary's letter a part of the record?

Colonel ROCKWELL. I would be very glad to, Senator.

I have a number of letters that I wrote the Under Secretary and I would like to have them in there, Senator Vandenberg, so there will not be any question whatever about our having called his attention to the fact that something was wrong.

The CHAIRMAN. You can put any correspondence you wish in the record.

Senator VANDENBERG. It seems to me on the face of the statement as you make it the position of the Government is totally indefensible.

Colonel ROCKWELL. That is the way I feel about it. I think instead of acknowledging their error now, they are holding out a little promise to me that the next time they come around they will be fair, but I do not think, Senator, we ought to take that. Do you?

Senator VANDENBERG. No.

Senator GUFFEY. I agree with you. We have one case in Philadelphia that is far worse than that.

Senator WALSH. I understood you to say the Government had ordered a large amount of parts.

Colonel ROCKWELL. Yes.

Senator WALSH. That, in your opinion, were unnecessary and therefore would be useless and thrown on the market later.

Colonel ROCKWELL. I would not say that they are absolutely unnecessary, Senator. When you are operating military trucks all over the world you have to have a large supply of parts, because you cannot afford to run out of them. I do not criticize the Army at all for having a large supply of parts. What I am referring to, when the war ends, those parts will be thrown on the market. That is something that will knock our business out. When you talk to the men there they say, "We cannot pay any attention to that." They might be saying to us, "You are not complaining about your profits here,

we allowed you a good profit—you are complaining about taxes." When we talk to Congress, Congress says, "You are not complaining about taxes, you are complaining about renegotiation." It does not make any difference which it is if it ruins our company, does it, Senator?

The CHAIRMAN. Well, Colonel, the truth is that on the economic front the one single congressional act which conveys absolute and arbitrary power to anybody is the Renegotiation Act. There are no standards in it. There is no remedy under it. Those who contract with the Government are simply bound hand and foot. They must do what they are told to do or else.

Colonel ROCKWELL. Well, Senator, I think they could be fair about this thing.

The CHAIRMAN. I think the Under Secretary of War and the Under Secretary of the Navy and the others who are directly responsible for these renegotiations are very good men. It shows you, though, how even good men act when they have arbitrary power, and how it will ruin them ultimately if it is continued.

Colonel ROCKWELL. Mr. Karker said the act was vicious and un-American. If you know Americans, I would say it is very difficult to get good Americans to operate under that act.

The CHAIRMAN. Even the War Powers Act gave the President the power to take over your business, but, nevertheless, it requires that just compensation be paid to you. However, there is no requirement that they pay you anything under these renegotiations, except they say they propose to be fair and just and do the thing in a perfectly fair way. I have no doubt they do intend to do that, but when they are renegotiating between those contractors and using an arbitrary power, without standards or without real restrictions or restraint, they inevitably would make mistakes and create discriminatory favors on one side and harsh discriminations on the other side. That is simply human and you cannot help it.

Colonel ROCKWELL. I will tell you another thing that is simply human, Mr. Chairman, if I may. You take people down here who have never had power and give it to them, and when I talk to them I am treated as if I had never amounted to anything, and they have the full force of the Government back of them and they become very arbitrary. We find them just as arbitrary, just as arrogant as they are ignorant, and we find them just as stupid as they are stubborn.

The CHAIRMAN. There is no question about that, but arbitrary power ruins even good men like Under Secretary Patterson and Under Secretary Forrestal. They want to be good and just, but arbitrary power will ruin them and ruin the citizen in the process.

I agree with you fully on this Renegotiation Act. If I had it in my power, I would throw it out entirely and rely absolutely on the taxing laws. In the beginning there was some excuse and some reason for it, because excess-profits taxes were not so high and the Government was engaging in new businesses or engaging in a volume even of old business in which it had had no previous comparable experience. But that time certainly is past. If the procurement officers of the various services really know what they are doing, they are disposed to deal fairly with the American contractors.

Colonel ROCKWELL. Well, Senator, it has been quite a task to run a company. As Mr. Lincoln said, we no longer can dictate anything in connection with the company; it is all dictated from Washington.

We agreed to give our employees increases in wages. In 1937 our factory was taken over and we were forced then to give them increases in wages. This year we agreed to give them increases in wages and we were told by the National Labor Relations Board we cannot give it to them, that it might bring on inflation. It seems to me in 1937, when we had the highest pay in any factory in Detroit, it was a pretty good time to stop inflation.

The CHAIRMAN. Yes; we could have stopped inflation at one time; but we were not worried about inflation then.

Colonel ROCKWELL. That is right.

Now, Senator, we cannot offer one of our officers $25 more a month without the approval of the Internal Revenue Department, but a new war contractor who gets one of these fancy contracts and who has plenty of smart lawyers to show him how to set up a lot of subsidiaries, is able to hire our men. They say, "We need the men worse than he does." If you have a man and pay him $275 a month and he is offered $725 a month by a war contractor you know there is no use trying to keep him there and have him work for you while he is dissatisfied.

This thing is so full of loopholes that it is really amazing. It is amazing that we have been able to keep our plant together as we have, battling against people who know very little about it, but when they come down here they certainly are able to settle all these questions that people like Mr. Lincoln and myself have been battling for 25 years. We still do not think we know all the answers, but they do not hestiate to tell us they know all the answers.

Senator VANDENBERG. There ought to be some kind of special Distinguished Service Medal for any businessman who survives the war contracts with the Government.

Colonel ROCKWELL. All you have got to do is look at the record. You would find a large number of them are not surviving.

The CHAIRMAN. Thank you very much, Colonel.

(The matter submitted by Colonel Rockwell is as follows:)

SUPPLEMENTAL STATEMENT OF COL. WILLARD F. ROCKWELL

THE LAW

Mr. Maurice E. Karker, having retired as Chairman of the War Department Price Adjustment Board and thus being in a position to freely express himself on the subject, said of the renegotiation law:

"In my judgment, as an individual, it is a dangerous and un-American statute, but we are in a dangerous and destructive war which justifies unusual precautions and conditions."

Mr. Karker could have added, without fear of successful contradiction, that the statute was so palpably unconstitutional that submission to it by industry could only be explained on either the ground of patriotism or fear of retaliatory action.

We are in a dangerous and destructive war, but this does not justify the use of methods which dangerously approximate the destruction of constitutional rights. There is too much of a tendency during war, on the part of some elements in the country, to treat the Constitution of the United States as an annoying document which interferes with their plans for dominating industry. Obviously such a point of view, if it were to prevail, would prove far more dangerous and destructive to the country than war. Especially is this true when the same results as those sought to be accomplished by the renegotiation statutes, can be substantially effected by constitutional methods, namely, through the taxing functions of the Government. There is no basis for dissension on the point of preventing war profiteering. It is conceded that this should be effectually prevented, but by constitutional methods.

It seems plain that the renegotiation law is unconstitutional from several angles. It is inconceivable that a tax statute would be passed giving the Secretary of the Treasury authority to levy taxes as he saw fit, but that is virtually what the renegotiation law does because it enables the head of the department to conclusively determine excessive profits.

This law is unconstitutional because it impairs the obligations of contracts, interferes with the freedom to contract, deprives persons of property without due process of law; is plainly discriminatory and arbitrary; is an illegal delegation of legislative functions to administrative officers; is a delegation of uncontrolled and uncontrollable judicial power, and finally, is too indefinite and uncertain as a penal statute.

The renegotiation idea had its origin in section 403 of the Sixth Supplemental Defense Appropriation Act of April 28, 1942.

Several features of this statute immediately challenge one's attention as being most unusual.

In the first place, it will be observed that the statute delegates to the Secretary of War, Secretary of the Navy, or Chairman of the Maritime Commission, who in turn are authorized to delegate to such individuals or agencies and these latter in turn are authorized to likewise delegate, the unlimited and unrestricted authority and discretion conferred by the statute. Bear in mind that this means the point of view of the individual in office at the time the question arises. To quote Mr. Justice Cardozo in the Schechter case (295 U. S. 495), this would seem to be "delegation running riot." The obvious result of such delegation of authority and discretion is to make the scope, application and enforcement of the statute depend upon the point of view, whether experienced or inexperienced, of the group or individual with whom the contractor is compelled to negotiate. This was conceded in the congressional debates. The statute, it will be observed, does not define with any definiteness who are contractors and subcontractors, subject to its provisions. It simply provides for renegotiation when a contract or subcontract is made with the department. Necessarily whether a subcontract is within the terms of the statute depends upon the point of view of the one who has the duty of so determining.

It will also be observed that renegotiation which implies mutual discussion in an attempt to arrive at an agreed result is somewhat illusory because the statute defines renegotiation as and including the "refixing by the Secretary of the Department of the contract price," which, under the delegation feature, of course, means the "refixing" by anyone however inexperienced bhe may be in corporate or business affairs, of the contract price. Thus, renegotiation, while possibly affording the contractor an opportunity of presenting his views, means, in the end, the price or profit the department decides upon. The coercive features of the statute are of course quite convincing in this respect. In other words, once a contract is entered into with the department, it has the right under the statute to unilaterally repudiate one of its essential terms, namely, the price and the result is, by statute, a declaration that a contract with the Government is no contract at all.

The secretary of each department is authorized to determine when the profits are excessive and is also authorized to disallow salaries, bonuses, or other compensation when, in his opinion, these are unreasonable and is likewise authorized to disallow excessive reserves or costs. This, of course, also means that the individual or group to whom authority has been delegated has the same authority. Reduced to its simplest terms, this means that, without regard to their knowledge of, or experience in, a particular business or the necessities of that business, the delegated authority has the right, without restriction or without any standard, to finally determine according to its ideas, the allowable amounts of the foregoing items. This is delegation with a vengeance and is without precedent, so far as can be ascertained. This means a government of men and not one of laws. In addition, this means the delegates fix such contract prices as they think are fair. This is not "just compensation" for the taking of property as the Constitution requires: *Monoghagela Nav. Co.* v. *U. S.* (148 U. S. 312); *U. S.* v. *McFarland* (C. C. A. 4th) 15 Fed. (2d) 823). This constitutional guaranty is not suspended during war. *National City Bank* v. *U. S.* (275 Fed. 855); *U. S.* v. *Cohen Grocery Co.* (255 U. S. 81). "Just compensation" is a judicial question which is precluded by this statute.

In *United States* v. *Cohen Grocery Co.*, supra, the Supreme Court said, at 520 (65 L. ed.):

"We are of opinion that the court below was clearly right in ruling that the decisions of this court indisputably establish that the mere existence of a state of war could not suspend or change the operation upon the power of Congress of the guaranties and limitations of the fifth and sixth amendments as to questions

such as we are here passing upon. (Citing cases.) It follows that, in testing the operation of the Constitution upon the subject here involved, the question of the existence or nonexistence of a state of war becomes negligible, and we put it out of view.

"The sole remaining inquiry, therefore, is the certainty or uncertainty of the text in question; that is, whether the words, 'That it is hereby made unlawful for any person wilfully * * * to make any unjust or unreasonable rate or charge in handling or dealing in or with any necessaries,' constituted a fixing by Congress of an ascertainable standard of guilt, and are adequate to inform persons accused of violation thereof of the nature and cause of the accusation against them. That they are not, we are of opinion so clearly results from their mere statement as to render elaboration on the subject wholly unnecessary. Observe that the section forbids no specific or definite act. It confines the subject-matter of the investigation which it authorizes to no element essentially inhering in the transaction as to which it provides. It leaves open, therefore, the widest conceivable inquiry, the scope of which no one can foresee, and the result of which no one can foreshadow or adequately guard against. In fact, we see no reason to doubt the soundness of the observation of the court below in its opinion to the effect that, to attempt to enforce the section would be the exact equivalent of an effort to carry out a statute which in terms merely penalized and punished all acts detrimental to the public interest when unjust and unreasonable in the estimation of the court and jury. And that this is not a mere abstraction finds abundant demonstration in the cases now before us; since in the briefs in these cases the conflicting results which have arisen from the painstaking attempts of enlightened judges in seeking to carry out the statute in cases brought before them are vividly portrayed. As illustrative of this situation we append in the margin a statement from one of the briefs on the subject. And again, this condition would be additionally obvious if we stopped to recur to the persistent efforts which, the records disclose, were made by administrative officers, doubtless inspired by a zealous effort to discharge their duty, to establish a standard of their own to be used as a basis to render the section possible of execution.

"That it results from the consideration which we have stated that the section before us was void, for repugnancy to the Constitution, is not open to question. * * *"

In *Standard Chemicals & Metals Corporation, Appt.* v. *Waugh Chemical Corporation, Respt.*, 231 N. Y. 51, 131, N. E. 566; 14 A. L. R. 1054, 1056, Mr. Justice Cardozo, in his opinion, says:

"I feel constrained to hold, in adherence to the ruling of the Supreme Court of the *United States* v. *L. Cohen Grocery Co.*, decided February 28, 1921, 255 U. S. 81, 65 L. ed. 516, 41 Sup. Ct. Rep. 298, and *Weeds* v. *United States*, 255 U. S. 104, 65 L. ed. 532, 41 Sup. Ct. Rep. 306, that the prohibition of the Lever Act is void, and that illegality cannot result from the failure to obey it. I do not overlook the fact that the court was there dealing with a criminal prosecution. The ground on which it placed its judgment applies, and with like consequences, to civil suits as well. The prohibition was declared a nullity because too vague to be intelligible. No standard of duty had been established. No test had been supplied, as where statutes direct adherence to reasonable or market values (*International Harvester Co.* v. *Kentucky*, 234 U. S. 216, 221, 58 L. ed. 1284, 1287, 34 Sup. Ct. Rep. 853; *Collins* v. *Kentucky*, 234 U. S. 634, 638, 58 L. ed. 1510, 1511, 34 Sup. Ct. Rep. 924), or to rates fixed by a commission or other legislative agencies. There was merely the denunciation of 'acts detrimental to the public interest when unjust and unreasonable in the estimation of the court and jury.' *United States* v. *L. Cohen Grocery Co.*, supra. The variant views of judges of the district courts were quoted as evidence of the absence of a standard. If this is the rationale of the decision, its consequences are not limited to criminal prosecutions. A prohibition so indefinite as to be unintelligible is not a prohibition by which conduct can be governed. It is not a rule at all; it is merely exhortation and entreaty. The act, as the Supreme Court construes it, rejects all objective standards, all determinate or determinable criteria, the tests of practice, or precedent, or the market, or the vicinage. Rejecting these, it sets the individual adrift upon the unchartered sea of subjective prejudice and favor. The arbitrium boni viri, unrestrained and undirected, becomes the test of right and wrong. I do not say that the law-making body is incompetent, in time of war, to compel the trader to accept such prices for his commodities as juries may consider fair. That question is not here. I am concerned now with the question whether there is an offense against the public order, bringing down upon his contracts, as a consequence, the penalty of illegality and forfeiture if he fails to adjust behavior to ideals of equity and wisdom as varied as the minds of men. Offending contracts

are not merely modified, their exactions scaled down to conform to the finding of right reason, as declared by court or jury after the event. They are wiped out altogether, their exactions adjudged illegal, their makers viewed as malefactors, for failure to conform to the unknown and unknowable. I do not attempt to consider whether the act might have been so restricted or interpreted as to save its validity either wholly or in part. Since the decision of the Supreme Court, the fact of indefiniteness is no longer open to inquiry. The lack of any standard, either expressly established, or ascertainable with approximate certainty from sources aliunde, is to be accepted as a datum. Disobedience is impossible unless there is something to be obeyed.

"We are told that the statute, if unintelligible and uncertain in its inception gained meaning and certainty, and, with those qualities, validity, upon the promulgation by the President of an order fixing prices. I put aside the question whether the order, rightly construed, did prescribe a maximum beyond which charges were to be prohibited. Even if it did, it did not save the statute which it was intended to effectuate. We are not dealing here with an authority such as may be found in page 25, under which the President is expressly empowered to fix the price of coal and coke, with the aid of elaborate tests and safeguards for the protection of producers. They are to be allowed the cost of production, the expense of operation, maintenance, depreciation, and depletion, and in addition thereto a just and reasonable profit (25 (pp. 3115–1/8q)). We are dealing here with an authority, declared in general terms, "to make such regulations and issue such orders as are essential effectively to carry out the provisions of this act'."

In *United States* v. *McFarland et al.*, supra, the Court said at 826:

"By section 120 of the Act of June 3, 1916 (39 Stat. 166, 213 (Comp. St. Sects. 3115f–3115h)), the President was authorized to place an order with anybody for any needed material of the sort usually produced by such person. Such an order was to be given preference over all private engagements, whether they were prior in date or not. Failure to comply with it entailed serious penalties, and moreover authorized the President to take over the plant of the recalcitrant and operate it, just compensation being, of course, made.

"(1) The President, as Commander in Chief of the Army and the Navy, doubtless had the constitutional power in wartime, in cases of immediate and pressing exigency, to appropriate private property to public uses; the Government being bound to make just compensation therefor. *Mitchell* v. *Harmony*, 13 How. 115, 133, 14 L. ed. 75; *United States* v. *Russell*, 13 Wall. 623, 20 L. ed. 474; *Roxford Knitting Mills* v. *Moore & Tierney*, 265 F. 177, 170, 11 A. L. R. 1415. The first of the above cases shows how careful the courts are to restrict the exercise of this power within narrow bounds. Various statutes, passed during or in anticipation of our entry into the World War, expressly authorized the President to requisition sundry classes of property of which the Government had need. Quotation and analysis of these various acts of Congress is not necessary to any matter now in hand. It is sufficient that in the spring of 1918 almost everybody believed that under them he could take over all or any portion of the wool in the country, if he thought that it was required for war purposes. The Government, of course, was bound to pay just compensation for whatever private property it appropriated. Under most of the statutes, if the President and the owner could not agree as to what amount would be just, the United States paid him 75 percent of what it thought was right, and authorized him to sue it for whatever balance he claimed was still due him.

"(2–4) The President was given certain powers to fix prices of various commodities, of which it does not appear that in the spring of 1918 wool was one. Whether this could be constitutionally done we need not now stop to inquire. The Supreme Court has expressly reserved the question whether Congress may lawfully authorize the President, even in wartime, to fix conclusively the maximum prices at which one individual may sell to another. *Matthew Addy Co.* v. *United States*, 264 U. S. 239, 44 S. Ct. 300, 68 L. ed. 658. It would, however, now seem clear that none of the statutes empowering the President or other executive agencies to fix prices authorized him or them finally to say what anyone must take for any property of his wanted by the Government for its own use. *Monongahela Navigation Co.* v. *United States*, 148 U. S. 312, 13 S. Ct. 622, 37 L. ed. 463; *National City Bank* v. *United States* (D. C.) 275 F. 855. The constitutional requirement that the Government must pay just compensation for what it takes is one which war does not suspend. *National City Bank* v. *United States* (supra); *United States* v. *L. Cohen Grocery Co.*, 255 U. S. 81, 41 S. Ct. 298, 65 L. ed. 516, 14 A. L. R. 1045. In the absence of agreement between the owner and the Government, what is just compensation is a judicial question, to be decided by the courts and not by the executive. *Monongahela Navigation Co.* v. *United States*, supra; *United States* v. *New River Collieries* (C. C. A.) 276 F. 690."

Another feature of this statute, which is apparent, is its discriminatory nature. It is, of course, aimed at those who are profiting as a result of the war, which is commendable. But who is not profiting as a result of the war? What factual basis is there for choosing only those who have contracts with the Government? The hotels, the railroads and a host of other business organizations are profiting, but they are not subject to the law. Why discriminate among those who are within the provisions of the statute? What basis is there, except administrative difficulties, for exempting those with $100,000 of war contracts? Would a tax statute with such discriminatory features be regarded as uniform?

It will be observed that the statute seeks only to reach contracts entered into after April 28, 1942, but the Departments by their regulations have added contracts entered into prior thereto but not finally paid for until after that date. There is no statutory authority for such a regulation and, in addition, it would seem to plainly be an impairment of a contract obligation which even the Government in time of war has no constitutional right to indulge in. The plain implication of the *Bethlehem Shipbuilding case* is to this effect. This and other cases will be elaborated on infra.

It is also to be noted that there is no possibility of judicial review of the conclusions of the delegates nor indeed any requirement that they give any reason for their action. It is enough that he or they think the price excessive or the charges unreasonable. This is obviously unconstitutional. *Cline* v. *Frink Dairy Co.*, 274 U. S. 445; *U. S.* v. *Cohen Grocery Co.*, 255 U. S. 81; *U. S.* v. *New River Collieries*, 276 Fed. 690; *U. S.* v. *Detroit Creamery Co.*, 255 U. S. 102; *Standard Chemicals & Metals Corp.* v. *Waugh Chemical Corp.*, 231 N. Y. 51. Due process requires a "standard" in civil as well as criminal proceedings. *Small Co.* v. *American Sugar Refining Co.*, 267 U. S. 233. It should be borne in mind that the Renegotiation Law contains a penal provision (Section 6 (e)).

Evidently the proponents of renegotiation recognized some of the weaknesses of the original statute for on October 21, 1942, the statute was amended by section 801 of title VIII of the Revenue Act of 1942. The same constitutional deficiencies are present in this statute as were present in the first statute.

The amended statute adds the Treasury Department as one of the Departments to enjoy the benefits of the original statute of April 28, 1942. (Subsequent amendments add additional "Departments.") In other words, contracts and subcontracts of the Treasury as the latter are defined by the amending statute, are subject to renegotiation as of April 28, 1942, and in addition for the first time by statute, all contracts and subcontracts as now defined, on which final payment has not been made, are subject to the statute although entered into prior to April 28, 1942. In other words, the October 21 statute is not only made retroactive to April 28, 1942, but retroactive as well, prior to the existence of any statute, as to any contract or subcontract on which final payment was not made prior to April 28, 1942. The same observation is true as to the July 1943 Amendment. This impairment of contract obligations is without precedent because it reaches contracts which were not within the original statute by any stretch of the imagination, but now by definition in the October and July 1943 amendments, contracts are included which were not subject to the original statute, but on top of the contracts which were entered into prior to any statute, by the mere circumstance that final payment had not been made thereon. In other words, if the Government delayed payment of part of the purchase price until after April 28, 1942, such contracts are made renegotiable by the statute of October 21, 1942. The same observations apply to the Departments added by the amendment of July 1, 1943. Similar retroactive provisions of tax statutes have been declared unconstitutional because they were arbitrary: *Nichols* v. *Coolidge*, 274 U. S. 531; *Untermeyer* v. *Anderson*, 276 U. S. 440; *Heiner* v. *Donnan*, 285 U. S. 312; see also *McCroy* v. *United States*, 181 U. S. 27 at 64.

By the amending statute, a subcontract is defined as: "* * * Any purchase order or agreement to perform all or any part of the work, or to make or furnish any article required for the performance of another contract or subcontract. The term 'article' includes any material, part, assembly, machinery, equipment, or other personal property."

This definition means that without regard to whether one has a contract with the Government if he makes a subcontract with any contractor in the chain which ends with the prime contractor, his contract is subject to renegotiation if his war business amounts to $100,000, and he is regarded by the Department as having a contract or subcontract within the definition of the statute. While the statute undertakes to define a subcontract, it is certainly vague as to which subcontract is intended. For example, is a subcontract to furnish brooms to a contractor who is a prime contractor on Navy work within the statute? Is a contract to furnish food to the employes of such a contractor within the statute? Numerous other

examples could be provided. Is the statute not intentionally so worded that the Department is given the right to arbitrarily determine who is within its provisions? Another observation is appropriate in this connection. The Government undertakes to say to third parties who contract, that because their product perchance goes into a war product, they are subject to renegotiation. Is this not a species of legal duress? *Union Pacific R. R.* v. *Public Service Com.*, 248 U. S. 67; *Swift & Co.*, v. *U. S.*, 111 U. S. 22; *Ward* v. *Love County*, 253 U. S. 17; *Atkinson* v. *Denby*, 7 Hurlst. & N. 934; *Morgan* v. *Palmer*, 2 Barn. & C. 729. If it is, it is hardly due process.

Fundamentally this statute is a supertax statute. It undertakes to reach profits in excess of those recovered by the excess-profit tax. In this view, it is plainly unconstitutional because certainly Congress cannot delegate its taxing authority to the Secretaries of War, Navy, etc. That this is a correct interpretation of the statute is clear from the statement of Under Secretary of War Patterson before the Senate Finance Committee on September 29, 1942, where he said:

"The suggested substitute, which was presented by General Somervell, was based on the theory that if every contract price could be reexamined by the parties in the light of actual experience under the contract, it should be possible to eliminate the bulk of excessive profits. No other compulsion upon the contractor was contemplated than (1) to furnish adequate data as to actual and legitimate costs and (2) in the light of such data to bargain in good faith, for the purpose of readjusting the contract price. It was thought that existing contracts could properly be subjected to such reexamination and the proposal submitted to the Subcommittee accordingly so provided. This proposal in effect would have given statutory sanction and implementation to voluntary readjustment of contract prices which was being widely practiced by the armed services prior to the adoption of the Case Amendment.

"The statute as finally enacted differed basically from the proposal submitted by General Somervell. In substance it imposed upon each of the services the duty of eliminating excessive profits by a process of renegotiation. Every contract and every subcontract made by every prime contractor for more than $100,000 is required to contain a provision for such renegotiation without regard to whether in the judgment of the Secretary such a provision was necessary or appropriate. The term renegotiation was so defined as, in the opinion of many lawyers, to authorize the Secretary to refix a contract price regardless of agreement with the contractor or subcontractor. In the light of the legislative history of the Act, there may be serious doubt as to whether it was the actual intention of Congress to confer any such power of unilateral redetermination of the contract price, but the words clearly permit of such construction and it has been widely adopted by the business community.

"Finally, the statute seems clearly to contemplate something more than the reduction of contract prices found to be excessive. In cases where excessive profits have already been paid to contractors, a clear duty seems to be imposed upon the Secretary to recapture such profits by various devices suggested in the statute. Thus the statute seems to impose upon the Secretary the duty of recovering excessive profits as well as the duty of reducing unreasonable prices."

Insofar as the various statutes undertake to reach contracts entered into prior to the date of the statute (and this includes retroactive features defining subcontracts) the statutes impair obligations of these contracts and are unconstitutional and void.

In *Perry* v. *United States*, 294 U. S. 330, and *Lynch* v. *United States*, 292 U. S. 571, the Supreme Court held that the United States was just as much bound by its contractual obligations as an individual and hence could not repudiate its contract obligations without violating the fifth amendment to the Constitution of the United States.

In *U. S.* v. *Bethlehem Shipbuilding Corporation*, 315 U. S. 289, the Supreme Court held that the Government could not repudiate a contract because of an alleged excessive price and Congress by the statutes, insofar as they are retroactive, is endeavoring to accomplish the same result. What one branch of the Government has been forbidden to do surely another branch cannot accomplish by statute.

Part of the valid legal administrative process required by the Fifth Amendment is an opportunity, not only for a hearing, but as well for review. *American T. & T. Co.* v. *United States*, 299 U. S. 232; *Pacific States Box & Basket Co.* v. *White*, 296 U. S. 176; *Morgan* v. *United States*, 304 U. S. 1. Where is there such an opportunity in this statute? The answer is—it is nonexistent. In fact there is no right given by the statute where amounts are withheld, to sue to recover the same and without such right the Government cannot be sued. This is confiscation.

Suppose we have all the courts in the country open for the review of the actions of the renegotiation officials, and applying to the contractor a decision that he has so many dollars of excessive profits. Assume the contractor can go into any court in the country and get that review. What review can he get? Read the statute. What does the statute say? What is the issue going to be when he gets into one of these open courts? The statute says excessive profits are profits found upon renegotiation to be excessive. What is the issue when he goes into court? Solely this one question, and none other: Leaving aside perhaps the contractor's ability to raise a constitutional question, leaving aside perhaps his theoretical but absolutely nonexistent privilege of attempting to prove wholly arbitrary action, so that he can set the whole thing aside—leaving those two things aside for the moment, the sole issue when he goes into that open court is: Were the profits in his case found to be excessive? Once the affirmative appeared, that would be an end to the matter. Is this due process of law? Of course not.

There is another obvious and unconstitutional defect in the statute. The statute plainly permits the exercise by an executive official, or by a subordinate of his own choosing, of judicial power to apply to specific cases the legislative rules so prescribed by them, whether or not those rules have been published and whether or not they have been or will be applied to others—and the exercise of that judicial power must be uncontrolled and uncontrollable, and none of the accepted principles invariably prescribed for the exercise of judicial power must be applicable. That is, there need be no requirement of due notice; no reasonable opportunity to be heard; no record of the proceedings; no findings of fact based upon an established record; and no formal decision.

PITTSBURGH 8, PA., *October 11, 1943.*

Subject: Renegotiation.

Hon. ROBERT P. PATTERSON,
Under Secretary of War,
Washington, D. C.

DEAR MR. SECRETARY: We are grateful for the time you gave us to present our case, in view of the many demands on you. We have been caught between two forces: Congress, which says it does not take too large a part of our profits through taxes; and the Board, which says it leaves us a fair profit before taxes. If all war profits were taken by Congress, we could not complain; but if our company receives a very much smaller net than our competitors, our stockholders are going to complain very bitterly about the management. Unfortunately, we were led to believe that the $10,000,000 settlement was final, and we simply cannot explain to the stockholders why we should pay an additional $2,500,000.

Mr. Stifel stated that our profits before renegotiation were $27,000,000, and you very properly reminded him that he was talking about profits on a large volume of business that was not subject to renegotiation. There has been no doubt in our minds that the Board was looking at the over-all profit. If the same percentage profit before taxes is applied to the entire following year, it appears that our volume of sales will be at least 20 percent greater and our net profit will be 20 percent less. We cannot give you the exact figures, because the amount renegotiated represents a deduction from our gross sales; but it appears inevitable that our stockholders will have at least 20 percent less available for dividends than in the part of a year presently involved.

We tried to emphasize the extremely speculative character of our business, which has shown a loss on an average of 1 out of every 5 years since the First World War. There is certain to be a large surplus of heavy trucks on the markets after this war, just as there was after the First World War, and we shall be forced to enter some new line of manufacturing to maintain our organization and retain even our peacetime factory pay rolls. We pointed out that we had borrowed $10,000,000, and the captain stated that this was only borrowed in September 1942; but we can show you that it was recommended to the directors in January, 1942, and the delay was occasioned by our efforts to obtain a satisfactory loan, in view of the obvious dangers of overproduction.

Your decision will affect the welfare of 11,000 stockholders and 8,500 employees. If, after due consideration, you leave us a larger amount than the Board has demanded, you have the power to take any excessive profit away from us in the

second year; but, if you leave us too little, the Board is less likely to grant us a fair margin in the second year, and our directors will face severe criticism from the stockholders.

You told us that the War Department is well aware of the service our company has rendered to the War Department and that it was not necessary for us to present evidence of that nature. I can truthfully say to you that our executives have put their utmost into serving the Army and that they have been very much depressed by the additional assessment, with its implied reflection on our efforts. In the aggregate, the executives received less money than they did in the previous year, due to the Treasury Department's abrogation of their long-established bonus contracts, so that, with the higher individual taxes, every one of them has suffered a severe reduction in net income.

You may be sure that our protest against the additional assessment has been most distasteful to all of us, for it is the first time in 25 years that we have not been able to reach a mutually satisfactory agreement with the War Department, or for that matter, with any of our large customers. In this case, I feel that I am personally obligated to the stockholders and to the employees to present their case to the best of my ability. Whatever the decision, our directors will do everything in their power to increase the quantity and quality of our war production, and I shall try to convince our executives that there is no reflection on them in the severe terms that have been imposed on our company.

Respectfully yours,

WILLARD F. ROCKWELL,
Chairman of the Board.

11:45 A. M.
October 15, 1943.

TELEPHONE CONVERSATION BETWEEN MAJOR COIT, ARMY SERVICE RENEGOTIATION BOARD, AND COLONEL ROCKWELL, CHAIRMAN OF THE BOARD, TIMKEN-DETROIT AXLE CO.

SUBJECT: RENEGOTIATION—TIMKEN-DETROIT AXLE CO.

Colonel ROCKWELL. Hello, Major Coit.

Major COIT. Good morning, Colonel Rockwell.

Colonel ROCKWELL. Have you seen my letter of October 12 to the Secretary?

Major COIT. No, sir; I have not.

Colonel ROCKWELL. Well, I wrote it October 12, but I suppose it takes a long time to get there. We were having a meeting of our directors in Canton (a stockholders' meeting) when you called up. Well, all we can say is that we cannot agree to that settlement as it would jeopardize the future of our company, and we have information which would definitely establish the inequity of the decision. That's all I can say to you.

Major COIT. I see. Well, I just thought I should call you Colonel Rockwell, and tell you what the judge's decision was, so that you could have the story.

Colonel ROCKWELL. Well, what is the next move?

Major COIT. Well, I suppose the next move is to have them issue a unilateral determination.

Colonel ROCKWELL. Have them do what?

Major COIT. Issue a unilateral determination.

Colonel ROCKWELL. Well, if he does we will just have to do the best we can. We feel the thing is absolutely inequitable and that if it has to be decided elsewhere that we can show that.

Major COIT. Well, sir, of course, that is your privilege.

Colonel ROCKWELL. We are awfully sorry for we have done business with the Army for 25 years and we never have had a fight with either the Army or any of our big customers. We simply haven't any excuse for the directors giving up their responsibilities and letting 11,000 voiceless stockholders and 8,500 voiceless employees take the——of losing what this thing will mean to us. I wrote a letter to the Secretary and I pointed out that that same determination on a full year, which you now have under consideration, or will have the year ending June 30, 1943, will mean that we will do from 20 to 40 percent more business, according to whether you talk about price before or after renegotiation, and the stockholders will receive after taxes 20 percent less.

Major COIT. Of course, I don't know as you can necessarily talk about 1943 as being directly comparable to 1942, Colonel Rockwell.

Colonel ROCKWELL. Well, if you will apply the same percentage on it, and there is no reason if that's a fair percentage on 1942 why that shouldn't be a fair percentage on 1943. As a matter of fact, we understand the Boards are going to say, "Well, you have had more time to prepare and therefore you should receive a smaller profit," so I say you will have us in the position of taking a 20 percent less profit for our stockholders and doing at least 20 percent more business.

Major COIT. I haven't heard any pronouncement like that, Colonel.

Colonel ROCKWELL. Well, I just can't imagine them allowing us a larger profit either before or after taxes in the second year than they did in the first period under consideration.

Major COIT. Well, I'm not saying they are or they aren't, but I haven't seen any pronouncement along the lines you speak of. Now there may have been one but I haven't seen it.

Colonel ROCKWELL. Well, I'm awfully sorry we can't reach a decision but as far as we are concerned we have got to fight that.

Major COIT. I'm awfully sorry, too, that we can't get together.

Colonel ROCKWELL. All right, thank you, Major.

Major COIT. Righto.

Colonel ROCKWELL. Good-bye.

WAR DEPARTMENT,
OFFICE OF THE UNDER SECRETARY
Washington, D. C., October 26, 1943.

Mr. WALTER F. ROCKWELL,
President, The Timken Detroit Axle Co., Detroit, Mich.

Subject: Renegotiation of the Timken Detroit Axle Co. for its fiscal year ended June 30, 1942, pursuant to section 403 of the Sixth Supplemental National Defense Appropriations Act, 1942, as amended.

DEAR SIR: I have given careful consideration to the matters raised by you at our meeting of October 8, 1943, in connection with the 1942 renegotiation of the Timken Detroit Axle Co. and have reached the conclusion that the proposal heretofore made to the company by the War Department Price Adjustment Board should be affirmed. I have therefore made a unilateral determination that $12,500,000 of the prices and profits realized by the Timken Detroit Axle Co. during its fiscal year ended June 30, 1942, under its contracts and subcontracts subject to renegotiation pursuant to the provisions of section 403, are excessive. A copy of such unilateral determination is enclosed herewith.

Very truly yours,

ROBERT P. PATTERSON,
Under Secretary of War.

WAR DEPARTMENT,
OFFICE OF THE UNDER SECRETARY,
Washington, D. C., November 30, 1943.

Mr. WILLARD F. ROCKWELL,
Chairman, Timken Detroit Axle Co.,
Detroit, Mich.

DEAR SIR: Your letter dated November 16, 1943 further concerning the renegotiation of Timken Detroit Axle Co. for its fiscal year ended June 30, 1942 has been received.

In the period during which the renegotiation of your company has been pending all of the points raised by you in your letter have been discussed at a number of meetings. In addition, some of such points were commented upon by you in your discussions with me, and these points and others were further referred to in the paper which you left for my consideration.

As you know, in order to place all companies on a comparable basis for purposes of renegotiation, it is the policy of the War Department Price Adjustment Board to consider and adjust prices and profits on a before-Federal-tax basis. Any conclusion based on the amount of profits remaining after Federal taxes is therefore not directly pertinent to renegotiation proceedings. Similarly, items of other income and other expense, such as are referred to in your letter in connection with your earnings during the years 1936-39, are excluded from profits considered during renegotiation in order to put all companies on the same basis.

You are correct in pointing out that the dividend and salary comparisons made in my previous letter are based on periods not wholly comparable because of the

change in the fiscal period made by your company during 1940. During renegotiation the aggregate amount of executive salaries paid by your company was allowed as a proper cost of doing business and was not a factor affecting the conclusion as to the amount of refund. Likewise dividends paid by the company were not considered to be pertinent to the rengotiation proceedings inasmuch as they are, of course, payable out of earnings after taxes, and were mentioned by me only because of your reference to the same in your letter of November 2, 1943.

The voluntary price reductions, to which you refer in your letter, made by your company during the fiscal year ended June 30, 1943, and further to be made during the current fiscal year are noteworthy and will be given full consideration in the renegotiation of the business of those years.

It may be that some of our differences in connection with the renegotiation of the Timken Detroit Axle Co. are brought about by a fundamental difference in our methods of approach to the problem. In this connection, I quote a part of a joint statement made by the Under Secretary of the Navy and myself under date of February 9, 1943, as follows:

"The rate of profit made on peacetime business is not of itself the basis for profits to be made on war contracts. Because of the unprecedented volume of business due to war orders a substantial reduction in profit margins below peacetime levels will usually leave contractors with an adequate dollar amount of profits on war work. Any single profit yardstick is invalid because of wide variations among contractors in investment, efficiency, past earnings, Government assistance, turn-over, and inventive contribution. However, in general, the margin of profit which a company makes on its expanded war sales may be limited to one-half or one-third of the margin of profit on peacetime sales."

It is my hope that you will again review the results achieved by your company in connection with war business during the fiscal year ended June 30, 1942, and conclude with me that the proposal made to your company was fair and just.

Very truly yours,

ROBERT P. PATTERSON,
Under Secretary of War.

WAR DEPARTMENT,
OFFICE OF THE UNDER SECRETARY,
Washington, October 20, 1943.

DETERMINATION OF EXCESSIVE PROFITS

Pursuant to section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended

Whereas the Timken-Detroit Axle Co. (hereinafter referred to as the contractor), holds contracts and subcontracts subject to renegotiation pursuant to the provisions of section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended (hereinafter referred to as the act); and

Whereas, renegotiation has taken place between the United Secretary of War and the contractor, pursuant to the provisions of the act, for the purpose of eliminating excessive profits realized by the contractor during its fiscal year ended June 30, 1942, under said contracts and subcontracts; and

Whereas, as a basis for said renegotiation the Under Secretary of War considered certain financial, operating, and other data submitted by the contractor or obtained by the Under Secretary of War from governmental or other reliable sources, relating to the profits realized by the contractor during said fiscal year under contracts and subcontracts; and

Whereas, the contractor has been granted full opportunity to submit such additional information and to present such contentions as the contractor deemed material in determining the excessiveness of said profits and the renegotiability of such contracts and subcontracts, at hearings of which due notice was given, and due consideration has been given to the financial, operating and other data and information so furnished or obtained and each of the contentions so presented;

Now, therefore, pursuant to the authority and discretion vested in the Secretary of War, the Secretary of the Navy, the Secretary of the Treasury, the Chairman of the Maritime Commission, the Administrator of the War Shipping Administration, and the respective boards of directors of the Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation, and Rubber Reserve Com-

pany, under the provisions of the act, and duly delegated to the Under Secretary of War under subsection (f) thereof, it is hereby found and determined;

That $12,500,000 of the profits realized by the contractor during its fiscal year ended June 30, 1942, under its contracts and subcontracts subject to renegotiation pursuant to the provisions of the act, are excessive.

That in connection with the payment or discharge by any means of the amount of excessive profits determined hereby to have been realized by the contractor, the contractor shall be credited with any amount to which it may be entitled under section 3806 of the Internal Revenue Code as computed by the Commissioner of Internal Revenue.

That the contractor is directed to repay such excessive profits less such tax credit, if any, to the Treasurer of the United States.

That the excessive profits so found and determined shall be eliminated by any of the methods provided in the act or any combination thereof; and the commanding general, Army Service Forces, and the commanding general, Army Air Forces, are hereby authorized and directed to take any and all action which may be necessary or desirable to effect such elimination.

ROBERT P. PATTERSON,
Under Secretary of War.

PITTSBURGH, PA., *November 2, 1943.*

Renegotiation of the Timken Detroit Axle Co. for its fiscal year ended June 30, 1942, pursuant to section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended

HON. ROBERT P. PATTERSON,
Under Secretary of War,
Washington, D. C.

DEAR SIR: Your letter of October 26, 1943, addressed to Mr. Walter F. Rockwell, has been received.

You know that the Detroit Renegotiation Board determined on a sum of $10,000,000 for the fiscal year ended June 30, 1942, and that we sent a check for that amount. If this board, which was in a position to examine into our efficiency was unable to arrive at the proper sum, we cannot understand why they continue to function.

The determination of a $2,500,000 additional assessment in Washington indicates that the entire matter has been handled with nothing smaller than units of $2,500,000 in mind.

In June 1940, in the presence of and at the request of Army officers, we offered our designs and patents to our two principal and direct competitors, both of whom refused to manufacture axles of the standardized design for the War Department. Both of these companies have published their financial reports showing that they have been allowed a much larger profit than we have been, although no one can show where they have contributed in the same degree as our organization.

When we were called before panel A in Washington, we attempted to show why we should be given at least equal treatment, but the panel gave us no hearing worthy of the name. Both the Detroit board and the Washington Board knew that there was a $600,000 profit for the fiscal year from a subsidiary and both boards stated that they did not care whether this sum was included or left out. This surely indicates the arbitrary and capricious manner in which the determination was made.

You personally stated that you were well aware of the contribution made by our company and we can see no reason why we should not be informed as to the manner in which our company failed to carry out its contracts, and why we should be penalized after the voluntary reductions we made before the Renegotiation Act was in effect.

One member of your Board states that you left us a fair profit before taxes and that our complaint is about the tax law. This absolutely is untrue, as we have seen no tax law which takes 100 percent of our earnings and our savings, but we are convinced that under renegotiation no consideration has been given to the savings which we have made through the use of our own capital. We believe that the sum of $12,500,000 represents an arbitrary and capricious figure, determined with prejudice and without a fair opportunity to present our case to a competent and unprejudiced board.

It is my duty to speak for 11,000 stockholders, and 8,500 employees. If we were to pay out $12,500,000, we believe that the directors would be liable for a

stockholder's suit, especially in view of the different treatment accorded our direct competitors, and the very much better treatment given our indirect competitors. We believe that the net rate of less than 3 percent on our sales will jeopardize our business future. After the last war our business sufferd tremendously when the surplus trucks were disposed of to our potential customers at sacrifice prices. We know that we have to face a much more dangerous surplus whenever this war may end. We must have enough capital left so that the company can survive and provide work for their employees.

Your action has caused a heavy depreciation in our stock which is not reflected in the quotations of our competitors' stocks. Our directors have felt it necessary to reduce the dividends paid to our stockholders and it is my personal opinion that we should further reduce payments, if the War Department Renegotiation Board maintains its present attitude. We could have no complaint, if the same treatment were accorded to all contractors, or if the taxes took all war profits. Our directors certainly cannot justify their acceptance of such harsh and drastic treatment as the Renegotiation Board intends to impose upon us. We call your attention again to the fact that Mr. Arnold Stifel mentioned $27,000,000 of profits before taxes, although no such sum was subject to renegotiation.

Our executives feel that the action of the Board against our company is degrading and insulting because of the greater allowances made to our direct competitors. We proved to you that we invested large sums of money in machinery and equipment, which made great savings, but the confiscation of these savings makes it impossible to continue to invest the company's money in machinery and equipment as the end of the war would find our meager profits invested in capital goods of very slight value, if we have no market for our products, as seems most likely from past experience.

In conclusion, I feel that our directors cannot possibly justify the acceptance of any such penalty on our company and that if any payments are withheld we shall have to use our best efforts to obtain legal redress against the contracting officers.

Respectfully yours,

WILLARD F. ROCKWELL,
Chairman of the Board.

WAR DEPARTMENT,
OFFICE OF THE UNDER SECRETARY,
Washington, D. C., November 9, 1943.

Mr. WILLARD F. ROCKWELL,
Chairman, Timken Detroit Axle Co.,
Pittsburgh, Pa.

DEAR SIR: Your letter of November 2, 1943, concerning the renegotiation of the Timken Detroit Axle Co. for its fiscal year ended June 30, 1942, has been received.

At my direction the War Department Price Adjustment Board has been set up in such a way that for the most part renegotiation proceedings are originally undertaken by local boards within the locality of the contractor. In order to prevent inequities it has been provided that the decisions of such local boards are subject to the review of the War Department Price Adjustment Board itself, and in cases where the Board finds it impossible to reach a bilateral agreement with the contractor review by my office has been provided. This was done in order that each particular case in which an agreement had not been reached might be judged in the light of settlements made in a given industry and with industry in general. Insofar as is possible the results of all renegotiation proceedings are furnished to local boards, but it is self-evident that the War Department has had closer contact with and is more conversant with a great variety of renegotiations than any local board can be.

Renegotiation proceedings with the Timken Detroit Axle Co. were undertaken on the basis of financial and operating data supplied by the company, and have covered an extended period during which not less than eight meetings were held. At the last meeting with the War Department Price Adjustment Board in Washington, at which you were present for only a part of the meeting, all of the data and the basis for the Board's proposal were completely outlined to the officers of the company.

During your meeting with me the Price Adjustment Board acknowledged the extent and value of the contribution made by your company. It also pointed out that your company's war business is substantially similar to its peacetime business, and that during the company's fiscal year 1942 renegotiable sales

amounted to approximately $49,000,000, on which your company realized profits amounting to $16,500,000, or 33.4 percent. During the years 1936-39, which are used by the Treasury as normal years for tax purposes, your company's average sales amounted to approximately $20,200,000, on which the company realized an average profit of $2,100,000, or 10.5 percent. In other words, before renegotiation, on renegotiable sales amounting to two and one-half times those of the years 1936-39 your company charged prices which resulted in its realizing profits before taxes amounting to nearly eight times the average of the prior years. After the adjustment proposed by the War Department Price Adjustment Board and affirmed by me, your company's profit realized on renegotiable sales amounted to 11 percent of such sales as adjusted, and in dollars amounts to twice the average of the years 1936-39. In addition to this war business your company enjoyed a more than average nonrenegotiable business, which included a substantial amount of Government business. During the period covered by this renegotiation, despite increasing profit margins, the voluntary price reductions made by your company amounted to only about 1¼ percent of the invoice price of its products.

In your letter you refer to action of your board of directors with regard to dividends to common stockholders. The data submitted by your company indicate that dividends paid by the company during 1942 were nearly three and one-half times the dividends paid by the company during 1940, and that during the same year salaries paid to executives amounted to nearly five times the amount paid during 1940.

Full consideration of the factors noted above, together with all of the other elements involved in the proceedings, with which you and your associates are familiar, led the War Department Price Adjustment Board to the conclusion that your company should refund to the Government $12,500,000 as representing excessive profits realized out of war business during its fiscal year ended June 30, 1942. My review of the Board's proposal and the factors on which it is based, some of which are outlined above, and of the matters raised by you at our meeting has convinced me that the Board's proposal is fair and just. Accordingly I have affirmed the finding and have issued the unilateral determination to which you refer. I am directed by the statute to eliminate such excessive profits by any of the methods provided in the act or any combination thereof.

Very truly yours,

ROBERT P. PATTERSON,
Under Secretary of War.

THE TIMKEN-DETROIT AXLE CO.,
November 16, 1943.

HON. ROBERT P. PATTERSON,
Under Secretary of War, War Department,
Pentagon Building, Washington, D. C.

DEAR SIR: Your letter of November 9 contains the first comprehensive data that we have received concerning the method used by the Government in computing excessive profits of the Timken-Detroit Axle Co. on renegotiable sales for the year ended June 30, 1942. In view of several statements that are at variance with the facts, we feel compelled to reply so that the record will be clear.

You state "At the last meeting with the War Department Price Adjustment Board in Washington, at which you were present for only a part of the meeting, all of the data and the basis for the Board's proposal were completely outlined to the officers of the company."

It is not true that all of the data and the basis for the Board's proposal were outlined to us at that time. No information was given to us as to the weight that had been given to our contribution to the war effort or the risks involved. We were not given any facts or data, other than a reference to a historical percentage arrived at for the period January 1, 1936, through June 30, 1940. As a matter of fact, our treasurer presented to the panel a summary of Timken Axle contribution to the war effort which was a duplicate of the presentation made to the Detroit board (which we had been advised by the Detroit board had been forwarded to Washington) and we were advised by the panel that they had never seen it before, and no discussion was entered into by them as to the merits of the data presented. We were simply told that the decision had been made that we must pay $12,500,000. It is my opinion that none of the four members of the panel was either competent to decide, or willing to listen to anything we

might say, and there was not the slightest indication that they would lower the amount by so much as a dollar. Furthermore, they specifically stated that they could not guarantee that $12,500,000 would be the top figure. We considered that this statement was made in a threatening manner and was convincing evidence of the prejudice of the Board.

Since you state "Renegotiation proceedings with the Timken-Detroit Axle Co. were undertaken on the basis of financial and other operating data supplied by the company," we presume that the statements quoted in your letter of November 9 were compiled from that data. If this is true, their incorrectness is further evidence of the incompetence of the people who have handled our case.

You state that dividends paid by our company during 1942 (we are presuming you mean the year ended June 30, 1942) were nearly three and one-half times the dividends paid by the company during 1940 (again we presume you mean the year ended June 30, 1940).

The facts relative to dividends are as follows; and we are giving calendar-year figures as well as fiscal-year figures in case your comparison was made on that basis:

	Dividends paid per share	Total money
Fiscal-year basis:		
Year ended June 30, 1940	$3.25	$3,214,762
Year ended June 30, 1942	4.25	4,215,893
Calendar-year basis:		
Year ended Dec. 31, 1940	3.25	3,215,614
Year ended Dec. 31, 1942	3.25	3,225,918

Until December 1940 there were 988,075 shares outstanding and in other years 991,975.

Instead of there being an increase in dividends to "nearly three and one-half times" or 350 percent, there was an increase on a fiscal-year basis of only 30 percent and on a calendar-year basis there was no increase in the dividend rate.

You state "that during the same year (meaning 1942) salaries paid to executives amounted to nearly five times the amount paid during 1940."

The facts relative to salaries are as follows for employees earning $10,000 or more per year (here again we give figures on a fiscal- as well as calendar-year basis):

	Number of employees	Total money
Fiscal-year basis:		
Year ended June 30, 1940	21	$269,491
Year ended June 30, 1942	22	483,831
Calendar-year basis:		
Year ended Dec. 31, 1940	21	337,997
Year ended Dec. 31, 1942	22	486,535

Instead of salaries increasing "nearly five times" or 500 percent on a fiscal-year basis, they increased 81 percent and on a calendar year basis only 25 percent. Do you consider this an unfair increase in salaries when these executives were responsible for a four and one-third times greater production? These salaries are only one-third of 1 percent of the sales for the calendar year of 1942.

You refer to our company's war business as being "substantially similar to our peacetime business," and that fact in itself entitles us to more liberal consideration, for the more units we produce for the Army the less business we will have postwar. Evidence that the Army will turn this equipment back to civilian use is contained in the press release quoted below.

"Approximately 750 Army trucks, 1939 models and older, in the Sixth Service Command area will be offered for purchase by civilians as fast as replacements become available," Maj. Gen. H. S. Aurand, commanding general, said in Chicago Monday.

"More than 15 percent of the trucks already have been sold to civilians, and the entire replacement program is scheduled for completion by January 1, 1944. The trucks are turned over to the salvage office at each Army post, which places them on an "invitation to bid," listing each truck individually by its model, year, and special number."

A continuation of this policy may place from 10 to 15 yea supply of heavy trucks on the market, completely ruining our post-war chances. To be prepared for this we must build up adequate reserves.

Reference is made to renegotiable sales in the 1942 fiscal year as amounting to $49,000,000 on which the company realized profits amounting to $16,500,000 or 33.4 percent and that during the years 1936–39, which are used by the Treasury as normal years for tax purposes, our company's average sales amounted to approximately $20,200,000 on which our company realized an average profit of $2,100,000 or 10.5 percent.

The figures cited for the years 1936–39 are operating profit figures before taxes and do not include other income and other deductions normally incurred in our business, and which we advised the price-adjustment boards should be considered in determining our normal profits. We normally earned a substantial interest income by financing a certain portion of our sales, and earned dividends from investments in subsidiaries, which we are sacrificing during the war period to provide a more liquid position for financing the war business. Including these elements in our profits our percentage of profit before taxes, to sales for the years 1936–39 amounted to 11.4 percent and for the period 1936 through to June 30, 1940, which the Price Adjustment Board, panel A, advised they used as the base period, it amounted to 13.4 percent.

Concerning your statement that "After adjustment proposed by the War Department Price Adjustment Board and affirmed by me, your company's profit realized on renegotiable sales amounts to 11 percent of such sales as adjusted, and in dollars amounts to twice the average of the years 1936–39," we would bring to your attention that these earnings were not primarily due to prices charged as stated by you but to savings made in the cost of production of the product. As we pointed out in our presentation to the price-adjustment boards there was a saving of approximately $10,000,000 as a result of efficient low-cost operation. The comparison as to profits for these sales compared to the average for 1936–39 should be made as follows:

	Renegotiable before adjustment	Renegotiable after adjustment of $12,500,000	1936–39
Sales	$49,556,600	$37,056,600	$20,210,533
Profit before taxes	$16,557,068	$4,057,068	$2,308,498
Percent to sales	33.4	10.95	11.4
Profit after taxes	$4,200,872	$1,033,506	$1,866,282
Percent to sales	8.48	2.7	9.2

Please note that the percentage of profit after taxes for the period of 1936–39 is three and four-tenths times the profit after taxes on the Price Adjustment Board basis.

You state that "in addition to this war business your company enjoyed a more than average nonrenegotiable business, which included a substantial amount of Government business." The law distinctly states that you were to adjust the prices on contracts not fully paid for on April 28, 1942, and your boards have no right whatever to question the profits we made on any other business. We were selling to the largest automobile manufacturers, and there never was the slightest doubt that they were able to protect themselves against high prices in placing a contract with a parts manufacturer. If they thought our prices were too high, they were in a position to produce in competition with us, and we had at least two direct competitors who were always willing to take their business.

Reference is made to the voluntary price reductions of our company only amounting to 1¼ percent of the invoice price of its products, but no mention is made that these reductions were only starting in the latter part of this period and that they had amounted to over $20,700,000 for the year ended June 30, 1943, and over $60,000,000 on orders received up to September 1943. By these reductions we are in effect continually returning large sums to the Government, and we absorbed all higher costs for tooling subcontractors plus their higher charges (in some cases 65 percent higher than our costs).

Respectfully yours,

WILLARD F. ROCKWELL,
Chairman, Board of Directors.

[From the Pittsburgh Press, November 3, 1943]

(Washington Column)

EFFICIENT FIRMS GRANTED HIGHER PROFITS BY ARMY

(By Peter Edson)

WASHINGTON—Information to show how the Government permits more efficient manufacturers to retain higher rates of profit, even after renegotiation of their contracts by price-adjustment boards to recover what are considered excessive earnings, is revealed by the War Department in the case of the Dixwell Corporation, the High Standard Corporation, and the High Standard Co. of New Haven, Conn. These firms have contracts to make Browning machine guns, the original face value of the contracts being $46,000,000.

The Treasury Department's list of individuals receiving from corporations compensation for personal services of more than $75,000 a year, just made public, shows that the Dixwell Corporation had seven executives, each of whom receive $200,000 or more for the past 2 years, as follows:

F. E. Bradley, $210,603 and $199,659; F. S. O'Reilly, $210,603 and $199,659; J. E. Owsley, $421,206 and $299,488; C. G. Swibelius, $631,809 and $499,148; Earl B. Swibelius, $210,603 and $199,659; Gordon Swibelius, $210,603 and $199,659; George R. Willis, $210,603 and $199,659.

FIVE TOOK CUTS

Here you have a total of more than $2,000,000 paid in salaries to seven men in 1941 and nearly $1,800,000 in 1942. Five of the seven took cuts of a mere $11,000 a year in 1942, though Mr. Owsley took a hack of $122,000 and C. G. Swibelius one of $132,000.

If you never before heard of the Dixwell Corporation or any of its seven top flight salaried men, that is understandable, for the Dixwell Corporation doesn't make anything itself. It is simply a holding company, giving engineering and management services to the High Standard Corporation and the High Standard Manufacturing Co. These two firms hold the war contracts and make the machine guns.

On the face of it, this may look like another war-profiteering case, but a second look reveals an entirely different story. Both the High Standard Corporation and the High Standard Co. have had their books examined by the War Department Price Adjustment Board.

The result of the renegotiation is that the High Standard companies will receive for the machine guns they make only $22,417,000, instead of the original contract price of $46,650,000. The saving to the taxpayers in this case is $24,233,000.

EFFICIENT OPERATORS

In spite of this tremendous return to the Public Treasury, Brig. Gen. Albert J. Browning of the purchasing division of Army Service Forces, emphasize that the High Standard companies are being permitted to retain high profits—higher profits than some of the other companies making machine guns—for the reason that the High Standard companies are more efficient operators.

Whereas the average price of machine guns from other manufacturers has been between $330 and $500 per gun, the High Standard price has been $250 per gun, and even at that figure they make and are permitted to retain a higher profit.

The case of the Dixwell Corporation, which has furnished the engineering brains and management experience permitting its High Standard subsidiaries to make this excellent production record, is still in the process of renegotiation. In this case there is a nice distinction. Under the renegotiation law, the Government price-adjustment boards may not take into consideration what any company does with its earnings, or what salaries it may pay its executives, so long as those salaries are not a cost of production. The seven $200,000-a-year men of the Dixwell Corporation receive no compensation for their services to the High Standard companies. The question is whether the fees charged by Dixwell for engineering services to High Standard, permitting them to make their good record were excessive.

The CHAIRMAN. Mr. Kellogg.

STATEMENT OF C. W. KELLOGG, PRESIDENT, EDISON ELECTRIC INSTITUTE, NEW YORK CITY

Mr. KELLOGG. Mr. Chairman, I can make my direct statement in about 7 minutes.

The CHAIRMAN. We may be called to the floor, and we would appreciate it. You can put, of course, your brief in the record.

Mr. KELLOGG. I am doing that.

My name is Charles W. Kellogg. My office is in New York City. I am president of Edison Electric Institute, the trade association of the electric-utility industry. One of the principal functions which the institute performs for its members and for the public generally is the compilation and dissemination of data about the industry. It is in carrying out of that function that I appear before you today, in connection with the pending tax bill (H. R. 3687).

For your information in considering my statement, I am handing you 6 tables and 2 charts which have been prepared by the institute. The tables show for the entire electric-utility industry the size and make-up of utility taxes during the base period and in recent years; the growth in investment and the decrease in return thereon; and the taxes expected to result from the application of the rates of taxation contained in H. R. 3687. The charts bring out the salient points in the tables. In confirmation, I am also filing a copy of a report prepared by the eminent New York economist, Lionel D. Edie, covering a study he has made of 20 selected utility companies.

Changes in corporate taxes approved by the House of Representatives in H. R. 3687 provide for raising the excess-profits-tax rate from 90 to 95 percent and also for reducing the allowance on the invested capital by one precentage point on amounts of such capital in excess of $5,000,000. As the basis for recommending on October 4, 1943, to the Ways and Means Committee of the House a general increase in corporation taxes, Secretary Morgenthau is reported as having said:

> Despite heavy increases in taxes, net corporation income, after taxes, has risen greatly since 1939.

I have quoted Secretary Morgenthau's statment not to question its accuracy, but to point out that the condition he reports with respect to corporations in general is not true with respect to electric utilities.

Experience with the operation of wartime taxes has demonstrated that the regulated electric-utility companies have been much harder hit than other types of business. Taking the 1936–39 "base period" as 100, the net income of the regulated electric-utility companies in 1942 was 88, or 12 percent below the base period and, if the change in excess-profits-tax rates in H. R. 3687 is made effective, it would drop to 86 for the year 1943, or a 14 percent decrease. On the other hand, the index number for the return on net worth of all manufacturing companies in 1942 stood at 164, or an increase of 64 percent over the base period.

On the average, the electric utilities require seven times as much plant investment per dollar of gross revenue as does the average

manufacturing concern. They are, therefore, particularly vulnerable to rate of return on investment. The figures I have submitted, covering the whole industry, show that the effect of taxes has been to reduce the rate of return on utility investments from 6 percent in the base period to 5.2 percent in 1943.

The utilities are a regulated industry and not able, therefore, to increase selling prices as can the average industrial. On the contrary, the average unit price at which they have sold residential electricity is now 17½ percent below the 1935-39 average, while the cost of living is up 23 percent and continues to rise about one-half of 1 percent a month. The index of wholesale prices is up 29 percent since that time.

Under present conditions, and possibly under future conditions, unless this industry is husbanded taxwise, it can only look to surplus for new junior money, unless it can attract outside capital made imperative through growing consumer demands. The two points of the magnet attracting such capital are (1) not alone the current dividend and resultant yield, but the trend of the amount disbursed; (2) the cushion in the form of surplus. Facts supporting these statements are brought out in detail in the study by Dr. Edie which I have filed with you for the record. It is the conclusion of that analyst that not only should the utility industry be exempted from any further increases in wartime tax rates, but that it is also entitled to pleads it cause for special relief from the rates set up under existing laws if it is to fulfill its role in meeting the challenge of the post-war.

The public-utility industry is keenly aware that all segments of the economy must contribute their share of the financial sacrifices required to implement the war effort. For that reason and that reason alone the industry has been hesitant to press its case for relief under the 1942 act although the record is clear. Our record of outstanding performance on the industrial front, with the security of this country and its institutions at stake, is one to which we point with pride. As soldiers in the ranks of industry we have done our fair share. However, the industry has borne far more than its fair share of business taxes. With the romance that goes with growth not entirely absent but certainly harnessed, we are compelled to seek stability of earnings to finance our required expansion along conservative lines. The present tax proposals written into the bill now before your committee compound the injury done by the 1942 act.

In closing, I believe the figures I have presented indicate that there should be no increase in existing rates of normal, surtax or excess-profits taxes, nor any decrease in allowable rates of return on invested capital.

As a source for raising the additional taxes which would be obtained from the private utilities under the rates of taxation contained in H. R. 3687, attention is called to the fact that at the present time publicly and cooperatively owned electric utilities are paying no Federal taxes. Yet such publicly and cooperatively owned utilities are called comparable to the private utilities in all respects. The suggestion that taxes on private utilities be now increased serves to emphasize the unfairness to them and to their customers that the publicly and cooperatively owned utilities are free of Federal taxes. Any loss of revenue caused by exempting utilities from the increased

rates provided in H. R. 3687 can be doubly offset by taxing governmentally owned utilities on the same basis as the private utilities now pay.

That is my statement, Mr. Chairman.

The CHAIRMAN. Thank you very much. You wish to put into the record the full statement?

Mr. KELLOGG. I would like to very much, sir.

The CHAIRMAN. You may do so. Thank you for your appearance here. Unquestionably the increase in the excess-profits rate from 90 to 95 and the reduction in the invested capital base works a very great hardship on all regulated utilities, railroads as well as other types.

Mr. KELLOGG. That is what I wanted to make particularly clear, Mr. Chairman.

The CHAIRMAN. I think the committee fully appreciates the problem before it, because regulated utilities are pretty heavily hit by these two provisions in the House bill. The problem is not an easy one to solve, though, as you know.

Mr. KELLOGG. I realize that, Mr. Chairman. I wanted to be sure your committee knew definitely that what applies to the generality of corporations does not apply to utilities. That is the point I wanted to particularly stress.

The CHAIRMAN. That is quite true.

Mr. KELLOGG. Thank you for your time.

(The matter submitted by Mr. Kellogg is as follows:)

TABLE 1.—*Estimated income statement 1943—Electric light and power companies*

[Millions of dollars]

	1941	1943	Percent change	1943 [1]	Percent change
Operating revenues	2,467	2,611	+6	2,818	+8
Operating expenses	947	1,011	+7	1,134	+12
Depreciation	279	294	+5	309	+5
Taxes	520	630	+21	710	+13
Total deductions	1,746	1,935	+11	2,153	+11
Operating income:					
Electric	721	676	−6	663	−2
Other departments	55	59	+7	66	+12
Nonoperating income	73	72	−1	70	−3
Gross corporate income	849	807	−5	799	−1
Interest, amortization, etc	312	310	−1	304	−2
Net income	537	497	−7	495	.....

[1] Estimated on basis of actual results of first 9 months of 1943 with Federal tax rates of House bill 3687 applied.

Source: 1941–42 as shown in Edison Electric Institute Statistical Bulletin No. 10, table 33, p. 39 (revised).

TABLE 2.—*Break-down of utility taxes* [1]

[Millions of dollars]

	1940	1941	1942	Increase	1943 [2]	Increase over 1942
Federal taxes:						
Income taxes	129	179	210	31	215	5
Excess profits	6	47	118	71	191	73
3½ percent excise tax	44	49	50	1	52	2
All other Federal	31	19	17	−2	17	
Total, Federal	197	294	395	101	475	80
State and local taxes	214	226	235	9	235	
Total taxes	404	520	630	110	710	80

[1] Preliminary figures.
[2] Estimate, based on actual results for first 9 months of 1943 and application of Federal tax rates contained in H. R. 3687.

TABLE 3.—*Growth of electric-utility tax burden—Percent of gross revenue*

Year	Spent for operating maintenance and depreciation	Spent for taxes	Balance available for return on investment and extension	Total
1930	46	10	44	100
1935	48	14	38	100
1940	49	18	33	100
1941	50	20	30	100
1942	50	24	26	100
1943 [1]	51	25	24	100

[1] Estimate based on actual results of first 9 months.

TABLE 4.—*Effect of Federal income and excess-profits taxes upon earnings of electric light and power companies* [1] *in the United States*

[Money amounts in millions of dollars]

Year	Net income before Federal income and excess-profits taxes	Federal income and excess-profits taxes				Net income after all taxes and charges
		Income	Excess profits	Total	Percent before taxes	
1917 [2]	122			6	5	116
1922 [3]	240			10	4	230
1927	508	36		36	7	472
1932	642	36		36	7	606
1933	437	33		33	8	404
1934	455	44		44	10	391
1935	459	39		39	9	420
1936	513	53		53	10	460
1937	575	66		66	12	509
1938	548	63		63	12	485
1939	628	89		89	14	539
1940	692	129	6	135	20	557
1941	763	179	47	226	30	537
1942	825	210	118	328	40	497
1943 [4]	901	315	191	506	45	495

[1] All privately owned utilities, including multiple-service companies which supply gas, water, [illegible]tion and other services in addition to electricity.
[2] Based upon United States census of central stations for 1917, which represented 78 percent of the electric light and power companies as now constituted.
[3] Based upon United States census of central stations for 1922, which represented 87 percent of the electric-light and power companies as now constituted.
[4] Estimated on basis of first 9 months and applying rates of Federal taxation as in H. R. 3687.

NOTE.—Years 1922 to 1938, inclusive, are actual collections as reported by Bureau of Internal Revenue years 1917 and 1939 to 1943 are as carried on utility books and may vary somewhat from actual collections.

TABLE 5.—*Earning power of invested capital—Return on net worth of all manufacturing companies compared with return on invested capital of electric utilities*

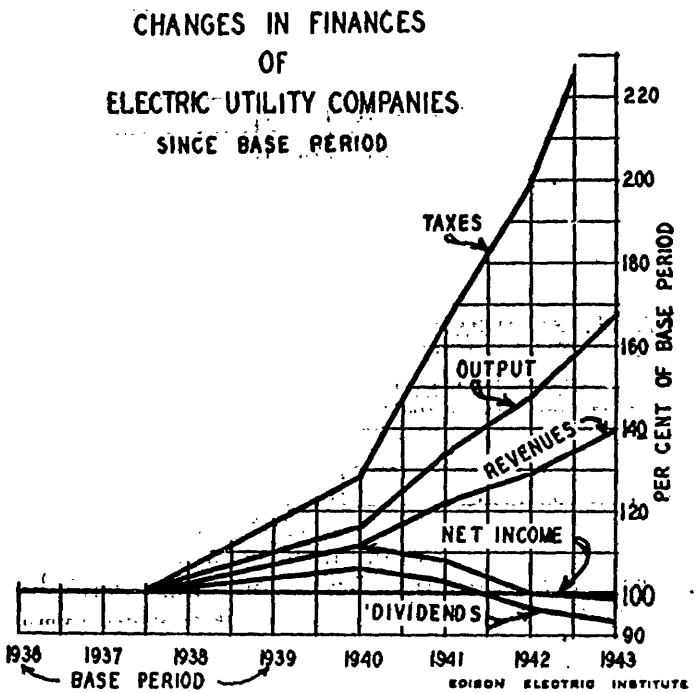
Year	All manufacturing companies [1]		Electric utility companies					
			Operating income		Electric fixed capital		Return on investment	
	Return on net worth	Percent of base period	Millions of dollars	Percent of base	Millions of dollars	Percent of base	Percent	Percent of base
	Percent							
1936	6.2	103	712	98	12,000	100	5.9	98
1937	8.0	132	726	100	11,950	99	6.1	101
1938	3.1	51	707	98	12,025	100	5.9	98
1939	7.0	116	749	104	12,100	101	6.2	103
Base period	.....	100	.....	100	.....	100	.....	100
1940	8.8	146	750	104	12,225	102	6.1	101
1941	12.4	205	721	100	12,475	104	5.8	96
1942	9.9	164	676	94	12,650	105	5.3	88
1943 (as per H. R. 3687)	.....	.....	663	92	12,825	107	5.2	86

Sources: Manufacturing companies, from U. S. Treasury Statistics of Income for years 1936–40, inclusive, as shown summarized by the National City Bank in its Bulletin on Economic Conditions, March 1943, p. 34. Years 1941 and 1942 as shown for 1198 companies by National City Bank in its April 1943 Bulletin. Electric utility companies, from Statistical Bulletins of the Edison Electric Institute; 1943 is a preliminary estimate.

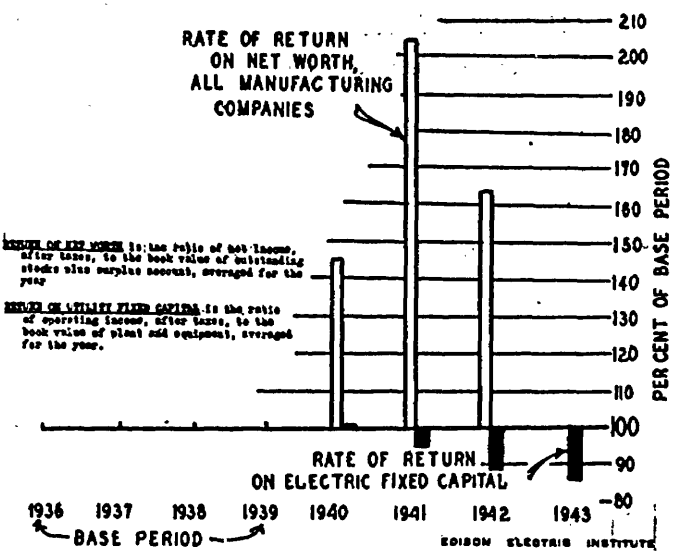
TABLE 6.—*Changes since base period in finances of electric utility companies*

Year	Generation		Revenues		Operating income		Fixed capital		Taxes		Dividends	
	Total, billion kilowatt-hours	Percent, base period	Total, million dollars	Percent, base period	Total, million dollars	Percent, base period	Total, million dollars	Percent, base period	Total, million dollars	Percent, base period	Total, million dollars	Percent, base period
1936	102	95	1,011	94	712	98	12,000	100	281	89	407	94
1937	110	102	2,031	100	726	100	11,950	99	308	98	442	102
1938	104	97	2,018	100	707	98	12,025	100	323	102	420	99
1939	115	107	2,148	106	749	104	12,100	101	352	111	453	105
Base period	.....	100	.....	100	.....	100	.....	100	.....	100	.....	100
1940	125	116	2,277	112	750	104	12,225	102	404	128	456	106
1941	144	134	2,467	122	721	100	12,475	104	520	165	440	103
1942	158	147	2,611	129	676	94	12,650	105	630	199	416	96
1943 [1]	181	168	2,816	139	663	92	12,825	104	710	225	400	93

[1] 1943 figures are preliminary estimates on basis of first 9 months and with rates of H. R. 3687 applied.


CHANGES IN FINANCES
OF
ELECTRIC UTILITY COMPANIES
SINCE BASE PERIOD
TAXES
OUTPUT
REVENUES
NET INCOME
DIVIDENDS
220
200
180
160
140
120
100
90
PER CENT OF BASE PERIOD
1936
1937
1938
1939
1940
1941
1942
1943
BASE PERIOD
EDISON ELECTRIC INSTITUTE

EARNING POWER OF INVESTED CAPITAL



ECONOMIC ANALYSIS OF THE EFFECTS OF THE 1942 TAX LAW ON PUBLIC UTILITIES

(Prepared by Lionel D. Edie & Co., Inc. Submitted before the Senate Finance Committee on December 2, 1943, by Charles W. Kellogg, president of the Edison Electric Institute, in testimony on H. R. 3687.)

OCTOBER 1943.

INTRODUCTION

In making a study of the effects of the 1942 tax law on the utility industry, one finds it necessary at the outset to give consideration to certain basic facts and to certain fundamental economic characteristics of the industry.

The contribution of the utility industry to the war effort has been immense. Foresight on the part of leaders in the industry in forward planning as well as ingenuity in getting the maximum use out of existing facilities has made it possible for the industry to meet all demands placed upon it by the war and by civilians. When it is recognized that in almost no other commodity has this been the case, the importance of this industry is more readily discernible. The utilities undertook sharp expansion of their facilities well before the European war started, and this program was continued almost without interruption through 1941, after which time curtailment on materials was so drastic as to preclude the degree of expansion desired by the industry.

The utility industry has in no way contributed to inflation, but rather enjoys the unique distinction of having reduced the product price at a time when practically all other prices have been advancing. The following table outlines the difference between the deflationary trend of the cost of electric power for residential use and the inflationary trend of the cost of living:

[Index: 1935-39=100]

	Residential revenue per kilowatt-hour (Edison Electric Institute)	Cost of living (Bureau of Labor Statistics)		Residential revenue per kilowatt-hour (Edison Electric Institute)	Cost of living (Bureau of Labor Statistics)
1936	105.6	99.1	1940	86.6	100.1
1937	97.2	102.7	1941	84.5	116.5
1938	93.6	100.8	1942	83.0	130.0
1939	90.4	99.4			

Between 1936 and 1942 an index of the average residential revenue per kilowatt-hour shows a 21.3 percent decline whereas a cost-of-living index shows a 21-percent increase, and a general wholesale price index shows an increase of 23 percent.

Although a recital of past contributions by this industry is important, nevertheless it is far overshadowed by potential contributions which it can make during the post-war era. The industry is faced with many responsibilities which it will be able to meet only so long as its position as a dynamic factor in American economic life is preserved. If anything approaching full employment is to be achieved and maintained in the post-war era, nothing can be allowed to stifle future growth of the utility industry. An era which sees practical industrial and consumer application of products developed as the result of accelerated scientific research will present a challenge to the industry which supplies the basic power for all industry and for use of appliances.

Residential building.—Probably one of the most important post-war contributions will be in the building field. Post-war studies in this industry suggest that within 2 years after the war, residential building will be some 47 to 50 percent greater in dollar volume than in 1939. It is estimated that some 900,000 residential units will be built in each of the first 5 years after the end of the war, the majority of which will cost less than $6,000. Single unit family houses are expected to predominate, a circumstance which will intensify the demand for new utility construction in order to provide the requirements for these new customers.

Rural electrification.—Another field for a real contribution by the industry will be rural electrification. The responsibility placed upon utility companies by this type of customer is well recognized in the industry, and with the trend toward improved farm equipment, a program designed to provide for intensified farm electrification is likely to be undertaken.

Scientific developments.—No post-war planning for any industry can be successful which does not take into careful account the scientific advances which have been created by the war effort. The war has had the effect of speeding up scientific developments in every phase of American life. The impetus comes from urgent necessity in waging mechanized warfare on a gigantic scale. In a thousand ways the research laboratories of industry are cooperating day and night with the Army and the Navy to discover new techniques in order to win the war. Although war gives the immediate drive, these discoveries will carry over into peacetime and will then become a part of industrial technology. They will bring new and better electrical appliances, machines, automobiles, and countless other products which enter into the standard of living of the common man.

The war has accelerated scientific developments so much that in the space of 2 or 3 years as much as happening as would ordinarily happen over a period of 40 to 50 years. The greatest scientific revolution of all times is going on before our eyes and its consequences in the peace to come will have profound applications in every industry.

Electric power holds the key to future utilization of this scientific progress. The factory cannot use the latest and best machinery without power. The farmer and the workman in the city cannot enjoy fully the products of most of these advances without having power available. To be able to "turn on the juice" is the indispensable prerequisite to making the wonders of science work for the masses. This is the power industry.

The capital needs.—The post-war period will call for more generating capacity, more transmission lines, reaching more people as consumers. Decentralization of industry is shifting load balances and will continue to shift them. Planning ahead must take into account the need for raising capital to meet this challenge. Financing requirements must be anticipated. Tax laws now make it impossible for utilities to accumulate the reserves and to develop the financial strength needed to meet properly this coming period of strain. If tax laws or other political decisions are of a nature to weaken the equity market in utilities, common-stock financing after the war will be impossible. For several years past the industry has been unable to raise any significant part of its capital requirements through the public sale of equity securities. The very fact of 6- and 7-percent yields in the open market on representative outstanding utility common stocks at a time when the earning power of new capital probably is less than 5 percent can only mean, if it continues, that the industry will prove unable to perform its vital post-war service under private ownership. In brief, the tax policies now accepted or rejected determine whether the utility industry comes into its post-war responsibilities financially crippled or strong and able to perform admirably along with other industries in creating the post-war world.

The 1942 tax law has imposed an unfair burden upon the utility industry. If it is to survive as private enterprise, recognition must be given to the fact that the economic characteristics of the utilities are different from those of any other industry. The post-war responsibilities facing utility companies are legion, and the industry must be allowed to strengthen its finances if it is to cope with the problems which will face it in a post-war economy.

ANALYSIS

The purpose of this analysis is to determine whether the 1942 tax law has been unduly severe on utilities.

We recognize that in time of war, all industry must bear its fair share of an abnormally high tax burden. We have proceeded on the assumption that the utilities are willing to carry as much of the burden as should justifiably fall on their shoulders.

A utility in time of war should be able to earn enough after taxes to provide a reasonable and conservative dividend and to carry a balance to surplus adequate to maintain a capital structure which will permit it to do equity financing to meet future needs.

In terms of this objective, the accompanying chart shows what has happened under the 1942 tax law to a group of 10 leading utility companies as compared to leading industrial companies. As indicated by the chart, the 30 industrials in 1942 had a balance to surplus about 100 percent higher than that in the base period, 1936–39, whereas the 10 utilities in 1942 had a balance to surplus about 60 percent lower than that in the base period. These utility companies, designated as group I, are either wholly independent operating companies or operating subsidiaries sufficiently independent to conform to the pattern.

As a theoretical matter, one might say that the utilities would be all right on balance to surplus if they were to cut their dividends more sharply. As a practical matter and as a matter of sound financial policy, such drastic reduction of dividends would be open to serious objection.

In approaching the matter, it is in order to introduce some broad philosophy about dividend policy in the utility industry. Power and light companies are regulated growth companies. The effect of regulation upon earnings is to limit them to a stated return after taxes on the value of their property in public service. Out of this return the companies are to provide interest on their bonds, dividends on their preferred stocks, dividends on their common stocks and the reinvested surplus. The growth is not alone a matter of choice but also is one of compulsion, since the companies' franchises obligate them to provide service to the steadily growing number of customers who want it. A third distinctive factor in utility economics concerns capital requirements. The industry must provide at least $4 to $5 of plant to accommodate an additional annual $1 of business.

To bring these three distinguishing features of utility operations into one statement: the industry must expand steadily to meet the demands placed upon it, it requires new capital to do so, and its earnings are limited by regulation.

A proportion of the new capital must be equity capital to preserve a sound structure. The industry cannot offer investors the possibility of great increases in earnings, and yet it must enter the capital markets in competition with other lines of business which can offer such rewards. What the industry must be able to offer, as an alternative, is stability.

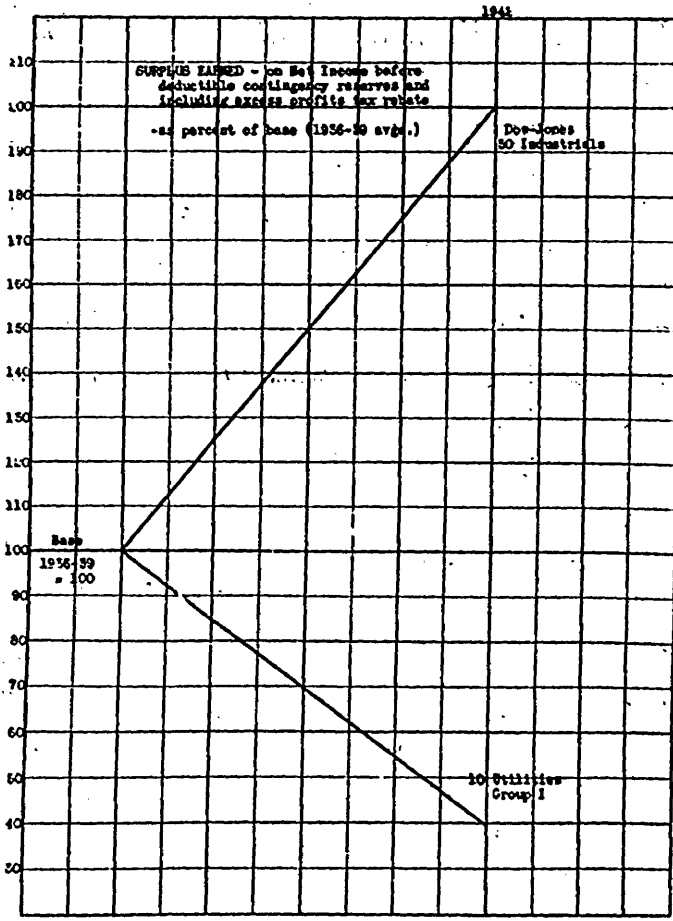
The 10 companies did, in fact, reduce their dividends in 1942. The annual dividend rates in effect at the end of 1942 were 7 percent lower than the actual 1941 payments. The present annual rates are about 3 percent lower than those prevailing on the average in the base period 1936–39 inclusive. Actually, in that 4-year period the dividends amounted to 75 percent of the earnings. This would seem to be in line with conservative principles.

Moreover, although present dividends of the 10 companies are about the same as those of 1936, the service rendered by the companies has increased 52 percent. In this connection the accompanying chart is helpful. It shows this sharp increase in power consumption in contrast with the negligible change in dividends per share. A third line at the bottom of the chart should be noted, showing total capital charges, including bond interest, preferred dividends and common dividends. This line reflects refunding operations to take advantage of cheap money. In 1942 this line was about 5 percent below the base period. In dollars, the savings in interest was $15,955,000. If it had not been for this saving, the 10 companies would have had a deficit to surplus in 1942. To put this point in another way, in spite of a 52 percent increase in services rendered to the public and in spite of substantial savings from refunding and improved capital structure, the common stockholder in terms of per share dividends is no better off than he was 6 years ago. Therefore, to say that he is receiving more than reasonable dividends or to say that further sharp cuts should be enforced is to make charges that cannot be supported.

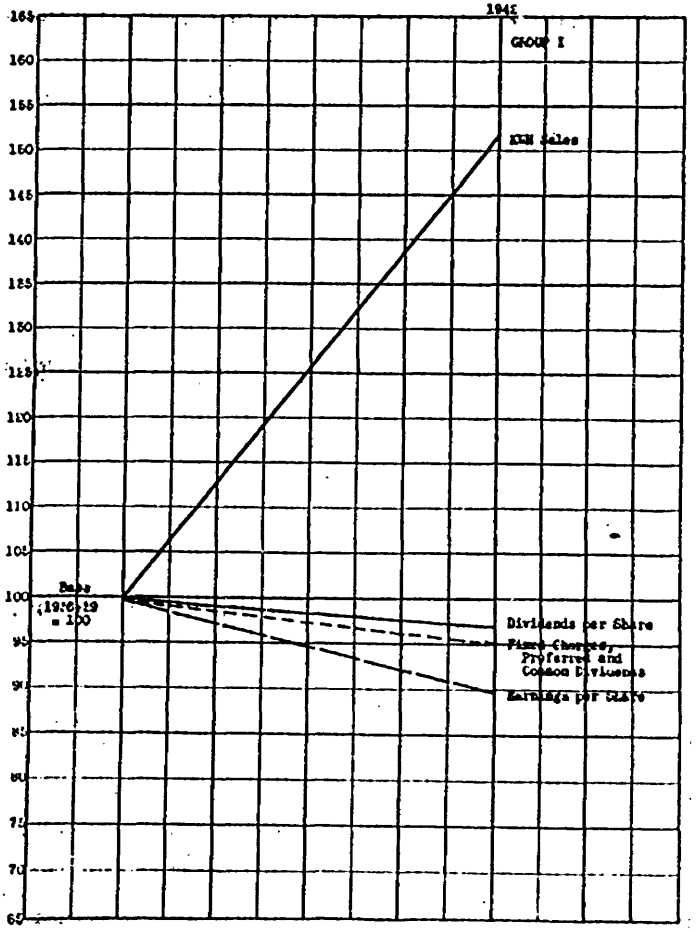
The 1942 tax law denies the utilities the ability to pay reasonable common dividends and to finance a conservative proportion of their growth out of retained earnings. It injures the ability of the industry to play its full part in meeting and stimulating post-war demands for service. It threatens the ability of the industry to survive without Government ownership.

As defined at the outset, these 10 group I utilities represent that part of the industry which has the greatest financial strength. If the companies which are strongest financially are unable under the tax law to accumulate adequate reserves for future needs, how much more difficult must the tax problems be for the rest of the industry.

This question can be solved by reviewing the experience of 10 companies which are largely owned by or are controlled by holding companies but which are not consolidated for tax purposes. Group II represents subsidiaries which are operating companies and which compute taxes much the same as they would if they were wholly independent. Historically their dividend policies have been influenced in varying degrees by the theory that capital-raising services would be provided by the holding companies. A distinct type of utility company is thus recognized and the 10 companies here singled out for intensive analysis are fair samples of the type and a representative cross section.


1941
SURPLUS EARNED - on Net Income before deductible contingency reserves and including excess profits tax rebate
-as percent of base (1936-39 avg.)
Dow-Jones 30 Industrials
Base 1936-39 = 100
10 Utilities Group I
110
100
90
80
70
60
50
40
30

The striking fact is sharp dividend cuts forced by the 1942 tax law. Dividends per share at the end of 1942 were approximately 37 percent below average dividends in the base period, 1936–39. This shock to dividends was the direct result of the tax law. There was no other way to absorb the burden. Whereas group I cut dividends in 1942, it still paid dividends about the same as in the pre-war period. When group II cut dividends, it had to do a drastic job and the result was a dividend level far below any pre-war normal.



One of the fundamental reasons for this difference is that the excess profits part of the tax law bears with special hardship on group II companies. Per dollar of net before taxes, the excess-profits tax burden was about 50 percent greater for group II than for group I. This is due to tax-saving mergers in group I, the greater use of invested capital bases by hydroelectric companies and heavier depreciation reserves in the base years.

Group II, like group I, expanded output sharply to meet war demands. For group II, output rose 63 percent above the 1936–39 average, and dividends fell 37 percent.

In group II, total capital charges including bond interest, preferred dividends, and common dividends reached a level at the end of 1942 which was 15 percent below that of the pre-war period, 1936–39.

Net after taxes per share of common in the same period declined approximately 23 percent for group II versus about 10 percent for group I.

Comparisons of balance to surplus are difficult to make. In the base period, group II companies were operating under a holding company system and part of the fundamental theory of that system was that the parent company rendered financial services and assumed large responsibilities for raising new capital for subsidiaries. In light of this relationship, subsidiaries normally paid out the bulk of net in dividends. People may argue whether the system was right or wrong but at any rate it was the system.

Accordingly, in the pre-war base period balance to surplus was not as large as it was for wholly independent companies. In 1936, balance to surplus in group II was about 15 percent of net after taxes and in 1938 slightly under 6 percent. To compare 1942 with the pre-war years is relatively meaningless because of the premises governing distribution of earnings. As a further reminder of conditions then prevailing, it is pointed out that during this pre-war period the administration sponsored a tax law which acted as a penalty on undistributed earnings and which was intended to compel corporations to maximize their dividends.

The 1942 situation may be described as follows: Voluntary balance to surplus in group II was only $4,064,000, or less than 8 percent of net before taxes. This was after dividends had been cut about $12,000,000 below the pre-war peak. In addition, rebate amounted to about $3,500,000, or less than 7 percent of net before taxes. By any reasonable test, the accumulation of reserves is inadequate and this is true after due allowance is made for the fact that dividend rates have been cut 37 percent below the pre-war average.

The accompanying chart shows graphically the behavior of sales, earnings, common dividends, and total capital charges for group II.

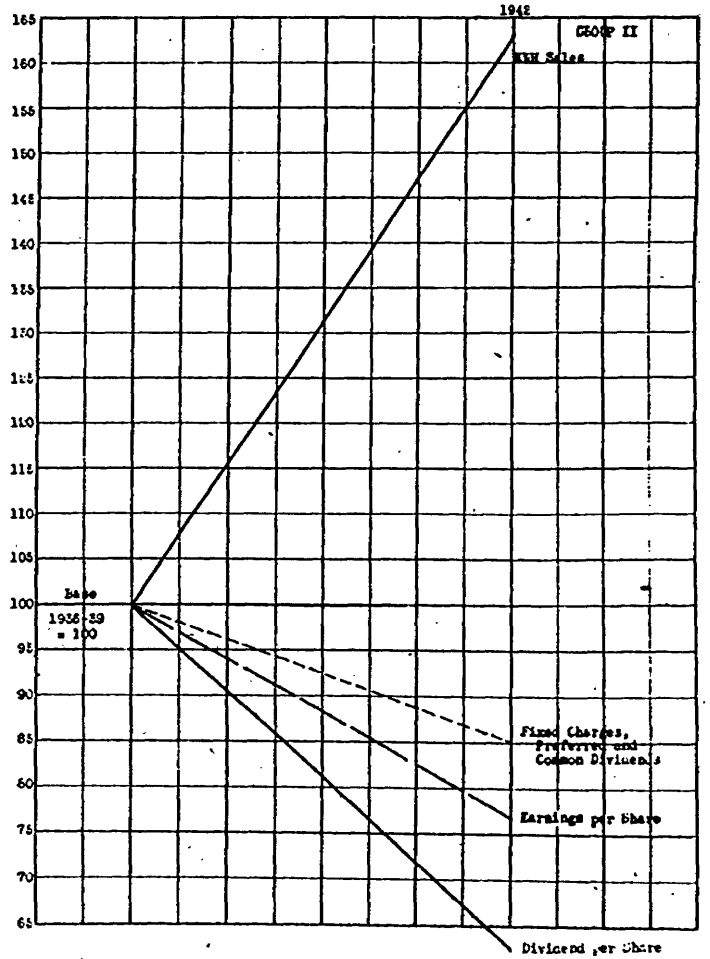
There is a third type which should receive special consideration, namely, the subsidiary which for tax purposes is included in a consolidated tax return by a holding company.

At this point a word of explanation is in order as to the method of analysis employed in this entire report. The method does not use statistical aggregates. It uses fair and representative samples drawn from two distinct types of groups of companies within the industry. Statistical aggregates can easily be deceptive. The only way to avoid the pitfalls of misleading statistics is to take individual cases and to give them careful analytical treatment. This process developed the differences between groups I and II. Within these groups, it is believed that all individual companies follow reasonably closely the pattern shown by the 10 sample companies in each group.

The 20 companies have sales equal to 37.5 percent of the total for the industry, but the conclusions drawn from this sampling hold good for about two-thirds of the industry. The remaining third presents so many special problems that it is not sound or feasible to apply the sampling method. A statistical aggregate for this group would be utterly meaningless and even the sampling method is unable to be used. An examination of 10 companies as candidates for a group III revealed that no 2 companies followed a common pattern. To average such unlike and discordant elements would yield a certain set of figures, it is true, and to a mathematician such figures might be interesting, but to an economist, or to a legislator, or to an executive, they would be absolutely misleading.

Not only does this report reject statistical averages as a method to be applied to the remaining third of the industry, but also it cautions anyone against making inferences or drawing conclusions from such data.

To illustrate these discrepancies between companies: One shows only 25 percent of reported taxable net paid in Federal income taxes and another shows 53 percent. Highly complicated and technical factors in consolidated returns account for the difference. One company shows a huge increase in balance to surplus due to the



fact that it is forced by the Securities and Exchange Commission to refrain from paying out any dividend, and another company shows that even after a substantial cut in dividend, balance to surplus declined sharply. Under such circumstances, to make statistical generalizations would make economic nonsense.

Although statistical method is unable to cope with such a situation, nevertheless broad common sense judgment can be applied. In an effort to do so, this report makes the following observations:

(a) In a majority of cases, the effect of consolidated returns is to mitigate the blow of the excess-profits tax. If it had not been for the consolidated return, many of the subsidiaries in this group would probably have been ruined financially by the 1942 tax law. The consolidated return contained an element of salvation for numerous weaker companies which otherwise would have been put in a hopeless position.

(b) Under the Holding Company Act of 1935, provision is made for divorcement of most subsidiaries of holding companies and for grouping of certain remaining companies into integrated systems. This is the law and the Securities and Exchange Commission has taken a stand in administering the law which forces the so-called death sentence even under war conditions. This is a fact and not a theory. It raises a question of philosophy as to how the tax law ought to treat with such a situation. Should the tax law think more of today's status, wherein a subsidiary has the status of being part of a holding company system, or of tomorrow's status, wherein a subsidiary will be divorced from the consolidated tax return and will have to pay taxes as an independent operating company? As long as the intent of Congress is as defined in the Holding Company Act, the tax law should be consistent with that intent. That is to say, as long as the intent is to force the subsidiary to stand on its own feet, the tax law should be such as to permit it to do so.

(c) The 1942 tax law does not comply with this requirement. Certainly many and probably most of these subsidiaries now saved by consolidated returns would find themselves in a ruinous tax position if suddenly forced out of that status. Their taxes would be greatly increased and their dividend rates would have to be reduced to a point which would make it impossible for them to use private capital markets, if indeed they were not in many cases forced to eliminate common dividends altogether. Thus, legislation which in theory was promised to protect the investor would turn out in practice to be his ruination. To force segregation under the 1942 tax law is a severe legislative penalty against the investor. The law should be changed to correct this unfortunate situation. It should be changed so as to make the status livable and endurable as the Holding Company Act is enforced.

CONCLUSIONS

A. The 1942 tax law is specially damaging to utilities and in the interest of sound national policy some correction of the tax law is needed and is justified.

B. In fundamental economic reasoning, the basis for exceptional tax treatment of utilities is that in a period of wartime inflation their costs tend to rise sharply along with the costs of other industries but the per unit selling price of their product not only fails to share in the inflationary trend but actually tends to fall below the prewar level. The mere fact that ceiling prices are applied to other industries does not deny the truth of this statement because such ceiling prices are very substantially above prewar prices and the head of the Office of Price Administration has said that even under price ceilings he expects prices to continue to go up at the rate of about one half of 1 percent per month. No one holds out an expectation that utility rates will go up one-half of 1 percent per month or any other percent.

C. Under the 1942 tax law it is impossible for the relatively strong companies to accumulate the requisite reserves to meet future needs. The companies not so strong financially are forced into drastic dividend reductions and even after such reductions they cannot accumulate proper reserves.

D. This analysis recognizes three types of cases, identified as group I, group II, and group III. Group I consists of companies of marked financial strength, relatively conservative capital structures and either wholly or in substantial part independent of holding company control. Group II consists of subsidiary operating companies which do not come under consolidated returns. As pointed out, statistical analysis of group III as a whole is misleading.

E. It should be clearly understood that the purpose of tax relief is to enable the utilities to meet their future needs. What are these needs? They are to accumulate proper reserves to meet the exigencies of the transition from war to peace, to maintain a financial position whereby they can hire back former employees who have been in the armed forces, and to maintain a credit status whereby they can utilize private capital markets in raising expansion capital through equity financing. The 1942 tax law is undermining their hopes of using private capital markets by forcing dividend cuts below a point which commands the confidence of the investing public and by preventing a proper balance to surplus and a proper accumulation of reserves. Without such reserves, common stock money cannot be attracted to the industry now or in the future.

Senator VANDENBERG. I want to put a brief from M. D. Harbaugh, Cleveland, Ohio, in the record. It contains an amendment regarding the allowance for development expenditures.

The CHAIRMAN. That may be put into the record.

(The brief referred to is as follows:)

BRIEF BY M. D. HARBAUGH, CLEVELAND, OHIO

ALLOWANCE FOR DEVELOPMENT EXPENDITURES INDEPENDENT OF PERCENTAGE DEPLETION

The proposed amendment is intended to clarify the status of development expenditures for mines.

For oil and gas wells "intangible drilling and development costs" are carefully defined in the regulations and are allowed certain options with respect thereto, but such regulations cover situations peculiar to oil and gas and are recognized as not applicable to mines.

For mines the regulations, section 19.23 (m)—15, set up the rule that "All expenditures in excess of net receipts from mineral sold shall be charged to capital account recoverable through depletion while the mine is in the development stage." This rule is not applied to expenditures for plant and equipment for which ordinary depreciation is allowable, but the Bureau considers it applicable to a considerable field of expenditures which it classes as "development," but without definition of that term.

The "development expenditures," which (if made before the mine reaches the production stage) the Bureau holds recoverable through depletion are, in general, expenditures—

(1) For exploration and discovery of commercial ore worth trying to mine.

(2) For facilities such as shafts, tunnels, main haulage drifts, etc.,—not to prove the existence or commercial nature of the ore but to furnish necessary means for its mining.

(3) For stoping, caving, stripping and other work which are simply advance costs of mining the ore. Sometimes such work can be done as breaking of ore proceeds, but in other cases economical operation is possible only if there is considerable work of this kind before breaking of ore begins.

There is no question that those expenditures during the development period for exploration and discovery of commercial ore are properly chargeable to capital account recoverable through depletion.

But depletion was never intended to cover expenditures for facilities for mining and expenditures which are simply advance costs of mining. Such items should be considered as allowable deductions, separate and apart from depletion; either through depreciation (to the extent appropriately allowable as "depreciation of improvements"), or as mining costs to be charged off either when incurred, or as deferred costs when the mineral benefited is recovered.

Under the proposed amendment, the question of when such expenditures should be allowed as deductions is left to be covered by rules of the Commissioner. The amendment simply establishes the principle that development costs subsequent to exploration leading to initial discovery are to be allowable to addition to depletion.

The amendment is made applicable only to percentage depletion of mines (sec. 114 (b) (4)), which seems the only situation where this question is important.

The matter is of particular importance at the present time because the high tax rates greatly intensify the unfairness of a rule which was of much less importance when rates were lower; also because the Bureau tends increasingly to require recovery through depletion of items which should properly be charged as operating expense.

PROPOSED AMENDMENT TO INSURE TAXPAYERS THE RIGHT TO CHARGE OFF DEVELOPMENT EXPENDITURES (AFTER INITIAL EXPLORATION AND DISCOVERY) INDEPENDENT OF PERCENTAGE DEPLETION

Amend section 114 (b) (4) by adding the following sentence:

"Such depletion allowance shall be exclusive of and in addition to the return of costs of development (incurred subsequent to exploration resulting in the initial discovery), whether such costs be charged to expense in the taxable year or deferred subject to extinguishment when the mineral benefited is recovered."

The CHAIRMAN. Unless there is some witness who would like to put a brief in the record at this time to dispense with his appearance later, we will recess until 2 o'clock.

Mr. NOYES. Mr. Chairman, I would like to file my brief.

The CHAIRMAN. Very well.

(The brief referred to is as follows:)

BRIEF BY PIERREPONT B. NOYES, PRESIDENT, ONEIDA, LTD., ONEIDA, N. Y., NOVEMBER 29, 1943

1. Silver-plated flatware (spoons, forks, and knives) are "a household necessity" just as much as crockery or glassware or pots and kettles.

2. The Government and the War Production Board have shown that they consider silver-plated flatware "an essential civilian commodity"—see War Production Board General Limitation Order L-140-b, issued November 5, 1943.

3. Only 18 percent of the country's ouput of silver-plated flatware is sold in jewelry stores.

4. This 18 percent jewelry store distribution, plus the silver with which it is coated to protect diners' mouths, has confused plated flatware with luxuries.

5. The luxury tax laws of 1924 and 1942 exempted silver-plated flatware, including it in a paragraph with "surgical instruments, eyeglass frames."

6. This exemption was overlooked in the law of 1941.

7. The Ways and Means Committee of the House has approved this exemption and has written it into the bill as sent to the Senate.

Mr. MOLNAR. Mr. Chairman, I would like to submit a letter to be included in the record.

The CHAIRMAN. Very well.

(The letter referred to is as follows:)

WASHINGTON, D. C., *November 24, 1943.*

Senator WALTER F. GEORGE,
Chairman, Committee on Finance of Senate,
Washington, D. C.

DEAR SENATOR GEORGE: I submitted the following to the Ways and Means Committee but in some way it was overlooked, and I think it is important also for economic purposes. In addition I believe the Treasury Department could save for the taxpayers about $100,000,000 a year in interest.

I am writing with reference to Public Law 68, Seventy-eighth Congress, which provides for the current payment of the individual income tax.

Under the provisions of this act employers are authorized to estimate the wages which will be paid to any employee in any quarter of the calendar year and to determine the amount to be deducted and withheld upon each payment of wages to such employee during such quarter, and to deduct and withhold upon any payment of wages to such employee during such quarter such amount as may be necessary to adjust the amount actually deducted and withheld upon the wages of such employee during such quarter (sec. 1622 (j)). It is my understanding, however, that employers are not required to make return of the amount so deducted until the expiration of the current quarterly period. It is also my understanding that even though a man is hired by the day his employer is permitted to retain and to use the amount deducted from his wages until his quarterly payments are due. I feel that such a practice is grossly inequitable and I respectfully suggest that section 1622 (j) be amended in order to compel the employer to make returns upon wages withheld not longer than 2 weeks following his pay-roll date. Many cases have come to my attention in which employers have dishonored their contracts with per diem employees and I feel that if the employer was compelled to make semimonthly returns to the Treasury Department the rights of the employee would be more adequately protected.

For the reasons mentioned I suggest that section 1622 (j) be amended as follows: "The Commissioner (strike out the word 'may') under regulations prescribed by him with the approval of the Secretary (strike out the word 'authorize' and insert the following words:) shall require employers (1) to file returns of wages withheld with the authorized agent of the United States Government each week, if wages are paid on a per diem basis or weekly, and (2) if wages are paid semimonthly the employer shall be required to file such returns semimonthly."

Respectfully submitted.

JOSEPH MOLNAR.

The CHAIRMAN. We will reconvene at 2 o'clock.

(Whereupon, at 12:10 p. m. the committee recessed to 2 p. m. of the same day.)

AFTER RECESS

(The committee resumed at 2 p. m., pursuant to recess.)

The CHAIRMAN. The committee will please come to order. Mr. Shaw.

STATEMENT OF LUCIEN W. SHAW, ASSISTANT TO THE PRESIDENT, LOCKHEED AIRCRAFT CORPORATION

Mr. SHAW. My name is Lucien W. Shaw. I am appearing on behalf of the hundred-odd companies who are members of the Aeronautical Chamber of Commerce of America, Inc. I am assistant to the president of the Lockheed Aircraft Corporation.

Since 1921 the Aeronautical Chamber has spoken for the aircraft-manufacturing industry on matters of public interest. Its member companies are now producing about 75 percent of the total value of all airframes and aircraft engines, propellers, accessories and spare parts being produced in this country for the prosecution of the war—the remaining 25 percent being produced almost entirely by companies whose normal business is outside the aviation field. Included in the roster of members of the Aeronautical Chamber are practically all of the names commonly associated with aircraft with which you are familiar: Bell, Bendix, Boeing, Consolidated-Vultee, Curtiss-Wright, Douglas, Lockheed, Martin, Republic, United Aircraft, and many other companies playing an important part in the war effort whose names you would immediately recognize.

We are appearing before you because of our belief that it is vital for America to have a strong aircraft industry for all time in the future and because of our deep concern as to our ability to assume this responsibility. We believe that you, and the Nation generally, desire the industry which has produced the Flying Fortress, the Liberator, the Marauder, Mitchell, Thunderbolt, Lightning, and other important planes, to maintain America's position of leadership in aviation. Because of the difficulties we see ahead we are not sure of our ability to do this unless Congress recognizes these difficulties in connection with this pending legislation.

Production of aircraft in the United States has expanded phenomenally. Both the rate of growth of the industry and its present size far exceed that of any industry the world has ever known. In 1939, output was approximately $200,000,000. The 1943 output of the prewar aircraft manufacturers represented by the Aeronautical Chamber is about 60 times 1939, or approximately $12,000,000,000. In 1944 it will be a substantially greater amount. By comparison, the all-time peak for automobile production was less than $4,000,000,000. In October 1943 alone, 2,000 more military aircraft were produced than in all of the year 1940.

To accomplish this production it is estimated that the peak employment requirements of the manufacturers of airplanes, airplane engines, and propellers will be 1,650,000 employees, as compared to approximately 44,000 on January 1, 1939. In addition, the many subcontractors and suppliers who are of the highest importance in maintaining aircraft production are estimated to require over 1,400,000 employees, making a total for the entire industry of over 3,000,000.

This enormous expansion has placed the aircraft industry in a position of extreme hazard at the conclusion of the war. The financial problems which we will then meet will be so serious that there are no adequate measures which our individual companies can take to protect themselves from possible disaster. It is for this reason that we come to Congress to explain our situation.

This can best be done by presenting to you in summary form certain data recently presented by the Harvard Business School of Business Administration in a booklet entitled "Financial Position of the Aircraft Industry." Copies of this bulletin are being furnished to you, and I would like to summarize for you a few of the facts which it presents.

In preparing the study Harvard obtained from 11 major aircraft manufacturers their audited financial figures for 1942 (the latest which are available) and earlier years. These 11 companies represent over three-fourths of total war-plane construction in the United States. By dividing the totals of the financial figures by the number of the companies represented, Harvard obtained figures for an average aircraft company typical of the industry.

The most startling fact developed by the Harvard study is the very small margin by which current assets in the aircraft industry exceed current liabilities. Current assets, of course, mean cash, accounts receivable, and inventories. Current liabilities include amounts owed to employees for wages, to suppliers for material and parts, and to the Government for taxes, renegotiation refunds, advances, and progress payments received against expenditures on war contracts. Chart 1 on the opposite page shows that at the end of 1942 the typical aircraft company had only $1.09 of current assets for each dollar it then owed. On the same date the average for non-aviation-industry corporations, selected as typical companies by Harvard for comparison, was $2.20 of current assets for each dollar owed. In other words, the aircraft companies have only the very narrowest margin or cushion of funds and inventories to meet immediate obligations. Obviously, any shrinkage in the value of inventories, for example, even in a minor amount, would make the industry unable to meet its debts.

Furthermore, the quick-cash assets (cash and marketable securities) of the typical aircraft company are far short of the amount required even to pay debts to the Government for taxes and renegotiation. Chart 2 shows a deficit in quick-cash assets of over $20,000,000 for the typical aircraft company.

Chart 3 shows that the working capital of the typical aircraft company is only 28 percent of its inventory as compared to 146 percent for an average non-aircraft-industry company and as compared to a ratio of 78 percent for aircraft companies in 1939.

Chart 4 shows that an 8-percent decline in the value of the total assets for which the 11 aircraft companies are responsible would wipe out the stockholders' capital. It also shows that an 11.6-percent decline in the value of inventory for which the companies are responsible will wipe out working capital.

We are seriously concerned as to the huge amounts of inventory for which our companies are responsible. The risk of loss upon termination of contracts with respect to inventories is very great. The reasons for this are well set forth on page 17 of the Harvard study:

> The average company had expanded its production twentyfold in a period of 3 years, and under conditions which made it necessary to subordinate all other

considerations. The control of inventories has been hampered by such factors as frequent design changes, schedule changes, sudden shifts in the demand for spare parts, a high labor turn-over, inexperienced clerical and supervisory personnel, and frequent rearrangements of factories and warehouses.

All these factors have had an effect on the ability of the average company to maintain inventory records comparable with those which would be kept under normal peacetime conditions. For example, few if any of the major war-plane manufacturers take a physical inventory at their fiscal year end, for such inventory-taking would involve a slow-down of production. Any simultaneous physical checks on all work in process are impractical in view of the vast number of parts and the interference with production which would be involved. Although the companies do usually employ a crew of men who make a continuous count of raw material items throughout the year, the difficulties of maintaining controls comparable with normal peacetime standards are great.

Appreciable amounts of obsolete or surplus materials tend to accumulate in inventories under such conditions.

As shown in chart 5 another alarming fact with respect to the condition of the industry is that the typical company has working capital sufficient to pay wages, salaries, and material expenses at wartime levels for only 2 weeks.

Furthermore, as shown in chart 6, cash and equivalents on hand of the aircraft industry are sufficient to pay expenses of operation for only 5 weeks.

The foregoing figures show the reason that aircraft people are concerned about their ability to survive at the end of the war. You will probably wonder as to the reason which has brought about such a result. The basic reason is the large volume which the industry has undertaken, coupled with existing controls imposed upon war profits by the income-tax structure and by renegotiation.

Our tax structure, and to some extent, renegotiation, have been based on the theory that pre-war earnings and invested capital are the proper measures to determine reasonable war profits. In many instances this is proper. However, it does not take account of the great risks resulting from overextended operations. To illustrate my point, may I suggested that no sane banker operating on a capital of $10,000 would take on $10,000,000 of loans and deposits. But if he had a capital of $1,000,000, he would be perfectly safe. Just as an increased volume of loans means increased risks to the banker, so increased volume of sales means increased risks for the aircraft companies.

The demand for planes has forced the aircraft companies to expand their volume way beyond what sound business management would have dictated. The only protection which they can have against these forced risks is sufficient profit or reserve which can be set aside to provide for these contingencies when they arise. The figures show that the tax structure and renegotiation have not made a sufficient allowance for this purpose.

I should like to demonstrate that the wartime earnings allowed the aircraft industry are far less than those allowed better established, less expanded enterprises. The Harvard study shows that, after taxes and renegotiation, the aircraft industry was allowed profits of only 2.7 percent on sales in 1942. This may be compared to 8.3 percent for General Motors, 13.8 percent for du Pont, 7.5 percent for Sangamo Electric, 10.6 percent for Deere & Co., 10.5 percent for Eastman Kodak, and 7.4 percent for Johns-Manville. In 1939 the aircraft industry earned 10.4 percent.

The CHAIRMAN. Is that on sales?

Mr. SHAW. That is percentages of sales retained by the companies after taxes and after renegotiation.

The CHAIRMAN. Percentages of sales?

Mr. SHAW. That is correct, sir.

The CHAIRMAN. Did your industry verify the Harvard figure of 2.7 in the aircraft industry?

Mr. SHAW. That is an actual figure derived from the 1942 audited statements of the 11 companies, which includes 75 percent of the industry, studied in the report. This is an actual figure. However, the range was, I think, probably from 2.1 percent to slightly over 3 percent, but as you can see, the average of any of the companies is in a far less favorable position than the more established, less expanded companies whose names I have mentioned here, and of course there are many others who received similar amounts after taxes and after renegotiation.

I should also like to point out, as shown by chart 7 that the aircraft industry has followed a very conservative policy with respect to the earnings which it has received. Chart 7 shows that only 23 percent of profits received by the aircraft industry in 1942 were paid out as dividends to stockholders, as compared to 64 percent distributed by average industrial companies. The aircraft industry, obviously, has acted upon the fears which I have described by retaining in the business most of its profits, allowed after renegotiation and taxation, to prepare for the difficult post-war period. We are fearful, however, that the amounts which we are thus permitted to retain will be far from adequate.

I have endeavored to show you the weak financial position of the aircraft industry. You may wonder what we anticipate to be the probable drains upon our financial resources during the post-war reconversion period. You undoubtedly realize that in view of all the uncertainty as to aviation developments, demand for aviation equipment, size of military establishment, and other factors, it is impossible for us to make precise estimates as to our post-war requirements. I can point out to you, however, some of the factors which lead us to believe that we must have substantial financial resources at the end of the war if we are to survive.

First, we cannot escape the conclusion that we will suffer losses upon the termination of our contracts. In view of the enormous expansion which I have described and the constantly changing conditions under which we have been operating, it seems inevitable that we will not be able fully to support all of the expenditures and costs which we have actually incurred. We are doing our best to maintain adequate accounting systems but it seems probable that unavoidable wartime human error will cost us substantial sums on contract termination settlements. In addition, we will have substantial expenses for rearrangement of our plants and facilities to be ready to carry on peacetime production.

We do not believe that the American people wish our industry to be supported solely at Government expense by maintaining our industry entirely upon post-war production for the Army and Navy. We foresee a great future for post-war commercial and private aviation. To be ready to meet this future, however, we have a great deal of work to do in product engineering which we are of course not

able to do during the war. However, the development of models for post-war aviation will be extremely costly. Great efficiency in airplane equipment is being achieved but the models are very complicated. It will undoubtedly require three or four million dollars for engineering work alone to develop a design for an advanced, large-size commercial transport after the war. Furthermore, the engineering work must be followed by a costly period of tooling up, so that it is very likely that $15,000,000 or more will be expended by a single company on a single model before the first unit is completed and ready for delivery so that income from it starts to flow in.

When we turn our thoughts to development of private planes we face a similar prospect. Private planes will take their place in American life only when we achieve mass production of them. The engineering work and tooling required to accomplish this will again be very costly and run into many millions of dollars.

We cannot escape the conclusion that there will be a period of months, and perhaps of more than a year, during which the inflow of funds will be virtually stopped while we do our product engineering and prepare for peacetime work. During this period we must maintain our engineering staffs and keep at least a nucleus of our organizations. We will of course make every effort to find other ways of keeping busy as much of our working force as possible. We will have the continuing burden of property and other taxes, depreciation charges, and other expenses. These costs will run into large sums each month and we are fearful that our financial resources will not hold out until our peacetime sales commence and we can achieve a normal peacetime operating status.

I should like to summarize the drains upon our financial resources which we foresee in the conversion period:

1. Contract termination—11.6 percent inventory decline wipes out working capital.
2. Cost of rearrangement of plant.
3. Designing new transport planes—expenditure before first delivery, $15,000,000.
4. Mass production of private planes—X million dollars for production line tooling.
5. Maintaining organization until post-war sales provide sufficient funds.

We believe that the events of this war have amply demonstrated that America must have for all time in the future a strong aircraft industry. This can only be possible if the industry has sufficient finances to do its job and do it well. The position of leadership in aircraft engineering and production techniques which we now have can only be maintained if the aircraft industry has the resources to maintain itself. This can be insured, however, only if the Government now recognizes the gravity of the problems with which our industry will be faced at the end of the war.

Your committee has before it a revenue bill in connection with which you will doubtless consider several matters which are of vital importance to the aircraft industry. I should like to discuss these matters with you and make some recommendations for action. These matters may be listed as follows: (1) Adequate post-war reserves, (2) renegotiation of war contracts, (3) improvement of the carry-back provisions in the tax law, (4) improvement of the existing

post-war reserve provision, and (5) practical amortization of plant facilities.

1. Adequate post-war reserves: Your committee very properly caused the enactment in the Revenue Act of 1942 of a provision for a post-war reserve which had the salutary effect of lessening somewhat the impact of a 90-percent excess profits tax rate. While there are many concerns for whom the existing reserve is adequate, we believe that there are many others as to which it is not. Although the Treasury has pointed out that corporations have accumulated since 1939, after dividends and taxes, around $12,000,000,000, we think it is apparent that this accumulated reserve is not evenly distributed among all classes of taxpayers. The aircraft industry is probably the outstanding example of an industry which has not been able to accumulate adequate reserves for the post-war problems it faces.

It appears, therefore, that a further reserve is very much needed in some cases and should be given serious consideration by your committee. It is apparent, however, that such a reserve must be selective in its operation so that it will provide the greatest benefit to those who need it most and a lesser benefit to those whose need is less.

There seems to be a simple method whereby this can be accomplished. Your chairman has advocated such a method for a long time and it has been discussed by others in Congress. This method would permit a present deduction for a post-war reserve in arriving at net income. We believe that the deduction should be 20 percent of net income. The amount represented by the deduction would, however, be paid into the Treasury along with the tax. For the amount of the reserve the taxpayer would be issued a special issue of Government bonds. The proceeds of these bonds should be taxable to the taxpayer when received.

This relatively simple provision seems to do the job well. Those who suffer losses after the war, when they would collect the proceeds of the bonds, would not pay a tax because of these losses and they should not, since they, by their losses, have shown their need for the reserve. Those who suffer no losses would be taxed upon the proceeds and would thus receive less benefit from the provision and they should, since, by earning income in the conversion period, they have shown that they needed the reserve less.

In considering this proposal you will be faced with a decision as to the rate of tax which should be imposed upon the proceeds of the bonds when collected by the taxpayer. Various proposals have included taxation at capital gains rates, taxation at normal tax rates, taxation at full tax rates in effect in the year of receipt, and taxation at war rates which were in effect when the original deduction was taken. Our industry would be wholly satisfied with any of these proposals. If we are so fortunate as to have income in the post-war year in which we collect the proceeds of the bonds, we will be delighted to pay any reasonable tax burden thereon, and we believe that other taxpayers should feel the same way.

If such a reserve is adopted we hope it will not be found necessary to tie up the bonds received so that they cannot be used when the need arises. The events of the war have fully demonstrated that

the post-war reconversion problem of different war contractors will be strung out over a long period of time as the demands for war equipment change and become less. It will not, therefore, be possible for you to select a single date after which the proceeds of post-war bonds can be collected, without destroying the utility of the provision to many taxpayers whose need arises before that time. It should be possible to permit realization of the proceeds at any time if such proceeds are to be fully taxable, because no taxpayer would collect the proceeds now and pay taxes at high wartime rates if he might obtain the proceeds later when his need arises and he might have losses and pay no tax.

We strongly recommend that your committee adopt a provision for this type of reserve in the current revenue bill. It will go a long way toward solving the serious financial problem of the aircraft industry. If its adoption is deferred any longer, it may come too late to be of any substantial assistance to us.

2. Renegotiation of war contracts: Your committee will doubtless hear from various witnesses on the subject of renegotiation of contracts. I do not intend to discuss it at length but only to present its peculiar impact upon the aircraft industry. Our industry certainly subscribed to the general view that no excessive profits should be derived from this war. We recognize that renegotiation of war contracts was a device created to prevent excessive profits. The present weak financial condition of the industry is due in part at least to renegotiation.

We cannot understand the logic of a system which for example, allows the Boeing Aircraft Co., which has certainly made one of the outstanding contributions to the war, a profit after taxes and renegotiation of 2.1 percent on sales and allows du Pont 13.8 percent, General Motors 8.3 percent and other companies the amounts I previously described. Those companies are doubtless entitled to what they received, but we feel that some increased recognition should be given to the aircraft industry.

Furthermore, we believe it is clear that there is no theater of the war effort in which there are enough airplanes. General MacArthur doesn't have enough; we do not have enough bombers in England to maintain thousand-plane raids every night, which would unquestionably shorten the war. The men who are responsible for producing the maximum possible number of airplanes are the executives of the various aircraft companies. Renegotiation of contracts has taken large amounts of time of these people and will doubtless continue to do so if it continues to be applicable to their companies. We do not believe that this is in the interests of the war effort or of the American people.

We should like to make it clear that, as far as its effect upon our industry is concerned, we believe that renegotiation of contracts is an unsound process not in keeping with our principles of Government. If you cannot repeal renegotiation there are two proposals which we recommend you adopt:

(a) Allow an option to elect an increased tax rate in lieu of renegotiation. Due to the great demands which renegotiation makes upon the time of our executives, we would be willing to pay a reasonable amount of increased taxes in lieu of being renegotiated, despite our

weak financial position. We recommend, therefore, that you allow all contractors an option to be taxed at a 95 percent excess-profits tax rate and at an 85 percent ceiling rate (rather than the present 80 percent), instead of being renegotiated. This proposal would eliminate present vast uncertainties and would save enormous amounts of time of American businessmen which should be devoted to production efforts.

(b) Provide a "floor" after taxes. In the alternative, if you cannot adopt the foregoing option, we recommend a "floor" which will allow a contractor to retain after taxes, either (1) an amount equal to the excess profits credit, or (2) an amount equal to 3 percent of sales. If this proposal is adopted, renegotiation should be done after taxes rather than before.

(c) Eliminate retroactive renegotiation. We believe that the recapture by renegotiation of profits earned before the renegotiation statute was passed on April 28, 1942, is thoroughly unsound. Your committee has generally been opposed to retroactivity and to discrimination. Both are involved in renegotiation with respect to profits earned before April 28, 1942. We recommend the elimination of this retroactivity and the refunding of retroactive amounts previously taken by renegotiation with respect to items delivered before April 28, 1942.

3. Improvement of the carry-back provisions in tax law: Your committee should be given much credit for adopting in 1942 the thoroughly sound provision for the carry-back of losses and unused excess profits tax credit. These provisions are correct and in theory are very beneficial to industries such as the aircraft industry, since they recognize that war profits may be artificial and should be averaged to reflect post-war losses.

Unfortunately, the carry-back provisions as now written are of no practical value to an industry such as ours which is faced at the end of the war with a shortage of liquid assets with which to meet the post-war reconversion problem. This is because the carry-backs result merely in a right to tax refunds. Under the orderly procedure generally in effect with respect to tax-refund claims, it is a matter of years before they are processed in the Treasury Department and actual payments made. Refunds under the carry-back provisions will therefore be received long after our industry has faced its reconversion problem and either solved it or gone into bankruptcy. We seriously doubt our ability to solve our problem without immediate benefit of the carry-back provisions.

It is possible to eliminate this difficulty by providing for prompt credit or payment of refunds from the carry-back provisions. It gives me pleasure to say to you that the Treasury Department has recently fully recognized this problem and has developed a most constructive proposal intended to solve it. We hope that your committee will give the Treasury proposal the recognition which it should have and adopt a provision embodying the Treasury's proposal.

I should like to place in the record an excerpt, included at the end of my statement, from the testimony of Randolph E. Paul, general counsel of the Treasury, before the Subcommittee on War Contract Termination of the Senate Committee on Military Affairs, given October 27, 1943, in which he outlined the proposal which we fully endorse.

4. Improvement of the existing post-war reserve provision: I have already referred to the post-war provision which your committee caused to be included in the 1942 Revenue Act. We think this was a very proper provision. It has one defect which merits serious consideration. It is actually very important, though it may not now appear so. This reserve provides nonnegotiable bonds which become negotiable at the cessation of hostilities. Companies such as ours will only receive any benefit from the reserve when the bonds become negotiable and we can sell them and obtain the proceeds. I believe it is fair to say that probably the cessation of hostilities will be the date when the actual need for the reserve arises in only a few cases.

The changing conditions of the war have already shown that cancelation of contracts and commencement of the conversion problem for individual companies is going to occur over a long period of time. When the German phase of the war ends one group of contracts will be canceled; when the Japanese phase ends most of the remaining contracts will be canceled, and so on. It is essential that some revision of the post-war credit be provided to insure that the proceeds will be available to each taxpayer when its need arises. This can probably best be done by providing, in the alternative, for negotiability of the bonds upon certificate by a Government agency that the taxpayer has had a large portion of his contracts canceled.

This problem does not appear of immediate importance but it will be vital to our economy when we get a little closer to the end of the war. We recommend that your committee take prompt action on the matter before the situation becomes serious.

5. Practical amortization of plant facilities: In the Second Revenue Act of 1940, Congress provided for 5-year amortization write-off for tax purposes of the amounts invested by manufacturers in plant and equipment. This was a very proper provision based on recognition of the fact that such facilities would be useful only during the war and that their write-off should extend only over the same period. The provision further recognized that the war might not last 5 years and permitted a shorter write-off if the end of the war should occur, or if a particular manufacturer's facilities should be certified by the War or Navy Departments as not to be necessary further in the war effort. This latter provision will be of great importance if the war does end, as we all hope, in less than 5 years from the time some of these facilities were acquired. Unfortunately, it is not clear that the latter provision will be effective.

In the first place, it probably will not become operative until the Army and Navy provide certificates of "nonnecessity." This involves a very serious responsibility which will cause them great difficulty. Furthermore, respreading amortization over a shorter period merely results in a right to tax refunds which, under normal procedure, will not be payable for years. Again, therefore, Congress should make effective this important provision which it has already fully recognized in principle. The provision could be greatly improved by furnishing manufacturers an option to respread amortization over a 3-year period not to end prior to Jnauary 1, 1944, and by providing that resulting tax refunds must be made immediately without waiting for an audit of the entire tax liability for the year. Such a change would be of substantial assistance in meeting the financial problem of the aircraft industry which is heavily involved in plant expansion with its own

funds, though, of course, the Government has provided a large part of the plants now operating.

It is understood that a bill which is probably acceptable to the Army and Navy, H. R. 3712, has been recently introduced by Mr. Disney of the Ways and Means Committee in the House of Representatives which would provide for the 3-year write-off referred to. We recommend that your committee incorporate the provisions of this bill in the revenue bill, coupled with a further provision for prompt payment of tax refunds arising as a result of the respreading of the amortization deduction.

On December 17, 1943, a dinner is to be held in Washington to which Mr. Orville Wright has been invited by the President of the United States to honor him on the fortieth anniversary of the first flight of an airplane at Kitty Hawk. America invented the airplane and should retain its leadership in aviation.

We believe that your committee has a very serious responsibility in establishing tax and related policies which will be fair and equitable and at the same time will not stifle successful conversion in the post-war period. The aircraft industry is most anxious to take its place in the Nation's economy after the war. We believe that you recognize the necessity of our industry's being in a sound financial condition at the close of the war so that America can retain supremacy of the air and be in a strong position to prevent future wars. To make this possible, however, it is essential that the problems which I have discussed be given careful consideration and adequate solutions be devised. The efforts of your committee in solving these problems will be greatly appreciated.

(The charts and the excerpt from the testimony of Mr. Paul, mentioned, are as follows:)

RATIO OF CURRENT ASSETS
(CASH, MARKETABLE SECURITIES, RECEIVABLES AND INVENTORIES)
TO CURRENT LIABILITIES
(ALL OBLIGATIONS DUE WITHIN ONE YEAR)

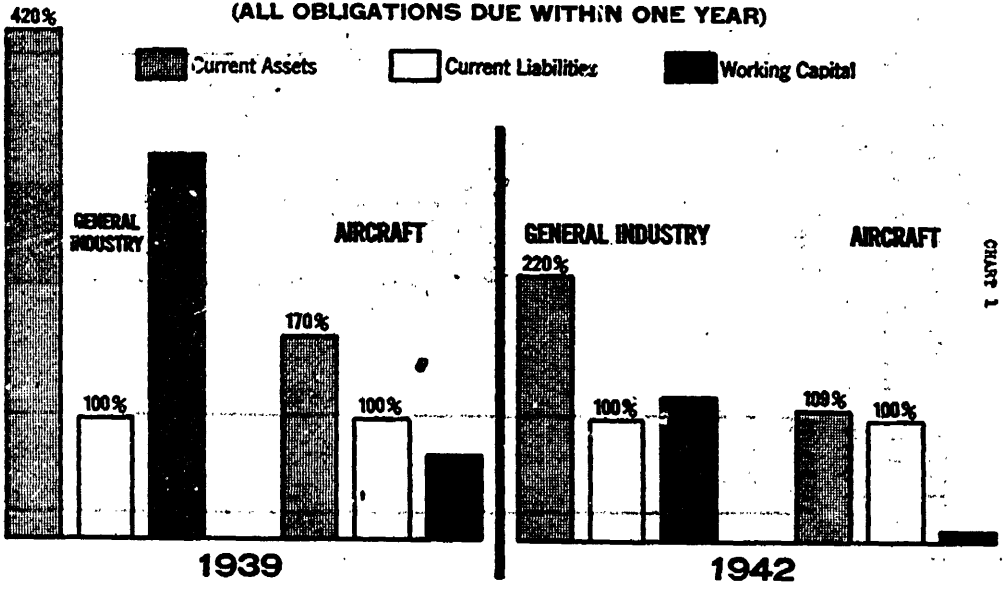


CHART 1

CHART 2

TYPICAL AIRCRAFT COMPANY OWES FAR MORE TO THE GOVERNMENT THAN IT HAS IN "QUICK CASH" ASSETS

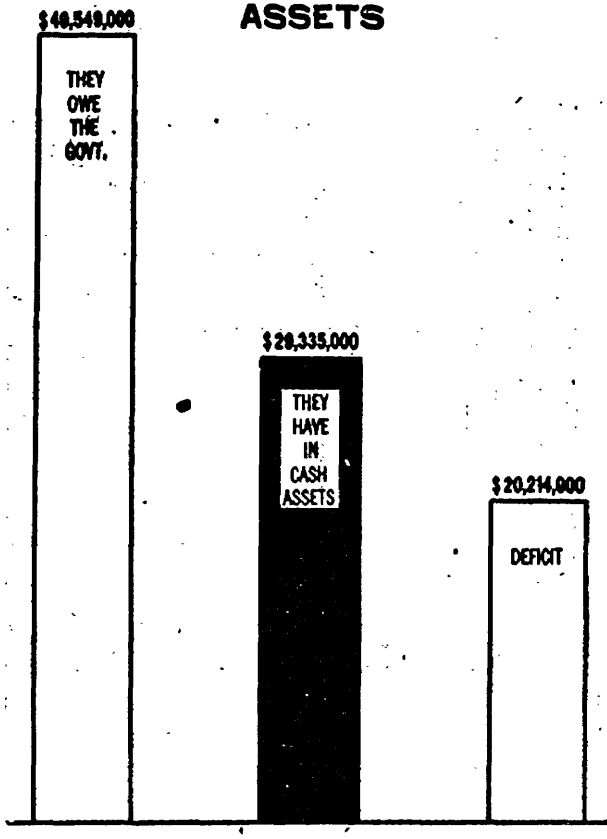


CHART 3

WORKING CAPITAL AS PERCENT OF INVENTORY

(COMPANY OWNED)

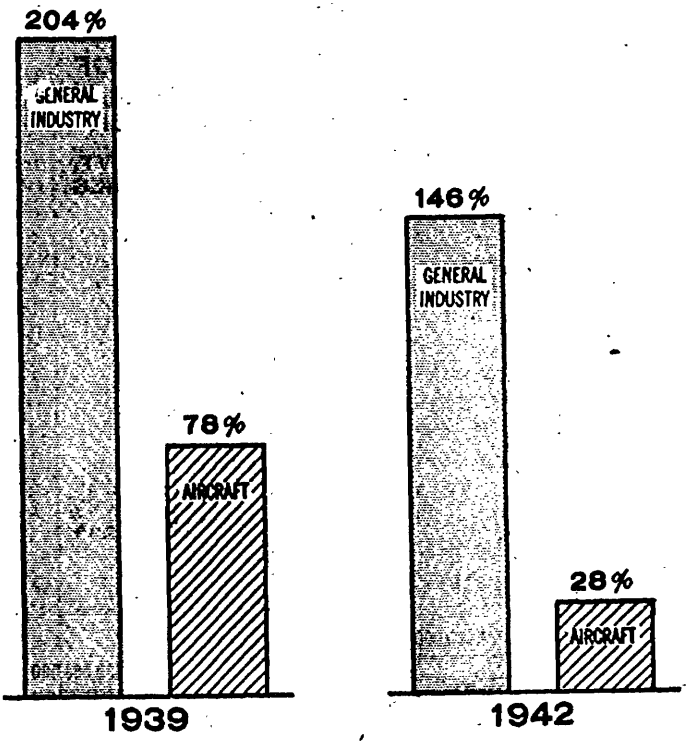


CHART 4

THEY CAN GO BROKE!

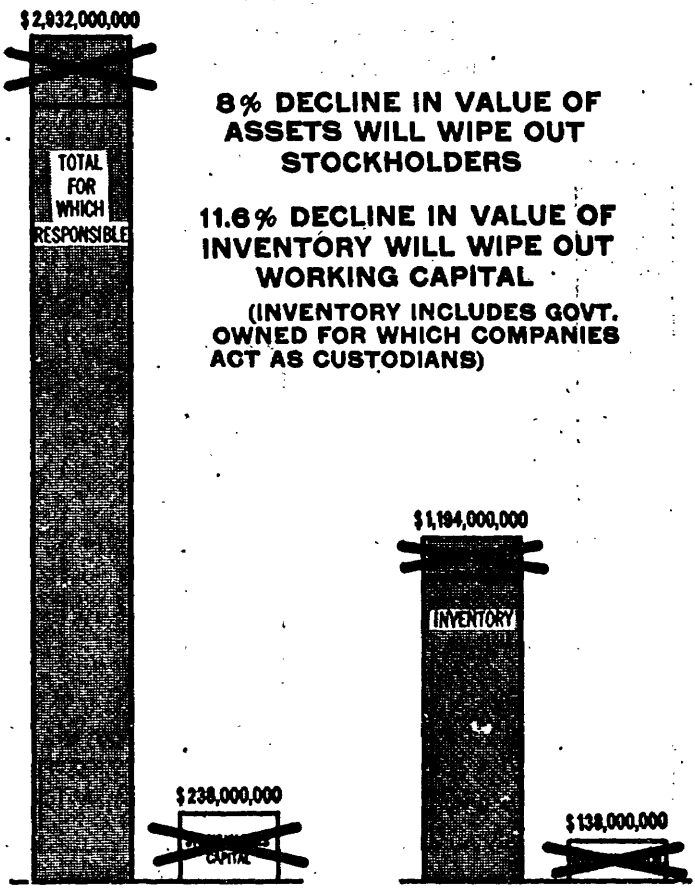


CHART 5

TYPICAL AIRCRAFT COMPANY HAS BEEN DRAINED OF WORKING CAPITAL

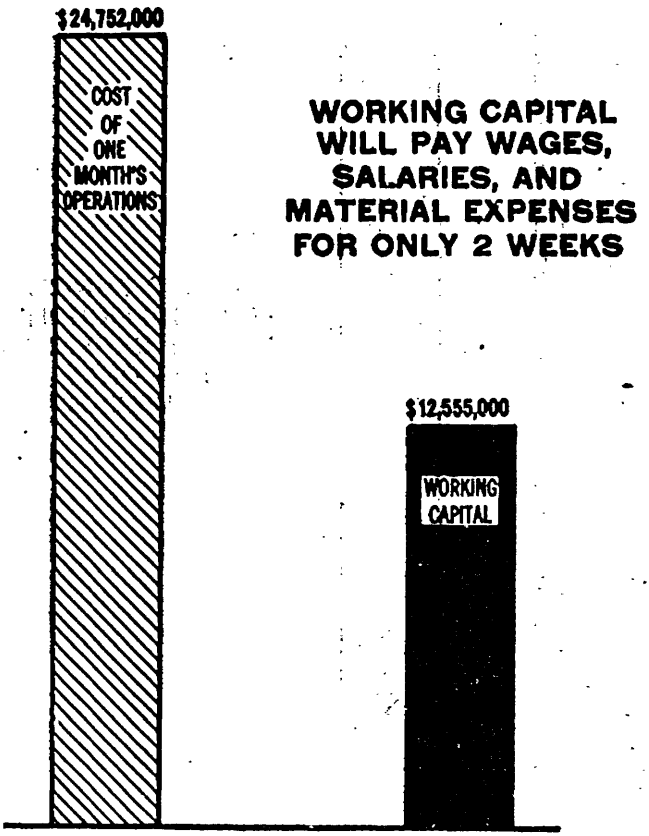


CHART 6

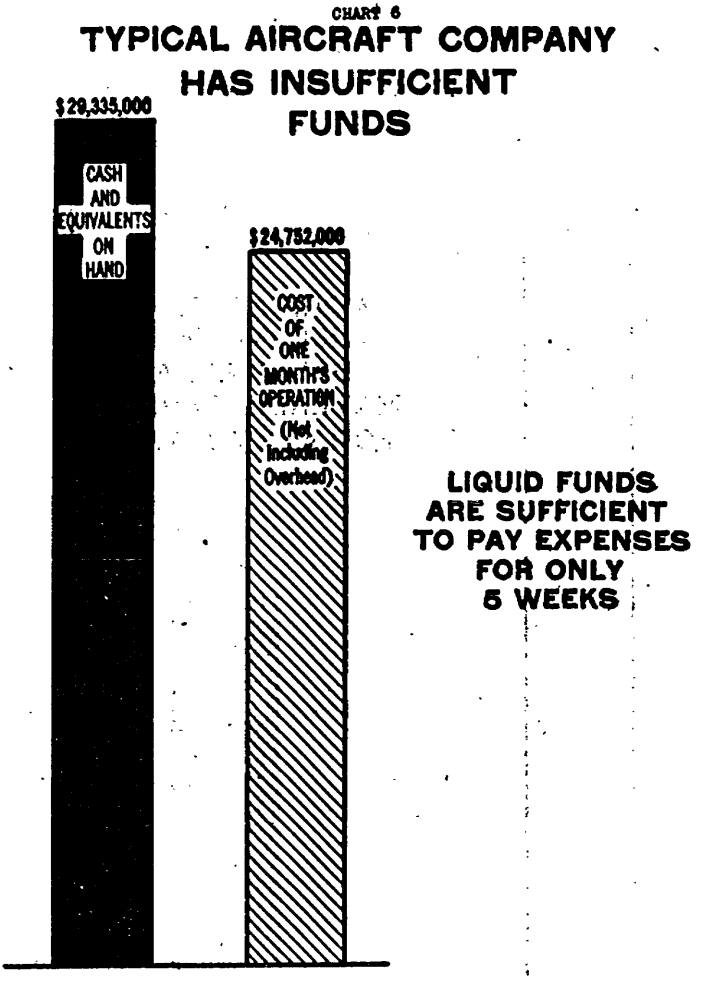
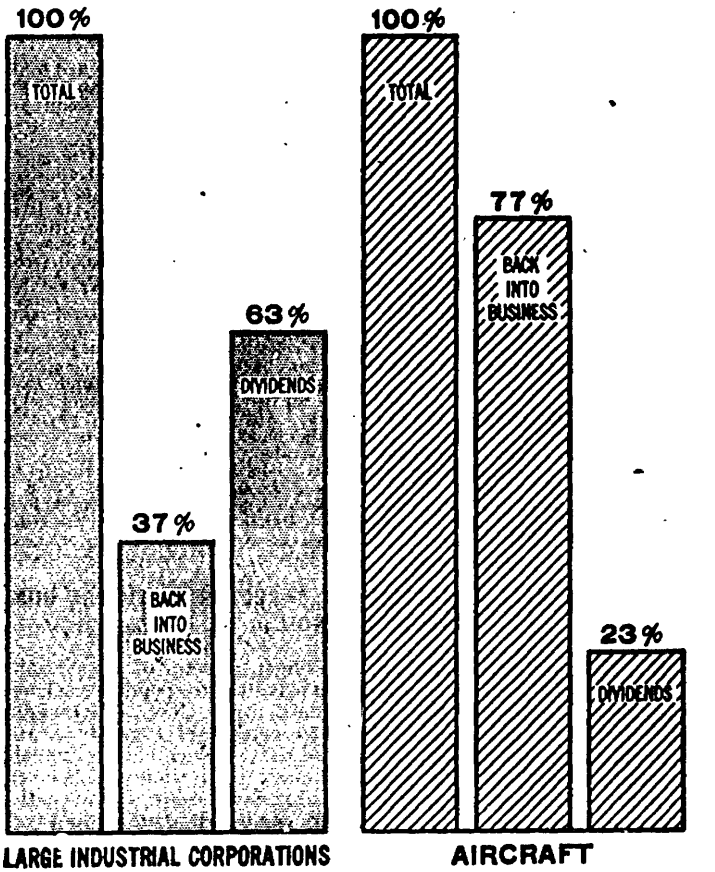

TYPICAL AIRCRAFT COMPANY HAS INSUFFICIENT FUNDS
$29,335,000
CASH AND EQUIVALENTS ON HAND
$24,752,000
COST OF ONE MONTH'S OPERATION (Not Including Overhead)
LIQUID FUNDS ARE SUFFICIENT TO PAY EXPENSES FOR ONLY 5 WEEKS

CHART 7

WHERE THE "PROFITS" GO



EXCERPT FROM TESTIMONY OF RANDOLPH E. PAUL, GENERAL COUNSEL OF THE TREASURY, BEFORE THE SUBCOMMITTEE ON WAR CONTRACT TERMINATION OF THE SENATE COMMITTEE ON MILITARY AFFAIRS, OCTOBER 27, 1943

The Treasury has been considering means of accelerating refunds under the carry-backs. We have submitted to the Ways and Means Committee a proposal intended to facilitate a quick improvement in the cash position of taxpayers whose situation in this respect has suffered by reason of post-war adjustments. As tentatively worked out it would embody the following principal features:

1. If, for any taxable year beginning prior to the expiration of some reasonable post-war period, a corporate taxpayer anticipates the realization of a net operating loss or the existence of an unused excess-profits credit which could ultimately be used as a carry-back against the taxable income of the 2 prior years, it may apply for complete or partial deferment of the quarterly tax payments due in that year with respect to the preceding year's taxable income and also of any payments of deficiencies in tax which are due.

2. The extent of the postponement of these payments would be limited to the amount of the refunds of taxes that would result from the anticipated carry-backs.

3. A statement of the estimated amount of these losses or unused credits and of the resulting refunds would be required to be filed with the Collector of Internal Revenue, together with supporting data sufficient to satisfy him of the reasonableness of the taxpayer's claim. Generally speaking, such data would include a statement of profit and loss for at least the preceding quarter and the business circumstances tending to support a projection of the loss results, or of earnings below the credit level, for all or the remainder of the taxable year. The latter information would be of particular importance in instances where the estimated loss or credit claimed is greater than a proportionate projection of the quarterly results would indicate. Evidence of falling earnings or of anticipated reconversion costs, inventory losses, dismissal wage payments, contract terminations, and similar items would be pertinent in this connection.

4. Partial protection should be given to the revenue by permitting acceleration of the collection of deferred payments, or other protective measures, where subsequent circumstances indicate the ultimate collection of tax to be in jeopardy.

5. When the taxable year from which a carry back is anticipated is completed, the usual return will be filed and a precise computation of the refunds to be claimed can then be made. The amount of the deferred payments would first be offset against the claimed amount of refunds. Any excess of deferred payments would be collected with interest. On the other hand, it is proposed that payment of any balance of refunds due would be accelerated.

The procedure for acceleration would, it is believed, involve the making by the Commissioner of a tentative determination of the amount due. This would be credited or refunded within the shortest possible time, probably in from 60 to 90 days. Thereafter, the final determination of claims for refund would proceed in ordinary course; on ultimate readjustment the taxpayer would repay any erroneous refunds or the Government would pay any balance of refunds remaining unpaid.

STATEMENT OF J. S. NOFFSINGER, DIRECTOR, NATIONAL HOME STUDY COUNCIL

Mr. NOFFSINGER. I am J. S. Noffsinger, director of the National Home Study Council, an association of private correspondence schools, with offices located at 839 Seventeenth Street NW., Washington, D. C. I represent approximately 70 percent of the private correspondence school field in the United States which enrolls annually more than 750,000 students, which number is approximately 60 percent as many students as are enrolled in all resident colleges, universities, and professional schools of this country combined. Our student body consists of young adults, whose average age is 26 years. These people are, for the most part, employed in commercial and industrial positions and are desirous of following courses of instruction which will "upgrade" them in their present field of employment. While our schools have contractual relations with more than 5,000 industrial and commercial corporations for the upgrading of their respective employees, yet the bulk of our enrollment comes from individual

students who are enrolled without reference to their training program being sponsored by their employers.

Our interest in bill H. R. 3687: We are interested in the part of this bill relating to postal rates. Home study courses of instruction like life insurance must be "sold" and the U. S. mails have been proven to be a satisfactory method of securing both desirable prospects and effecting sales as well as transmitting individual instructions to the students enrolled.

Volume of postage used by this field: Private correspondence schools spend in excess of one and three-quarter million dollars in postage per year, approximately 40 percent of which is spent in third-class mailings.

How this field uses third-class mail (1) to circularize selected lists for the securing of interested or logical prospects; (2) to follow-up logical prospects with sales materials; (3) to send encouragement letters to students after they have been enrolled; and (4) to send lesson materials.

What our field secures through the use of third class mail: (1) We secure approximately one-third of our entire volume of business through this medium; (2) the business secured by this method requires the use of approximately 2,000,000 money orders per year; (3) this business also requires an estimated 9,000,000 additional first-class mailings, as well as (4) a large amount (unestimated) of parcel-post mailings.

The effect of doubling third-class postage rates on correspondence school: 1. Schools would be compelled to (*a*) eliminate most of their circularization; (*b*) expand the amount of their national and local advertising; (*c*) expand the amount of private circularization by local distributing companies; and (*d*) employ more commission salesmen.

National and local advertising, circularization by local companies, and the use of commission salesmen are now slightly higher in cost but are much more productive than circularization. With the proposed increase of third-class postage rates, the cost of circularization would probably exceed the cost of other methods of contacting prospective students and would therefore be eliminated as far as possible.

2. It is our conservative estimate that, if the proposed rates were made effective, from one half to two-thirds of the present volume of third-class mailings now used by correspondence schools would be eliminated because of the cost item.

The result of increased third-class rate on Federal income: 1. It is our conservative judgment that if the proposal to increase the present third-class postage rates were effected, the correspondence-school field would definitely decrease the total dollar amount of third-class postage used.

2. There is also a high probability that since the total volume of business of this field would be decreased, the Government would also lose—instead of gaining—on the amount of revenue received from the accompanying (*a*) post-office money orders; (*b*) first-class mail; and (*c*) parcel post.

Specific examples showing why schools are not able to pay the additional increase on third-class rates:

School No. 1. This school does an average annual gross volume of business amounting to approximately $2,000,000. During the past 13 years it has not declared any dividends to its stockholders. If

all other items of their business had remained the same and the third-class postage rates as proposed had been doubled, the school would have had an average deficit of more than $75,000 per year.

School No. 2. This school has an average annual gross volume of business amounting to slightly more than $1,000,000. Small dividends have been paid at irregular intervals during the past decade. If other items in their business had remained the same and the proposed increase in third-class postage had been effected, this school would have operated with a deficit every year during the past decade.

The above two examples are typical of our entire country.

Why increased costs cannot be passed on by the field to its customers. It is logical to ask why a relatively small increase in cost should not be passed on to the customers within the field if the field itself is unable to absorb the increase. This field cannot pass on this increase to its consumers for the following reason:

Complete courses of training are usually offered which range from the most elementary principles to the higher or theoretical aspects of the various courses or areas of learning. Tuition contracts are usually sold by schools for an entire course of study. Students, however, usually study only as long as they can do so with profit to themselves, with reference to their daily vocation or job. When the course of study is no longer profitable for the objective which the student had when he enrolled he ceases to study and also ceases to pay his monthly tuition. As a result the total amount of tuition actually collected by schools ranges from 60 percent to 65 percent of the total contract price. Total tuition fees could be increased but the actual realization thereon would remain practically constant. Therefore increased cost cannot be successfully passed on to the consumer in this field.

Conclusion: (1) It is our considered judgment that an increased rate on third-class postage would, within this field, actually create less revenue for the Government and would also be definitely harmful to the field. It would therefore not be in the public interest to have the rate increased.

STATEMENT OF HARRY J. RUDICK, CHAIRMAN, TAXATION COMMITTEE, ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

Mr. RUDICK. Mr. Chairman, the taxation committee of the Association of the Bar of the City of New York respectfully submits to the Senate Finance Committee the following recommendations with respect to certain provisions of the revenue bill of 1943 as passed by the House of Representatives.

I. Section 115. Acquisitions to Avoid Income or Excess-Profits Tax.

(a) Subsection (a) should be amended to read substantially as follows:

> If any person or persons acquire, on or after October 8, 1940, directly or indirectly, control of a corporation (to the extent of 50 percent or more) and the dominant purpose of such acquisition is to use the deductions, allowances, or credits of such corporation to absorb income that would otherwise be taxable, then such deductions, allowances, or credits shall not be allowed.

(b) Appropriate changes should be made in subsection (b) to reflect the change in subsection (a).

II. Section 116. Trusts for Maintenance or Support of Certain Beneficiaries:

This section should be clarified and made to conform to the Ways and Means Committee report by providing that the section is applicable to cases where the discretion to distribute rests in the grantor in his capacity as trustee or cotrustee.

III. Section 501. Valuation of Unlisted Stock and Securities for Estate-Tax Purposes:

This section should be deleted from the bill.

IV. Section 502. Appointment of New Trustee of Certain Discretionary Trusts Not Transfer Subject to Tax:

This section should be deleted from the bill.

V. Section 503. Use of Commissioners in Cases Before The Tax Court of the United States:

This section should be deleted from the bill.

VI. Section 701. Renegotiation of War Contracts:

That part of this section which confers jurisdiction over renegotiation cases upon The Tax Court of the United States should be deleted.

Brief comments with respect to the above recommendations follow.

I. Section 115. Acquisitions to Avoid Income or Excess-Profits Tax: Our committee is in full sympathy with the purposes of this section. As tax lawyers we are all too familiar with the devices it is aimed at. However, we think that the section in its present form is much too broad. Its literal application would cover many legitimate transactions which should not be brought within its compass. For example, the language of the section would seem to embrace a situation where a parent corporation which had owned a subsidiary prior to the imposition of the excess-profits tax dissolves such subsidiary in order to use its deductions or credits against the income of the parent. Since the two corporations from an economic viewpoint are really one enterprise, there does not seem to be any equitable reason for denying them the right to equalize the advantages of the one against the disadvantages of the other.

It seems to us that the section is primarily aimed at the flagrant practice of buying up corporate shells with large excess profits credits or potential losses to absorb income that would otherwise be taxable; and we think this objective will be attained if the section is amended to read substantially as follows:

If any person or persons acquire, on or after October 8, 1940, directly or indirectly, control of a corporation (to the extent of 50 percent or more) and the dominant purpose of such acquisition is to use the deductions, allowances or credits of such corporation to absorb income that would otherwise be taxable, then such deductions, allowances or credits shall not be allowed.

II. Section 116. Trusts for Maintenance or Support of Certain Beneficiaries: This section should be clarified. Section (a) would add subdivision (c) to section 167 of the code by providing that the income of a maintenance trust is not taxable to the grantor merely because such income, *in the discretion of another person or the trustee*, may be used to support a person whom the grantor is legally obligated to maintain. The section is not explicit in excluding from the income of the grantor the income of such trust where the discretion is in him as trustee or cotrustee. The report of the Ways and Means Committee specifically states that this section is not applicable if the discretion to apply or distribute the trust income for the support of the beneficiary rests solely in the grantor, or in the grantor in conjunction

with other persons "unless the grantor has such discretion as trustee." It is believed advisable to write into the statute the intent of Congress as expressed in the House Ways and Means Committee report. The new provision could be clarified by changing the phrase "in the discretion of another person or the trustee" to read "in the discretion of another person, the trustee or the grantor, acting as trustee or cotrustee."

III. Section 501. Valuation of Unlisted Stock and Securities for Estate Tax Purposes: This section should be deleted. The Commissioner and the courts in valuing unlisted securities where there are no sales, now consider as a valuation factor, in proper cases, sales of securities of similar corporations. See *Rheinstrom* v. *Willcuts* (26 F. Supp. 306); *Estate of Jacob Fish* (1 B. T. A. 882); *Oxford Paper Co.* v. *United States* (74 Ct. Cls. 295, 56 F. (2d) 895). To compel by statute, in all cases involving unlisted securities, consideration of values of listed securities of comparable corporations may protract the trial of cases without adding important valuation evidence. It introduces collateral issues, such as whether the corporations are actually comparable and whether the listed securities are properly valued. In any event, the section is also defective since it limits the comparison to listed securities and thereby impliedly excludes consideration of easily valued unlisted securities of similar corporations.

The section would add a rule of evidence which is not properly part of the taxing statute. It is believed that the enactment of the statute may have the effect of giving undue weight to a single valuation factor. In addition, it may have the effect of excluding, by implication, in valuing listed securities, other proper valuation factors in cases where market quotations do not represent true value.

IV. Section 502. Appointment of New Trustee of Certain Discretionary Trusts Not Transfer Subject to Tax: This section should be deleted. The report of the Ways and Means Committee does not state the reason why section 502 is necessary nor what defect, if any, in the gift-tax law as it now exists the section would remedy. In the absence of a satisfactory explanation, it is recommended that the section be deleted and reconsidered at some time in 1944 in connection with a general consideration of the estate and gift-tax provisions of the Internal Revenue Code. It is believed wise to avoid tinkering with individual sections of the estate and gift-tax law until that time.

V. Section 503. Use of Commissioners in Cases Before the Tax Court of the United States: This section permits the appointment of commissioners in cases before The Tax Court of the United States, such commissioners to be attorneys from the legal staff of the court. No reason is assigned in the Ways and Means Committee Report for this change, but possibly it is tied in with the proposal to expand the scope of The Tax Court by conferring upon it jurisdiction over cases involving renegotiation of war contracts. For reasons which are explained below our committee is definitely opposed to conferring such jurisdiction upon The Tax Court. However, even if our recommendation in this regard is not followed, we nevertheless recommend against the proposed appointment of commissioners, at least until it is shown that The Tax Court cannot function efficiently without such commissioners. It is believed that the taxpayer will be better assured of an adequate hearing if his case is heard directly by a judge of The Tax Court rather than by a member of its legal staff. The latter are

usually younger men and may lack the requisite experience to act in tax cases.

VI. Section 701. Renegotiation of War Contracts: That part of section 701 which confers upon The Tax Court of the United States jurisdiction over cases involving renegotiation of excessive profits growing out of war contracts should be eliminated. To our minds adoption of this proposal would be a serious mistake. The Tax Court was set up for the sole purpose of reviewing cases dealing with Federal income, estate, and gift taxes (although it has also been given jurisdiction over certain processing taxes). The singleness of purpose of The Tax Court has enabled its judges to become highly qualified authorities in the tax field and their opinions have been given great respect by appellate courts and tax practitioners. More important, the court has been able to expeditiously dispose of the cases which come before it.

If the court is now burdened with the additional duty of deciding renegotiation cases, its usefulness as a tax tribunal will be materially impaired. It is generally agreed that renegotiation is not essentially a tax problem and should in fact be dissociated from the determination of income and excess-profits taxes. A forum dealing with tax problems is not especially well equipped to deal with such things as the efficiency of a contractor, the complexity of his manufacturing technique, his inventive and developmental contributions, and so forth. These items and others are, under the section as drawn, required to be taken into account in determining excessive profits. Cases which involve such questions are bound to consume a great deal of time, leaving correspondingly less time for the consideration of tax cases. The number of tax cases which will arise in The Tax Court will certainly increase to a tremendous degree by reason of the complexity of present tax laws and the extremely high rates. In short, if The Tax Court is required to pass upon renegotiation cases, as well as the greatly increased number of tax cases which it will be called upon to review, its efficiency will undoubtedly be impaired to the disadvantage of all parties concerned. Moreover, due to the congestion of the calendar which is bound to occur, the collection of deficiencies and the payments of refunds, also the settlement of cases, will be materially prolonged to the detriment of the public revenues and taxpayers as well. If it is felt that judicial review of renegotiation disputes is desirable, it seems to us that the preferable procedure would be to constitute a temporary new court for that specific purpose.

The CHAIRMAN. At this point I would like to insert in the record a letter from the National League of Women Voters and the resolution referred to therein, and a statement on behalf of the National Industrial Traffic League.

(The documents referred to are as follows:)

NATIONAL LEAGUE OF WOMEN VOTERS,
Washington, D. C., December 1, 1943.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: I am enclosing a statement expressing the position of the League of Women Voters on some aspects of the proposed tax bill. I trust that you will have this statement included in the record of the hearings before your committee.

Very sincerely yours,

MARGUERITE M. WELLS, *President.*

DECEMBER 1, 1943.

To: The Senate Finance Committee.
From: National League of Women Voters.
Re Taxation.

In 1942 the National League of Women Voters advocated, before your committee, a reduction in personal exemptions and in exemptions for dependents greater than finally included in the tax bill. We advocated much higher rates on personal income, suggesting that the beginning rate might be 30 percent. We advocated collection at the source of the bulk of the personal income tax. We believed at that time, and we believe now, that drastic taxation is preferable to a run-away inflation. We believe, too, that the greatest possible proportion of the cost of the war should be paid for out of the income created by the war. We have not changed our minds. Again, it seems to us that the Treasury proposal is a minimum proposal.

We do not believe that price controls can hold against the pressure of the large amounts of surplus purchasing power in the hands of the people. Although such controls may hold fairly well for some time, the piling up of funds in the people's hands is a serious inflationary threat in the post-war period when there will be increased demand for doing away with rationing, price control, credit controls, etc. We remember that the greatest inflation resulting from World War I, came after the end of the war.

It is our conviction that the personal income tax has not been used to the fullest possible extent to reach the income of the lower income groups; that extending it downward would be preferable to a general sales tax. We do recognize the need for reaching this mass purchasing power, and if Congress is unwilling to use the more equitable method of the income tax, it will have to resort to a general retail sales tax, which will not be effective unless applied at a very high rate. We can see no value in a general sales tax that will bring in only a small amount of revenue. The difficulty of administration is too great to warrant its use for a small return.

The Senate has before it a number of measures on which its action may make the difference between a run-away inflation and a stable economy. The tax bill is one of these issues. The public has a right to expect the Senate to act in the long run interest of the country as a whole, not for the short run interest of any group—including the large group of taxpayers.

STATEMENT OF THE NATIONAL INDUSTRIAL TRAFFIC LEAGUE IN THE MATTER OF H. R. 3687, TITLE IV, "POSTAL RATES"

1. The National Industrial Traffic League, with headquarters at 450 the Munsey Building, Washington, D. C., is a national organization consisting of individuals, firms, corporations, and associations, embracing within its membership approximately 300,000 users of the Postal Service, having a vital interest in postage rates and in fees for special services.

2. Postage rates are charges for services performed, and are not a proper source of revenue for general purposes. Any policy of using postage rates as a revenue producing measure is contrary to sound economic principles and to the declaration of the founders that the Postal Service is a public service for the benefit of the public and should be rendered at the cost of operation.

3. The present scale of rates provides sufficient revenue to meet current expenses of the Post Office Department and will produce an excess of revenue under the present volume.

4. The passage of the Burch bill, H. R. 2001, requiring all executive departments, bureaus, and agencies to pay postage on official mail would provide the Post Office Department with additional revenue of $45,000,000 per year in excess of their current expenses.

5. Postage rates have a direct bearing on the delivered cost of merchandise to the consumer whether such merchandise is transported through the mails or whether sales are developed through the mails and merchandise delivered by other methods.

6. Postage rates are an important factor in the final cost of all types of merchandise now under price ceiling control. It is unjust and discriminatory for one branch of the Government to force an increase in the cost of merchandise while another branch definitely establishes a ceiling on the sales price.

7. In keeping with the President's order of April 8, 1943, postage rates should be frozen for the duration of the war and 6 months thereafter because: Any upward revision of rates would be inflationary and contrary to the established policy

of the administration; any restrictions on increased charges for merchandise or services should apply to services performed by departments of the Government as well as on services performed by private industry.

8. The testimony of the Postmaster General at the hearing before the subcommittee of the House Committee on Appropriations on January 12, 1943, clearly indicates that it would be inadvisable to increase postage rates before making a complete study of the present cost ascertainment structure and considering the effect of increased or decreased volume of one type of mail matter upon other classes. This is particularly important in the case of third-class mail, which is used almost exclusively for promotional and sales development purposes. Previous experience of the Post Office Department with increased rates on post cards and on first-class local mail proved that an arbitrary increase in rates yielded considerably less revenue because of the decreased volume.

9. It is the considered opinion of the National Industrial Traffic League that no revision of rates should be made without thoroughly studying the effect of an increase or decrease of volume of one type of mail matter upon another class. The National Industrial Traffic League opposes the passage of H. R. 3687, title IV, "Postal rates," as contrary to the policy of establishing postage rates with due consideration to all factors involved, as requiring action on admittedly incomplete cost information, as inflationary in character, and as adverse to the established policy of the administration.

The CHAIRMAN. Mr. Henry.

STATEMENT OF MR. ROBERT E. HENRY, REPRESENTING THE COTTON TEXTILE INDUSTRY

Mr. HENRY. My name is Robert E. Henry, I am president of the Dunean Mills, Greenville, S. C., and I am appearing here as a representative of the cotton textile industry and shall address my statement to only the renegotiation provisions of the revenue act now before you.

The cotton textile industry has from the very beginning of the renegotiation law believed that the application of the law to the textile industry, and to similar industries, was without justification. Whatever reasons led the price adjustment boards to apply this statute no longer exist.

We are here, therefore, to urge upon your committee that the cotton textile industry and similar mass production consumer goods industries operating under O. P. A. price ceilings be exempted from the requirement of renegotiation. We ask this exemption effective as of January 1, 1943.

The renegotiation law, according to its proponents, was enacted to cope with two unavoidable wartime necessities:

1. The necessity of obtaining rapidly many new articles as to which no previous cost experience was available.

2. The necessity of obtaining large quantities of other articles previously manufactured in such relatively small quantities as to make previous cost experience of little value under mass production.

In the case of industries manufacturing articles under either one or both of these conditions the renegotiation law could perform an important pricing function and at the same time achieve the objective of recapturing profits which, even under the excess-profits tax provision, could have been considered unreasonable and excessive. To what extent these same conditions obtain in the present stage of our war production and procurement program I am not prepared to say. In my sincere opinion I doubt that these conditions ever did prevail in established industries that have produced for many years standardized articles on a mass-production basis primarily for civilian consumption, and in the cotton textile industry they do not exist today.

The military fabrics produced by this industry are basically the same as the commercial fabrics it has been producing on a mass-production basis for many years. When some changes were necessary they were not of a material character and the costs involved were predictable with reasonable accuracy by both the procurement officer and the contractor.

Even such variations from our standard fabrics presented no new problem for either the mills or the procurement agencies either at the time of Pearl Harbor, when Government purchases were accelerated, or when the renegotiation law was enacted. The reason is that purchases prior to 1942 were in great volume and the Quartermaster's Office, the largest single buyer, already had several years' experience with these purchases and with costs and prices.

Not only did these Government fabrics not differ materially from commercial fabrics in construction; they were and are made of the same raw material—American cotton, the price of which is supported by Government loans and quoted on organized futures markets and, therefore, is known with precision. In short, the fabrics we produced for the Government were in all important particulars the same as those which we had been producing over a period of many years in billions of yards for civilian consumers.

Unlike other industries, which were not on a mass production basis before the war, the volume of Government buying resulted in no changes in our manufacturing process. Indeed, there could have been no change, because the cotton textile industry is one of the oldest mass production industries in the country.

Senator DAVIS. What is the difference in retail price during wartimes as against peacetimes? How much increase have they had?

Mr. HENRY. Senator, I can't answer that question. I am dealing only with these fabrics in the primary markets.

Senator DAVIS. The reason I ask that question is because of renegotiation that takes place.

Mr. HENRY. Of course, the renegotiation takes place only with respect to those products which go for war purposes.

Senator DAVIS. What I am trying to get at is some way to do away with the renegotiation process we now have, and have something substituted that will be better for all concerned.

Mr. HENRY. That would please us no end.

Senator DAVIS. Have you got a suggestion along that line?

Mr. HENRY. I think so, as I go along. Perhaps you might not consider it an entire answer, but I will put it up to you as best I can.

Nor was the increase in volume of such a character that this country's profits could have reached unreasonable proportions. In 1939 the total production of fabrics was 9,100,000,000 square yards. In 1942 production amounted to 12,400,000,000 square yards, an increase of 36 percent. This increase in production was accomplished without any increase in productive capacity, it was in fact accomplished with 2,140,000 fewer spindles than we hand in 1939—a reduction of about 8¼ percent. The increase in production was made possible by increasing mill operation from two shifts to three shifts per day and by lengthening the workweek.

Accordingly, Mr. Chairman, neither of the two conditions that called for the renegotiation law in certain wartime industries obtained in the cotton textile industry.

Furthermore, Mr. Chairman, the cotton textile industry has been operating under O. P. A. price ceilings not only during the entire war period, but for months before Pearl Harbor. The first price ceiling was imposed in May 1941, when the industry was already operating at 121.7 percent of two-shift capacity and in the course of the next 12 months, when industry production reached its peak level, practically all our products were under price ceilings. Therefore, O. P. A. had available all the necessary facts to ascertain costs at peak production and to fix price ceilings that reflected such production. Fabrics sold to the Government were sold at the ceiling prices or lower.

All these facts, Mr. Chairman, were presented to the Ways and Means Committee, and it would appear that the recognition of their validity moved that committee to authorize the Board to exempt, in its discretion, contracts for the manufacture of standardized commercial articles. We are grateful to the House for this and other amendments, but feel that the exemption should be made mandatory by law.

When the renegotiation statute was enacted the industry was operating under the 1941 tax rate and it might have been thought by the Boards that the rates in that act were not high enough to recapture excessive profits even of such industries as textiles. But in the 1942 Revenue Act, passed late in October 1942, the normal and war surtax rate was increased from 31 percent to 40 percent, and the excess-profit-tax rate was increased from a maximum of 60 percent to 90 percent. Under the current revenue bill the excess-profit rate would be increased to 95 percent. Under either the present or the proposed rates it would be impossible for this industry to earn excessive profits.

You may ask, if this is so, why worry about the renegotiation law, since its purpose is only to recapture excessive profits, and if a company is not making excessive profits there will be none to recapture. Our answer, Mr. Chairman, is that under the Renegotiation Act what constitutes excessive profits is still left to the discretionary judgment of men, some of them inexperienced men, and the amount subject to recapture is likewise left to their varying discretionary judgments. We appreciate that the House has attempted to state the standards for a determination, but the application of those standards, by their very nature, will be applied with different emphasis by the many different men who administer the law to the thousands of contracts they will still be obliged to reexamine. The time, effort, expense, and uncertainty that confront management under the present law will continue under the proposed law. The injustice of the present law, which recaptures profits, arbitrarily determined, from mills producing for the war effort, and leaves untouched the profits of competitors producing the identical product for civilian consumers, will be continued under the proposed law.

I have already said, Mr. Chairman, that the renegotiation law can serve no important pricing function in established industries producing standardized commercial articles on a mass production basis, especially when the sales of such articles are made under O. P. A. ceiling prices. In industries where it does not serve a pricing function, application of the renegotiation law is nothing less than the imposition of another tax law; a tax law that does not apply equally to all industries and all companies within an industry; a tax law whose provisions are not clearly defined after careful debate by the Congress, but are applied in accordance with the discriminatory judgment of individual men.

Therefore, Mr. Chairman, in behalf of the cotton textile industry recommend that the law be amended to make mandatory by statute the exemption of contracts for the manufacture of standard commercial products produced on a mass-production basis and sold under O. P. A. price ceilings.

The CHAIRMAN. You ask that that be made applicable when?

Mr. HENRY. As of January 1, 1943.

The CHAIRMAN. Any questions, Senator Davis?

Senator DAVIS. No.

The CHAIRMAN. Thank you very much, Mr. Henry.

Mr. Berna.

STATEMENT OF TELL BERNA, REPRESENTING THE NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION

Mr. BERNA. Mr. Chairman, my name is Tell Berna. I am general manager of the National Machine Tool Builders' Association, a trade association comprising about 95 percent of the capacity of the machine tool industry in this country, and which has undertaken during the war to render to the other 5 percent essentially the same service it gives to its own members.

To sketch in the background very briefly, this Nation had, in 1938, about 900,000 machine tools. By the end of 1943 it will be around 1.8 millions. In other words, we have since the end of 1938 doubled the number of metal-working machines in the United States and, of course, the capacity has been more than doubled, since these are new machines as compared to machines some of which were in operation since 1900.

Besides the vast accumulation of modern metal-working machines in this country, about 200,000 have been shipped abroad through 1939 to 1943, inclusive, and therefore greatly reduce the hope of the industry for export markets after the war.

It is obvious that the industry has produced enough machines to meet the needs of even a prosperous and growing nation for many years to come. To accomplish this, the industry, whose normal peace time output is from 100 to 150 million dollars a year produced in

1939	$200,000,000
1940	440,000,000
1941	775,000,000
1942	1,300,000,000
1943	[1] 1,200,000,000

[1] Estimated.

The first point I would like to make is that these machine-tool builders do not ask or expect preferential treatment because of the contribution they have made to the war. They suggest that if this Nation is to pay better wages and employ more people, it must be by increasing the output per man-hour—by making better products at lower costs while paying good wages. This can only be done by using better manufacturing equipment.

The very foundation of a high standard of living is machine tools. It is therefore essential that this Nation have in the future a highly competitive vigorous machine-tool industry. To survive the period during which the Nation will absorb the machines already built, to redesign their product and make it even better than it is now, machine-tool builders must have reserves.

The effect of draining large sums in cash from practically every machine-tool company by renegotiation, is to guarantee the extinction of most of the industry soon after the war.

On the impact of renegotiation, Mr. Chairman, Colonel Rockwell this morning might just as well have been speaking of the machine-tool industry. His experience is typical. Mr. Shaw, speaking for the airplane industry, practically spoke for the machine-tool builder.

If you will consult exhibit 4 in that collection, you will find there a graphic representation of the distribution of gross earnings for nine large industries directly concerned in the war effort. You will find that from 1937 to 1941 for every gross dollar of earnings the airplane industry paid out 56 cents in taxes; the machine-tool industry 54 cents, so that we are the next highest as to the proportion of gross earnings removed by taxes. You will find the machine-tool builder paid out 18 cents of each dollar in dividends, the least of any of these industries. You will see there that he set aside the remainder for surplus, and then put more back into the plant and equipment than the surplus earned in those 5 years. Nineteen forty-two represents the first opportunity the machine-tool builder has had of setting up a reserve for the situation that he faces after the war which will be very grave, even though this Nation should enjoy unparalleled prosperity.

The House has written several amendments to this law—I would like briefly to discuss the effect of these provisions.

Exemption of standard commercial articles: The proposed War Contracts Price Adjustment Board is given the right (b–403–i–4) to exempt standard commercial articles (defined in b–403–a–7) such as machine tools. The secretaries have always had the right to do so. Merely to confirm this will have no effect. The provision should be made mandatory.

Exemption of equipment and supply contracts: By redefining subcontracts (b–403–a–5), orders for manufacturing equipment which does not become a component part of the end product are supposed to be made exempt from renegotiation. This was done, I think, because the House realized that this equipment is not expendable, that the machine tools, for instance, bought for war production, may be used for 20 or 30 years for peacetime production. It is therefore not entirely fair to regard the earnings resulting from their manufacture as a war profit.

Senator DAVIS. What is the average capital stock of the concerns that make up the machine-tool industry?

Mr. BERNA. It would be a little over a million dollars. Before the war the average employment was a little over 200 men. It is an industry of small companies and has always been a highly competitive industry. Really, it is a group of industries. In other words, we have about 21 companies making engine lathes, a half dozen companies making another type of machine. There are 221 different kinds of machine tools made by the industry.

Senator DAVIS. The tool industry is a pretty good barometer of business conditions; is it not?

Mr. BERNA. Senator, people don't buy new machines until they are pretty sure they are going to make enough money with those new machines to pay for them in a year or two, so that as we get back out

of a panic or depression, they first make use of what they have got, and then as the trend continues upward, they begin to buy new machine tools. As you say, it is a general barometer of good business conditions. You can't have better reaping machines, typewriters, or automobiles unless you get better machines to make them on.

In the House Ways and Means Committee Report No. 871 on the revenue bill of 1943, we find this statement:

> Under the new definition of subcontract, factory supplies such as tools or equipment, typewriters, business machines, etc., are exempt from renegotiation.

I do not believe the proposed amendment will have that effect. In 1942 about half of the orders received by machine-tool builders were from contractors acting for and in behalf of the Defense Plant Corporation. Legally speaking, these are prime contracts. The new definition of subcontract will not affect this very large portion of the orders for manufacturing equipment. Purchases for foreign nations are handled through lend-lease and contracts are placed by the Ordnance Department. These, too, are prime contracts and are not affected by the proposed amendment. To secure the result the House committee had in mind, and have stated as their purpose, sales of manufacturing equipment to the Defense Plant Corporation agencies and to the Ordnance Department for lend-lease should be made exempt in specific terms.

Exemption of $500,000 annual business: According to the amendments, annual business of $500,000 or less is exempt (b-403-C-6-B). As we understand this provision, a contractor whose total 1943 sales are $501,000 will be renegotiated, while his neighbor, doing $500,000 will be immune. It would seem more equitable to make exempt the first $500,000 worth of business of every contractor.

The price adjustment boards have always insisted that their function is the downward revision of excessive prices, and that this is not a taxing function. In spite of many elaborate explanations of this policy, machine-tool builders have never been able to understand it To take from a company by legal procedure, earnings that would not be taken by corporation taxes seems to them a taxing function.

They feel that to speak of "profits before taxes" is misleading. The sum earned does not belong to the company; cannot be set aside as a reserve, or expended in dividends, unless Federal taxes have been been paid.

To report that a company has been allowed to retain 10 percent on 1942 sales certainly sounds as if the Board had allowed a very generous profit. As a matter of fact, that might mean the retention of only 2.7 percent after taxes, and that residue is the only amount the machine tool builder may consider his profit.

To review in painstaking detail the efficiency of a contractor, the salaries paid to his executives, the contribution he has made to the war effort, the extent of risk assumed, the complexity of his business, the extent to which he had employed private funds in expanding to meet war needs and other considerations (b-403-a-4) and to deliberately brush aside all considerations of the taxes that may have already drained away 70 percent or more of a company's earnings seems unreasonable.

It is easy enough, when it has been determined to what extent a

company's profits are excessive after taxes, to arrive at the amount by which its prices should be reduced.

Renegotiation should be defined as a recovery of those profits which are found to be excessive after the payment of taxes.

Right of appeal on renegotiation of 1942 sales: This act provides that when the Price Adjustment Board has made a decision it will notify the contractor or subcontractor in writing and he will then have had a determination of the Board. This applies to 1943 and later years.

With reference to business done in 1942, the amendment as it stands (b-403-e-2) provides for an appeal by any contractor or subcontractor aggrieved by a determination of the Secretary made prior to the date of enactment of the Revenue Act of 1943 whether or not such determination is embodied in an agreement with the contractor or subcontractor.

May I draw your attention to the plight of the company that signs a so-called agreement before the enactment of this act but does not get it back signed by the Government until after the act becomes law. It has not been the custom of price-adjustment boards to put their demands in writing; legally speaking he does not have a determination of the Secretary made prior to the date of the enactment of the Revenue Act of 1943. He may not be able to prove the verbal demand. The wording of the agreement he has signed, perhaps under duress, is in the form of a voluntary acknowledgment of guilt and restitution of excessive profits.

The paragraph further provides that if he is aggrieved by a determination of the Secretary made after the enactment of the act, he may appeal, but only if the determination is not embodied in an agreement. The Secretary need only sign the incomplete agreement, and the contractor or subcontractor has no right to appeal.

Suppose a machine-tool builder has signed an agreement, mailed it in. He has heard nothing from it. These amendments become law. The Secretary need only sign the agreement and send it back. That machine-tool builder has no appeal from that decision, because the determination is embodied in the agreement and it is explicitly ruled out by paragraph (b) 403 (e) (2). I believe, Mr. Chairman, that is a misunderstanding and it should be corrected.

May I suggest that the right of appeal be extended to contractors under those circumstances.

In summary, we have five suggestions:

1. Make the exemption of standard commercial articles mandatory.
2. Provide that manufacturing equipment sold to the Defense Plant Corporation and to the Ordnance Department for lend-lease be exempt from renegotiation.
3. Provide exemption of the first $500,000 of every contractor's business
4. Renegotiate on the basis of profits after taxes.
5. Clarify the right of appeal.

The CHAIRMAN. We thank you very much. Your testimony will, of course, be examined by the members of the committee who find it very difficult to be on hand at this particular time.

Mr. BERNA. I can understand that. Thank you very much.

The CHAIRMAN. Mr. Boyer.

STATEMENT OF PEARCE F. BOYER, VICE PRESIDENT AND COMPTROLLER, REPUBLIC STEEL CORPORATION, CLEVELAND, OHIO.

Mr. BOYER. Mr. Chairman and gentlemen of the committee, my name is Pearce F. Boyer. I am vice president and comptroller of Republic Steel Corporation, the third largest steel company in the country operating plants or mines in a great many different parts of the country, including particularly the States of Ohio, Alabama, New York, Pennsylvania, Michigan, Illinois, Indiana, and Connecticut. In my capacity as comptroller I have charge of the corporation's income taxes.

Republic Steel is on the invested capital basis for excess-profits taxes. It has capital invested in its business of approximately $300,000,000 and, therefore, falls in the class of corporations which will be adversely affected by the proposal contained in the House bill to lower the invested capital credit before excess-profits taxes from 6 to 5 percent, and from 5 to 4 percent on substantial parts of its capital.

I am here to protest this proposal as well as the proposal to increase the excess-profits tax rate from 90 to 95 percent.

If these proposals are adopted it will mean that Republic can earn only $2.84 net on each $100 of invested capital before the balance of its earnings, if any, are classed as excess profits and taxed at 95 percent. This return is inadequate and will embarrass the company seriously in its financial and dividend policies; will seriously interfere with essential provision for post-war conversion and rehabilitation of its facilities and, above all, will cripple it in its hopes and plans to give back jobs to the 17,000 of its employees who are now in the armed service of the country, not to mention jeopardizing the interests of 65,000 present employees and over 60,000 stockholders and bondholders.

Many other corporations will be similarly affected. I want to be distinctly understood as making no plea for retention of war profits, but I do not and cannot believe that any such extreme burden as is now proposed is in the best interests of the country as a whole.

The Revenue Act of 1943 as introduced in the House on November 18, 1943, proposes to reduce the excess-profits credit for companies (with invested capital of over $5,000,000) which are on an invested capital base for excess-profits tax and to increase the excess-profits tax on earnings above the credit from 90 to 95 percent.

This will most seriously affect the post-war security of Republic Steel Corporation and many other companies which because of low earnings in the years 1936 to 1939 are on an invested capital base for excess-profits tax.

Vitally concerned in this matter are Republic Steel Corporation's 65,000 employees and 60,000 shareholders, all of whom have a stake in the post-war stability of the company. Especially to be considered are the 17,000 Republic boys who have gone to war and who must be assured of jobs upon their return.

As is well known, the 1942 Revenue Act, under which 1943 profits are taxed, provides for taxing excess profits by establishing a credit or base of normal earnings based on invested capital or average earnings

as defined in the law. The amount of the credit (i. e., normal earnings) is subject to normal tax and surtax amounting to 40 percent, and the earnings above the credit are subject to 90 percent excess-profits tax (95 percent proposed in 1943 amendment).

Invested capital credit: Republic has an invested capital of approximately $300,000,000 on which the invested capital excess profits credit is indicated below:

Invested capital	Present law		Proposed 1943 act	
	Percent	Credit	Percent	Credit
$5,000,000	8	$400,000	8	$400,000
$5,000,000	7	350,000	6	300,000
$190,000,000	6	11,400,000	5	9,500,000
$100,000,000	5	5,000,000	4	4,000,000
Total ($300,000,000)	5.7	17,150,000	4.7	14,200,000

Thus the proposed change would reduce the excess-profits-tax base for a company the size of Republic by $2,950,000, or 17.2 percent. Such invested capital excess profits credit is subject to normal and surtax. Deducting 40 percent normal and surtax, $5,680,000, from the normal earnings (excess-profits-tax credit) of $14,200,000, leaves $8,520,000 or 2.84 percent on invested capital.

Assuming a company with $300,000,000 invested capital had an income before taxes in 1943 of $50,000,000, under the present law the income and excess-profits-tax payable thereon would be $33,468,500 and the net income remaining after taxes would be $16,531,500. If the invested-capital credit and excess-profits tax are changed as proposed, such a company in 1944 would have to earn $69,500,000 before taxes in order to reach the same net income after taxes.

The following table illustrates this graphically:

	Present law	Tax	Percent	Proposed 1943 Revenue Act	Tax	Percent
Income before Federal taxes	$50,000,000			$50,000,000		
Excess-profits credit	17,150,000			14,200,000		
Normal and surtax on excess-profits credit		6,860,000	40		$5,680,000	40
Excess profit	32,850,000			35,800,000		
Tax on excess profits less post-war refund		26,608,500	90		30,609,000	95
Total tax		33,468,500			36,289,000	
Net earnings after tax	16,531,500			13,711,000		
Reduction in net income				2,820,500		
Additional income before taxes required to produce net earnings $16,531,000 as under present law				19,500,000		

Assume that such company had fixed charges of $12,750,000 per year consisting of charges for 6 percent dividends on preferred stock (representing investment of $100 per share); $1 a year dividend on common stock (representing an investment of $40 per share); and requirements for debt retirement, preferred stock retirement, sinking funds, etc. Under the present law this company must earn approximately $30,000,000 before taxes to meet these requirements. Under the new law as proposed, however, to meet these requirements, it would have to earn $43,000,000 before taxes.

It has been claimed that companies on an invested capital tax base have been increasing their invested capital out of earnings. In view of excess-profits tax of 95 percent on all earnings above the invested capital credit, it would be an impossibility for a company to effect out of earnings an increase in invested capital which would to even a slight degree offset the proposed change in the rate. For a company with an invested capital of $300,000,000 and an excess-profits credit of $17,150,000 under the present law to maintain its excess-profits credit of $17,150,000 under the rates proposed in the 1943 act, it would be necessary to increase its invested capital $73,750,000.

Discriminatory character of proposed change: By contrast, companies with invested capital up to $5,000,000, which are on an invested capital base for excess-profits tax, are permitted, under the terms of the proposed law, to remain upon the same base as they are under the present law—a base which permits them to retain and set aside for post-war purposes a far higher share of their earnings than is the case with large companies. Under both laws companies with invested capital up to $5,000,000 are permitted a credit of 8 percent on invested capital; whereas, under the new law, the credit on the second $5,000,000 of invested capital is cut from 7 to 6 percent, that on the next $190,000,000 from 6 to 5 percent, and above that from 5 to 4 percent.

To illustrate: If a company engaged in the steel business, having an invested capital of $5,000,000, owned a single bar mill or sheet mill it would be permitted to retain earnings of 8 percent on its invested capital free from any excess profits tax. If, on the other hand, a mill or mills of exactly the same character were owned by Republic, along with many other mills, Republic would only be entitled to retain 4.7 percent on the capital invested therein free from excess-profits tax. Thus in Republic's case the net earnings of such mills after taxes would be drastically less, simply and solely because of Republic's larger capital investment.

The stockholders of companies are the real parties at interest where corporate taxes are concerned. There is no reason either in justice or logic why a stockholder should be penalized simply because he held stock in a company with a large invested capital, instead of stock in a company with a small invested capital. We are dealing with an excess-profits credit to determine what are excess profits, and the stockholder who has invested in the larger company finds that what are "excess" profits to him are normal profits to his neighbor whose investment is in a smaller company.

It is this proposed reduction in the percentage of excess profits invested capital credit to which Republic chiefly objects, because by imposing such a disproportionate burden on a company like Republic, it will make it much more difficult for these companies to meet post-war conditions and correspondingly affect adversely a large number of employees and stockholders.

It must also be borne in mind that the large industrial companies have been a most important factor in the production of war materials. The shipbuilding and aircraft program in this war would not have been possible without the furnaces and mills of the large steel companies which had invested millions of dollars in equipment available for war production.

The company which is permitted to retain out of the war years at

least some reasonable portion of its earnings for plant rehabilitation will be able to put its plant and equipment in shape to reconvert quickly to peacetime conditions, merchandise its product, and maintain its employment schedules and its financial position.

The company, even though it may be large, which is unable to retain funds sufficient for plant rehabilitation and entry into post-war conditions will undoubtedly suffer thereby in volume of business, in employment and in earnings in the period following the war.

It is Republic's hope and desire that the moment the war is over Republic can rehabilitate its plants, which will be in serious need of a thorough overhauling because of continuous operation for war purposes, enter energetically into post-war merchandising, absorb its employees who are returning from war, maintain its employment schedules at high levels, and continue to pay reasonable dividends to its shareholders. This, we repeat, is a matter which in Republic alone affects 125,000 people.

This objective is difficult of attainment even under the existing tax law. It would seem impossible of attainment if the invested-capital excess-profits credit is further reduced as proposed in the new Revenue Act.

We urge that present rates on invested-capital excess-profits credit be left unchanged in the new law.

The CHAIRMAN. Is your company now paying excess-profits taxes?

Mr. BOYER. Yes, sir; we paid a total of $68,000,000 of taxes in 1942, and so far this year we have provided about $40,000,000 of taxes.

The CHAIRMAN. We thank you for your appearance.

Mr. BOYER. Thank you very much.

The CHAIRMAN. Mr. Smith.

Mr. GREELEY. Mr. Chairman, Mr. Smith has turned his time over to me. My name is Greeley.

The CHAIRMAN. Very well.

STATEMENT OF W. B. GREELEY, REPRESENTING THE WEST COAST LUMBERMEN'S ASSOCIATION

Mr. GREELEY. Mr. Chairman, I am W. B. Greeley of Seattle, Wash. I am secretary-manager of the West Coast Lumbermen's Association, which has 240 members representing about 75 percent of the production of Douglas fir and associated species of lumber in the Pacific Northwest.

My remarks are addressed to renegotiation and specifically to section 701 of the bill, paragraph (b), subparagraph 7, on page 106 of the print now before the committee, which defines "Standard commercial article"; also to subparagraph (d) on page 127 of the committee print, which gives the Board discretionary authority to exempt a standard commercial article if "normal competitive conditions affecting the sale of such article exist."

I want to make clear to this committee the practical effect of renegotiation of lumber contracts as a discriminatory tax upon the returns of a producer who sells standard commercial articles to the Government, from which a producer who sells the same commercial articles to private customers at an equal or greater profit is exempt. The phase of renegotiation which I have come to Washington to protest is summed up in one word, discrimination. Whatever the theory of renegotiation, it becomes a discriminatory tax when applied

to a standard commercial article, like lumber, of which the Government requires only a part of the quantity manufactured.

It is a discriminatory tax upon the patriotic producer who loyally gives the war agencies first call upon what he makes; and it is a premium on the lack of patriotism of a producer who avoids Government contracts and sells his goods in equally profitable or more profitable private markets.

I will illustrate this assertion by a brief reference to the west coast lumber industry. Ours is an industry of some 1,100 sawmills, which produce about one-third of the entire supply of softwood lumber in the United States. Our production was 8¼ billion board feet in 1942.

The War Production Board and the War Manpower Commission have gone to great lengths in helping the industry and demanding of the industry that it produce an equal volume of lumber in 1943. The operators have done everything in their power to hold up production against a growing shortage of manpower. At this date we are 10 percent behind last year's production; but the industry has on its books 1,100,000,000 board feet of unfilled lumber orders, a large proportion of which is for war requirements. The discrimination against Government sales, which renegotiation involves, works directly against the consistent efforts of the war agencies to maintain the maximum possible production of lumber in the Pacific Northwest.

Our lumber has been in great demand for war requirements. The most drastic war control applied to any species of lumber in the United States was extended to our principal wood, Douglas fir, by Limitation Order 218, issued by the War Production Board October 22, 1942. In effect, this order gives the Central Procurement Agency, which is the centralized lumber-buying office for 17 different war agencies, first call upon the entire production of Douglas fir lumber, excepting certain very limited grades. Any Douglas fir lumber that a producer wishes to sell to a private customer must be released by a local officer of the War Production Board. Before releasing the proposed order, the War Production Board determines first, whether Central Procurement needs this lumber; and second, whether the lumber is more urgently needed for some other nonmilitary use than that indicated by the producer. Instead of being released for purchase by a retail lumber yard in Chicago, for example, it may be released for sale to supply the needs of a farm area or a railroad company.

The effect of this order has been to closely direct the sale of Douglas fir lumber to war requirements; and thus to place a large proportion of it within the scope of renegotiation. At least 50 or 55 percent of the total production of Douglas fir lumber has been purchased or allocated by the Central Procurement Agency since its inception. A substantial additional percentage reaches contractors or subcontractors of the Government through the procedure of release; and therefore becomes subject to renegotiation. The fact that our lumber is under more rigid control than any other American woods and that we are well organized under local administrators of the Central Procurement Agency and War Production Board, has led Douglas fir to be drawn upon for war requirements far beyond its usual range of geographical distribution.

I can give you the record, Senator, of millions of feet of our lumber that has crossed the Mississippi River into your State and other States, primarily because this war order has placed our industry under very drastic control.

This statement is made without criticism. Our first obligation is to get on with the war; and ship our lumber where the Government wants it. But the fact should not be overlooked that every carload of Douglas fir lumber bought by the Government by virtue of the rigid control it has placed over this one part of the whole American lumber industry, carries an extra tax upon the producer in the guise of renegotiation.

In our own industry in the Pacific Northwest, there has been too much variation in observance of the limitation order. The majority of the mills have fully supported it. Our association has done everything in its power to make known the requirements of Central Procurement; to bring all the industry salesmen to its auctions; and to obtain unqualified acceptance of the obligation to put war business first.

Several companies have sold the Government from 60 to 75 percent of their entire production. The majority have sold from 40 to 50 percent. A few companies have sold the Government less than 25 percent. While many companies have almost completely withdrawn from private trade, a few companies have not only kept but enlarged their civilian trade outlets.

Fortunately, this disparity was substantially equalized in October by more drastic enforcement of the order. It is now administered on the basis that every Douglas fir manufacturer must apply at least 50 percent of his current production against Central Procurement business. But the fact remains that in our own region some companies approach renegotiation with a record of 60 or 70 percent of Government sales; many companies with 40 to 50 percent; some producers with less than 25 percent.

The greater your percentage of Government sales, the poorer is your case for renegotiation. Some companies who have been least zealous in supporting the war and most zealous in pushing their own private trade may avoid renegotiation altogether. Other companies must pay, through renegotiation, an extra tax upon their profits directly proportional to the percentage of government business they have accepted. Renegotiation under these conditions, dealing with a standard commercial article manufactured by hundreds of different producers, of which the Government requires but part of the supply, is a tax on loyalty.

In our situation, with a very active lumber market, there is no financial gain in selling the Government. Our sales have been subject to ceiling price regulations of O. P. A. since October 1, 1941. The returns on sales to private buyers are usually higher than on corresponding sales to a war agency because of the more liberal grade specifications offered by the private buyer. But of greater importance is the fact that every lumber manufacturer depends in peacetime upon a large clientele of wholesale and retail lumber distributors or industrial lumber users. This is his trade, who take their business to him and give him first chance to fill their orders. Such a trade clientele is one of the most important jealously guarded assets of any lumber producer. In times like the present when the supply of lumber is short, there is every commercial inducement to cultivate and hold this private trade, with an eye to post-war markets. The manufacturers who put these advantages behind them and loyally give the Government first call upon their lumber, do so at a commercial sacrifice. That is accepted by most producers of Douglas fir lumber

as their obligation to the war. But the Government itself commits a serious injustice when it imposes a penalty upon this type of loyal businessman, in the form of renegotiation, a penalty which is directly proportional to his support of the war in disposing of his own products.

I want to show you what this penalty is in dollars and cents. Our association has made a compilation of costs and returns in the production of west-coast lumber during 1942. It is based upon the records of 83 lumber companies, who produced 60 percent of the total for the entire industry.

These 83 companies, in 1942, had a gross profit on their sales volume, before taxes, of 16.5 percent. Of this gross profit, 68.9 percent was paid to the Government in income and excess-profits taxes. The companies were left an average profit of 5.1 percent on their volume of sales, or $1.76 per thousand feet of lumber sold. At that point renegotiation knocked on their door.

Out of a large number of renegotiations now in process, I have been able to obtain four complete records where settlements have been reached. These four companies sold 41.3 percent of their lumber to the Government in 1942. The renegotiations figured their profit on these Government transactions at $520,600. They demanded a refund of one-half of this amount, or $265,000. I do not know what taxes were actually paid by these companies in 1942. If they were comparable to the average tax of 68.9 percent of gross profit paid by the industry as a whole, renegotiation meant to them simply an additional tax of $82,415, or 6.3 percent more taken from their original profit. While the industry generally paid 68.9 percent of profit to the Government as taxes, these renegotiated companies paid 75.2 percent.

I do not cite this as an exact figure. It is an example to illustrate my point. And my point is that however it may be explained, renegotiation of contracts for standard commercial articles is, for all practical purposes, simply another tax on doing business. It is a discriminatory tax because it applies only on business done with the United States Government.

We respectfully submit that this is not just and equal taxation. It taxes one man's profits and exempts another man's profits, solely on the basis of whether he sells to public or to private consumers. It discriminates against the manufacturer who puts the needs of war first; and in the case of my own industry at least, it is definitely harmful to the all-out production which war agencies have called for.

It was our hope that this Congress would eliminate the renegotiation of contracts for standard commercial articles altogether. In my judgment, that would be the sound and proper course to clear up this whole situation, remove the discrimination and promote the war effort. The present bill proposes such exemption only when "In the opinion of the Board, normal competitive conditions affecting the sale of such article exist."

I do not know how the Board would apply that phrase to west-coast lumber. We have a normal number of suppliers; practically a normal volume of production. Competitive pricing is functioning in the case of a few lumber items; but otherwise, because demand is greater than supply, 90 percent of all sales are at O. P. A. price ceilings, and I can not believe that any court or any businessman would undertake to say this represents normal competitive conditions.

If the elimination of renegotiation in the case of all standard commercial articles is not possible, I ask the committee to at least remove the discriminatory phase of renegotiation as between sales to the Government and sales of the same article to private trade. To accomplish this with a minimum change in the present bill, I request that subparagraph (d) on page — be amended by adding to the authority of the Board to make exemptions from the provisions of the section, the following clause:

Or if, in the opinion of the Board, enforcement of this section would involve unfair discrimination against producers of a standard commercial article who contract or subcontract its sale to any department, in respect to other producers of the same article.

The effect of that suggested addition would be that if any situations such as I have described—and I am not speaking for lumber alone, for I know a similar discrimination exists in the case of any other commodity—if the Board finds that renegotiation would involve unfair discrimination between the supplier who favors Government business and the supplier who does not, then the Board would have the authority to authorize the exemption of such article from renegotiation.

I have a little additional matter I would like to file for the record, which deals with the application of the definition of timber. We think that is another example of the inconsistency and discrimination that arises from an attempt to apply renegotiation to these standard commercial articles which have been produced for years before we entered the war.

The CHAIRMAN. You may submit that.

Mr. GREELEY. This refers to discrimination in the application of section 701 (i) (1) (b).

This subsection exempts from renegotiation the product of mineral or natural deposits or timber, "which has not been processed, refined, or treated beyond the first form or state suitable for industrial use."

This provision for timber was made by Congress a year ago after extended hearings by the committees. We were satisfied that this legislation intended to exempt timber in the first form or state of production for general industrial use That is, lumber in the usual industrial or construction items.

Such lumber is not a finished article ready for use. It is a material—midway between the tree or log and the millwork or building or boat or freight cars. But the renegotiating departments have defined the first form or state of timber "suitable for industrial use" as "the log." Under such an interpretation this subsection appears to us to be meaningless as far as timber is concerned.

Only to a limited extent is the log itself an article of industrial use—as for poles or piling. Largely it is simply a reduction of the tree to a form in which it may be processed or manufactured into a material adapted to general industrial use. Lumber is merely the tree. or log, reduced to usable lengths and sizes. In our judgment, this administrative definition is a quibble and not a fair interpretation of the intent of Congress.

In applying this very narrow definition to timber, the administrators of renegotiation have discriminated against lumber. In their

regulations we find listed, as the first form or state suitable for industrial use, these comparable materials: Aluminum ingots, copper billets, refined lead bars, refined silver bars, cement, and pig iron.

If these materials are the first forms in the production line suitable for industrial use, it is inconceivable to us why lumber is not so classified. As it stands, the cement used in building a bridge is not subject to renegotiation, but the form lumber used with it is renegotiable.

The drafters of the regulation may have tripped over the words "processed," "refined" and "treated." They are terms customarily applied to the production of minerals—not to the production of lumber. We do not "refine" or "process" lumber out of the tree; we manufacture" it.

If the committee concludes that lumber should be dealt with on the same basis as that now applied to these other materials of mineral origin, I recommend that the word "manufactured" be inserted after "refined" in section 701 (i) (1) (B), so that it would read—

which has not been processed, refined, manufactured, or treated beyond the first form or state suitable for industrial use.

The CHAIRMAN. You do not deal with ordinary civilian goods?

Mr. GREELEY. No, sir; they have nothing to do with it.

The CHAIRMAN. I know they don't, but I wondered if they had taken a sideward glance at civilian operations.

Mr. GREELEY. No, sir; only to this extent: The first question they ask is, "What was your total profit during the period?"

The next is: "What was your proportion of Government sales?"

If your proportion of Government sales was one-third, then one-third of this total profit is subject to renegotiation and the private sales are ignored.

The CHAIRMAN. You are quite right in saying that that does result in very serious discrimination against the producer who furnishes to the Government as against the other producer who does not. That has happened in the case of certain garment manufacturers who took Government contracts and others who did not. Those who ducked the Government contracts went on with their business and furnished their regular customers, whereas the other garment manufacturers, one at least that I know of, who really put on almost a 100 percent war production, was losing all his trade, and it took him a long time to rebuild it.

Mr. GREELEY. Exactly. That is inherent in the effort to apply renegotiation to any standard article.

The CHAIRMAN. I don't believe you are going to get very much relief—and I might as well be frank about it—as long as it is left in the discretion of the renegotiation board whether they will exempt from renegotiation standardized articles. I don't think you would get it unless it is made mandatory.

Mr. GREELEY. Our first recommendation, sir, is that it be made mandatory. We certainly second the recommendation made by Mr. Henry in that respect.

The CHAIRMAN. Yes, sir. Thank you very much.

Mr. GREELEY. Thank you, sir.

The CHAIRMAN. Mr. Benjamin.

STATEMENT OF ALFRED H. BENJAMIN, PRESIDENT, ANGLO-AMERICAN TRADING CORPORATION

Mr. BENJAMIN. Mr. Chairman, my name is Henry H. Benjamin, president, Anglo-American Trading Corporation, 90 Broad Street, New York City.

We beg to submit for your consideration reasons against increased taxation.

1. The problems we are facing today are numerous, the chief one being the domination by the British Government of all foreign food commodities which enter into the cost of living in the U. S. A. and decreases our Government revenue. The commodities are chiefly meat, butter, eggs, pork, canned meats, wool, and so forth.

I might say that all these commodities are liquidated in the currency of the British Government, namely, sterling, so that when they are shipped out their manufactured products, they will be liquidated in sterling, too.

2. We have imported these products since 1912 in very substantial quantities, and during the last 10 years have imported meats produced in the dominions of Great Britain, all of which, since the 28th of April 1043, are now embargoed and under control of Great Britain, as a result of which we have been seriously handicapped in our business.

3. Meat and butter have clogged the refrigerated warehouses in all the following countries: Argentina, Uruguay, Canada, New Zealand and Australia, and promise to be a repetition of World War I, when similar conditions prevailed.

I might say that at the end of the World War there was so much material in these countries that it was actually destroyed before it could be shipped.

In Argentina the cattle raisers could not market their cattle in 1942 and early 1943 because the warehouses were already filled with refrigerated products, and Great Britain could not find tonnage to move this to destination.

4. We have 1,500 tons, approximately 3,000,000 pounds, of meat in New Zealand, purchased in 1942 and early 1943, and had arranged to transport this meat in U. S. A. steamers early May, but owing to the embargo placed on the meat on the 28th of April 1943 the War Shipping Administration boats returned to United States ports with empty refrigerated chambers in May of this year.

The British Government has since requisitioned this meat. The greater part of this meat had been sold throughout the civilian areas in the United States, where industrial plants were producing war materials. This included the Detroit and Pittsburgh areas, and the failure to deliver this meat naturally created a shortage, which was keenly reflected in the discontent that manifested itself in these various industrial centers. Out of this 1,500 tons of meat, 300 tons, approximately 600,000 pounds, of beef had been earmarked for the United States Army, and because of the embargo had to be canceled.

5. If this condition is permitted to continue for the duration of the war we shall not be able to import butter or meats from any of these countries after the war is over.

Great Britain will still dominate that situation, and after the war has ended and, as far as food commodities are concerned, we will be blocked out in all these producing countries, and it particularly applies to the oversea dominions, where the sentiment to continue their economic ties with the United States is strongly entrenched.

6. We contend that embargoes placed upon these products by our allies are economically unsound, and at the same time harmful to the Treasury receipts, as all these products are subject to a very high tariff, namely:

	Cents per pound
Butter	14
Beef	6
Lambs	7
Mutton	5
Offal	3

During the World War there was no embargo on any such character, and much lower duties prevailed by 50 percent—in other words, Senator George, the prices of meat and butter were 50 percent lower, and I can cite you many cases of meat double the price today what it was in World War No. 1—and our imports of meat and butter were substantial; approximately 150,000,000 pounds in meats and 50,000,000 pounds in butter.

7. The cost of living will be higher in 1944, because we will have a tremendous shortage of beef, lamb, butter, and poultry in the United States, and unless these restrictions are lifted by the British we will face trouble with the workers in the steel and coal industry, and, in fact, all industries contributing to the war effort.

I might incidentally add that I think we are playing into the hands of John L. Lewis by doing so.

Lend-lease undoubtedly plays a big part in these operations.

We are at the present time exporting to the other side hundreds of millions of pounds of pork under lend-lease. There is nothing coming in here from any other country in the world to fill up that gap, and that is the reason we are facing higher prices today and a scarcity of all these commodities.

9. We have appealed to the Combined Food Board of the United States Department of Agriculture, but they cannot give any relief to this situation. They have referred us to the State Department to give us the solution. The State Department, however, advise us that they are not empowered to make any decision in this matter. Yet this is a problem that requires immediate action on the part of our Government so that we can enjoy the same privileges as Great Britain in any of the countries named above, and all the restrictions now imposed should be forthwith lifted immediately, otherwise we will face a disaster in the way of a food shortage in 1944.

10. We submit some of the latest figures on meat produced in the four countries herein mentioned, and this establishes the fact that there is an adequate supply for the Allied armies, without putting embargoes on, thus restricting our trade relations with these dominions and with Latin America. It is destructive and harmful to the war program.

We estimate that between Australia and New Zealand there will be 350,000 tons of lambs available for export in 1943–44, and we conservatively figure that a hundred thousand tons of these lambs, representing 200,000,000 pounds of lambs, could be made available for shipment early in 1944 to the United States without interfering in the

slightest degree with the armed forces in Australasia, as most of our men prefer beef.

These lambs would arrive in the U. S. A. when our domestic supply from January to May, is practically nil, and would therefore not compete in any way with our own home-grown lambs, and would be helpful in reducing the cost of living throughout the Nation, and thus head off inflation.

11. The Treasury taxes proposed would add to our difficulties, unless relief is given to the importers. Butter is selling in Canada at 35 cents per pound, and the warehouses are filled to capacity. I am reliably informed that over 100,000,000 pounds is at present stored there, whilst our civilian population is without butter in many States.

12. Exports of materials to Mexico, Brazil, and in fact all the Latin-American countries, whether it be steel or any other commodities, has been made so difficult by Government restrictions that all earnings of exporters for 1943 must show considerable decreases, which indicates lower personal and corporation income taxes. This is not due to a lack of materials but is caused by arbitrary Government rulings as to export.

May I say this: During the last 2 years, on account of O. P. A. regulations, it has cost the American exporter, and I am speaking now for the rank and file, 20 to 25 percent to do business, and all the O. P. A. allows the exporter is 6 percent. That is the maximum that he can charge to his clients in South America of any Latin country.

13. I have been engaged in the export and import business since 1912, and during the greater part of this period I have been an individual taxpayer, and the corporation which I am president of, has paid its taxes to date since 1935.

I might say, talking about the Government, I think the Government played fair with the merchant. In 1917, when taxes were at a very low ebb, I paid $12,900 myself. In 1923 they sent me back a check for $3,800. I don't expect anything back during this war.

The CHAIRMAN. I wouldn't advise you to bank on it.

Mr. BENJAMIN. I wouldn't think so, Senator.

14. I have been privileged to appear before your committee in 1929–30; in March 1938; and in June 1939, on hearings relative to imports and exports.

15. Finally, our suggestions are that you, gentlemen, ease restrictions on exports and imports, and thereby increase revenues for our Government from these two fields and, at the same time, decrease the cost of living for 1944, as an effective and proper distribution of imports would lighten the burden of the average family, who are already heavily taxed. Further, we must not permit British control of meat and dairy products in the producing countries mentioned either for the duration of the war or in the post-war period.

I might say, Senator George, that this is the end of my statement, and I would like to call your special attention to an article that appeared in the Journal of Commerce, the 1st of December, showing where our neighbors on the northern front, Canada, hoped to get the jump on us and make a surprise attack on our economic front. If you will read that article, it deals with all the exports after the war is over. They are now preparing their post-war planning to invade the Latin-American countries, because they don't know how they are going to use their people. I say we have got to prepare for this post-war planning. It is a very important thing to help our boys that are

going to be coming from the war fronts. We have got to put them to work. We are fighting this war for a great cause, and I believe all these men should be employed when they come back.

The CHAIRMAN. We thank you very much.

(The papers referred to by the witness are as follows:)

Canada

	Pounds
Production of creamery butter, 1938–42, inclusive:	
1938	267, 347, 271
1939	267, 612, 546
1940	264, 723, 669
1941	285, 848, 196
1942	284, 591, 372
Total production of butter, including farm made:	
1938	358, 357, 271
1939	355, 071, 546
1940	348, 979, 807
Total production of butter, including farm made—Continued.	
1941	368, 644, 196
1942	363, 116, 372
Stocks of butter at Nov. 1, 1943:	
Creamery butter	72, 615, 176
Dairy butter	435, 694

Extract from New Zealand Meat-Producers Board's Twenty-first Annual Report, submitted to the annual meeting held on 25th and 26th of August 1943

[Killings for export at all works during the 1942–43 season commencing Oct. 1, 1942, up to May 29, 1943, are set out below, with figures for the previous season (to May 30, 1942) in parentheses]

Description	North Island		South Island		Total	
Beef (quarters)	460, 093	(472, 850)	9, 605	(5, 129)	469, 698	(477, 989)
Wether mutton (c/cs.)	528, 240	(675, 361)	55, 609	(82, 759)	583, 849	(758, 120)
Ewe mutton (c/cs.)	1, 153, 983	(1, 138, 008)	509, 024	(784, 438)	1, 663, 007	(1, 922, 446)
Lamb (c/cs.)	5, 676, 137	(5, 597, 745)	4, 857, 920	(4, 998, 822)	10, 534, 077	(10, 596, 567)
Pork (porkers) (c/cs.)	88, 666	(190, 459)	3, 067	(3, 530)	91, 733	(195, 989)
Pork (baconers) (c/cs.)	83, 843	(215, 200)	2, 248	(7, 382)	86, 066	(222, 582)
Boneless beef (freight c/cs)	687, 648	(619, 691)	52, 605	(14, 998)	740, 253	(634, 689)
Boneless bobby veal (freight c/cs.)	66, 573		11, 160		77, 733	
Sundries (freight c/cs.)	244, 686	(221, 057)	96, 131	(95, 922)	340, 817	(316, 979)
Total in freight carcasses	6, 905, 150	(7, 388, 434)	3, 491, 246	(3, 834, 557)	10, 396, 396	(11, 222, 991)

Dressed weight on New Zealand: Steers, consisting of 4 quarters of beef, 725 pounds; mutton, 64 to 70 pounds each; lambs, 36 to 40 pounds each.

[Complete statistics of the killings for export for the last 5 years are given below. In reading the figures in the last column, showing the total in 60-pound freight carcasses, it should be borne in mind that the weight in war years has been affected by deboning, etc.]

Season	Quarters—chilled beef	Quarters—frozen beef	Carcasses—wether mutton	Carcasses—ewe mutton	Carcasses—lamb
1937–38	238, 513	160, 243	1, 016, 546	1, 171, 541	9, 166, 771
1938–39	242, 202	173, 000	1, 449, 253	1, 147, 966	9, 783, 308
1939–40		659, 104	1, 302, 028	1, 915, 649	10, 357, 137
1940–41		607, 751	612, 486	1, 563, 325	11, 240, 001
1941–42		600, 425	725, 17[illegible]	1, 962, 280	11, 049, 772

Season	Carcasses—porkers	Carcasses—Baconers (including choppers)	Boneless—beef	Sundries	Total in 60-pound freight carcasses
1937–38	426, 355	228, 865	648, 383	603, 924	10, 307, 851
1938–39	350, 895	189, 581	750, 807	682, 374	11, 092, 420
1939–40	88, 962	341, 928	857, 749	764, 857	12, 973, 167
1940–41	222, 841	292, 118	743, 683	522, 005	12, 332, 827
1941–42	175, 001	190, 054	958, 627	554, 332	12, 194, 843

Dressed weight on New Zealand: Steers, consisting of 4 quarters of beef, 725 pounds; mutton, 64 to 70 pounds each; lambs, 36 to 40 pounds each.

Australia

[All the meat figures exclude the canned meat. Refers to frozen meat, except small quantity chilled included in beef. Information is not complete owing to the fact that figures are not available until a year after the period covered]

STOCK SLAUGHTERING

	1938–39	1939–40
Cattle	3,581,000	3,444,000
Sheep	10,417,000	10,417,000
Lamb	8,453,000	8,589,000
Pigs	1,840,000	1,953,000

EXPORTS, BY CARCASSES[1]

	1939–40	1940–41	1941–42
Lamb	5,593,000	7,459,000	5,132,000
Mutton	1,016,000	410,000	210,000

[1] No details available on beef, veal, or hogs.

	1939–40	1940–41	1941–42
	Pounds	*Pounds*	*Pounds*
Beef, frozen and chilled	274,000,000	195,000,000	116,000,000
Veal	11,000,000	4,000,000	1,000,000
Lamb	201,000,000	220,000,000	164,000,000
Mutton	43,000,000	19,000,000	11,000,000
Pork	52,000,000	75,000,000	34,000,000
Bacon and hams	4,000,000	7,000,000	6,000,000

EDIBLE OFFAL

	Period	Pounds
Add to:		
Beef	1939–40	20,000,000
Sheep	1939–40	4,000,000
Beef	1940–41	15,000,000
Mutton	1940–41	6,000,000
Beef	1941–42	5,000,000
Mutton	1941–42	3,000,000

(Includes all the meat preserved by cold process, and exported, excludes tinned meats.)

Dressed weights, Australian:	*Pounds*
Steers, average	725
Veal	120
Lamb	36
Mutton	50
Pigs	100

TABLE I.—*Argentine livestock census, Sept. 30, 1942*

	Head
Cattle	31,459,500
Sheep and lambs	50,902,430
Pigs	5,707,165

TABLE II.—*Killings*

[Number of heads]

Years and destination	Cattle	Sheep and lambs	Pigs
1939:			
Exports	2, 527, 788	3, 945, 859	250, 836
Home consumption	4, 927, 790	3, 736, 224	905, 661
Total	7, 455, 578	7, 682, 083	1, 156, 497
1940:			
Exports	2, 120, 877	4, 582, 452	169, 186
Home consumption	4, 862, 817	2, 935, 717	1, 007, 283
Total	6, 983, 694	7, 518, 169	1, 176, 469
1941:			
Exports	2, 762, 323	4, 426, 663	850, 389
Home consumption	4, 815, 921	3, 379, 244	1, 176, 956
Total	7, 578, 244	7, 805, 907	1, 727, 345
1942:			
Exports	2, 647, 320	6, 515, 874	905, 830
Home consumption	4, 490, 425	3, 711, 857	1, 435, 716
Total	7, 137, 745	10, 227, 731	2, 391, 546

TABLE III.—*Meat exports*

[Metric tons, 2,204 pounds]

	1939	1940	1941	1942
Frozen beef	464, 074	373, 531	376, 998	351, 184
Frozen mutton and lamb	54, 770	61, 816	49, 844	80, 327
Frozen offals	30, 455	27, 852	28, 620	28, 782
Canned meats	82, 518	79, 907	133, 315	112, 838
Fats and oils	68, 851	152, 421	84, 305	128, 580

Dressed weights, Argentina:	*Pounds*
Steers, average	775/800
Mutton, average	60
Lamb, average	34

Uruguay.—Cattle, sheep, and pig slaughtering

[Covering: 1939; 1940; 1941; 1942 and first 9 months, 1943]

Cattle:	
1939	961, 096
1940	941, 940
1941	994, 859
1942	1, 095, 861
1943 (9 months)	1, 030, 146

Sheep:	
1939	534, 095
1940	435, 107
1941	267, 642
1942	404, 936
1943 (9 months)	972, 454

Pigs:	
1939	54, 527
1940	77, 324
1941	74, 324
1942	62, 895
1943 (9 months)	71, 135

Dressed weights on Uruguayan

	Pounds
Cattle, average	600
Sheep, average	45/50
Lambs, average	34
Pigs, average	80

[From Journal of Commerce, December 1, 1943]

CANADIAN EXPORT DRIVE IMMINENT—MOVE HELD NECESSITATED BY INDUSTRIAL CRISIS WHICH LOOMS

(By Fred D. Fremd)

Canada, faced with a rapidly approaching industrial crisis, is expected in foreign trade circles here to seek a solution in a greatly expanded volume of exports in the near future, it was learned yesterday.

If this development takes place, it is feared, many United States exporters may find anticipated post-war markets already well supplied with Canadian goods. This would be especially true in South Africa and the West Indies, it was pointed out, and American traders, it is known, are looking forward to lucrative business in these areas after the war.

TONNAGE HELD AVAILABLE

Shipping services, with fleets believed to be materially augmented in recent months, have been restored to Canadian ports, it was said. Information as to the exact routes served is withheld for security reasons, but the vessels are being utilized in trades which would expedite enlarged export activity.

Overindustrialized during wartime production drives, Canadian business leaders are currently feeling the impact of both contract cancelations and failures to renew other contracts as they are filled. Unless foreign markets are developed speedily, it was forecast, an industrial unemployment problem of grave proportions is foreseen.

Plant capacity in Canada, it was said, is sufficient to provide for far more than domestic needs. The Government, observers declared, cannot be expected to risk a collapse on the home front by failure to do all in its power to stimulate export sales.

Another factor which will soon aggravate the unemployment problem, it was explained, will be the completion of a program of construction of military camps and other installations. This work is nearly completed now, it has been reported by businessmen returning from Canada, and upward of 100,000 men will be thrown out of work unless provision is made for their employment in industry.

At the same time a large, and in a sense comparatively idle, army is maintained in Canada, partly due to the fact that the Government is restrained from sending all but volunteer units overseas. Support of this army at home is a drain on Canadian finances, it was pointed out, and it was recalled that Canada has expended proportionately very large sums in United Nations mutual aid shipments which are the equivalent of American lend-lease.

POSITION SEEN FAVORABLE

Restrictions on industial production during the war, it was said, have not been as severe in Canada as in some other countries, with the consequence that Canadian industrialists may be in a favorable position to turn to the production of articles which are in demand in foreign markets.

United States factories, on the other hand, are subjected to very tight controls, and the War Production Board is not looked upon as an export-minded organization.

While lend-lease needs are provided for in War Production Board schedules, goods for movement through private trade channels to markets abroad are severely restricted.

Apprehension has been expressed here frequently that War Production Board is not taking the problems of private foreign traders into much consideration in its plans to permit an expansion of production of civilian supplies. In fact, it was said, it is decidedly difficult in many instances to obtain the release of used or excess materials for export.

Consequently, Canada, forced to seek foreign outlets to prevent a domestic crisis, is also prepared to "jump the gun" in reconstructing commercial export trade. Exporters here, in this eventuality, will be called upon to revise their post-war plans accordingly.

Inquiry disclosed that there are no exchange problems which would impede the immediate expansion of Canadian foreign trade as far as is known here.

BOTTOMS MORE PLENTIFUL

The steamship services which are reported ready to provide transportation from ports in Canada, it was said, had been diverted to United States ports during the critical days of submarine warfare, and it is also true that the operators at one time lacked bottoms. Now, however, bottoms are more plentiful, and Canadian shipyards are turning out vessels at a substantial rate.

While a majority of Canadian-built vessels have been transferred to British registry for the duration of the war, it was declared that there is nothing to prevent their operation from Canadian ports. It was recalled also that Canada desires to maintain a thriving merchant fleet after the war, so that there is the possibility that vessels delivered in the future may be retained under Canadian-flag operation.

It is not expected that either the United States or the United Kingdom would fail to cooperate to a considerable extent when and if the home front in Canada becomes especially acute. The Canadian contribution to the war effort has been great, it was pointed out, and the peculiar political situation in Canada is such that a prolonged period of unemployment might result in the rise to power of a government which would be decidedly reluctant to join in plans for world peace.

The French elements of the population, it was pointed out, hold a balance of voting power which has long been of great concern to Canadian political leaders anxious to maintain a policy of international cooperation.

The CHAIRMAN. Mr. Langdale.

STATEMENT OF HARLLEE LANGDALE, REPRESENTING THE AMERICAN TURPENTINE FARMERS ASSOCIATION COOPERATIVE, VALDOSTA, GA.

The CHAIRMAN. This particular proposal you are going to talk about was presented to the Ways and Means Committee?

Mr. LANGDALE. Yes, sir; it was presented to the Ways and Means Committee and it will be presented by Mr. Parker tomorrow, and some of the other group in a little more detail. He represents the committee on timber valuation and taxation.

The CHAIRMAN. All right.

Mr. LANGDALE. Mr. Chairman and gentlemen of the committee, my name is H. Langdale; my home is Valdosta, Ga.

I appear as president of the American Turpentine Farmers Association Cooperative, an association of producers of gum turpentine and gum rosin. The membership of this association produces more than 85 percent of the entire Nation's production of those commodities. Our members are located in the States of South Carolina, Georgia, Florida, Alabama, Mississippi, Louisiana, and Texas.

I wish to discuss the inequalities and discriminations of the present income tax law as applied to the growers, owners, and operators of timber. A timber owner who cuts his own timber, or who disposes of his timber under a timber-cutting contract, does not get the benefit of the capital gains treatment which he would get if he sold his timber outright on the stump.

Gum turpentine and gum rosin, as I am sure most of you know, are produced from living pine trees. The association is therefore an association of timber growers and forest owners. In the course of thinning their stands of turpentine timber and in utilizing the timber after it has been worked out for turpentine, these producers also engage in the production of pulpwood, cross ties, poles, saw timber, and various other forest products.

I am informed that on Friday, December 3, 1943, one or more representatives of the Forest Industries Committee on Timber Valuation and Taxation will appear before this committee. I have seen and studied the text of the statement which Mr. Lowell H. Parker, representing said Committee on Timber Valuation and Taxation, expects to present to the Senate Finance Committee on that day, and I wish to state that the American Turpentine Farmers Association Cooperative fully concurs in the said statement which Mr. Parker informs me he will present to you tomorrow.

I will mention that on October 14, 1943, I appeared before the Committee on Ways and Means of the House of Representatives on this subject of proposed amendment to the capital gains provision of the Revenue Code, and I am now appearing before the Senate Finance Committee to urge the adoption of the said proposed amendment. I find myself in the fortunate and, I imagine, unusual position of asking for a measure of tax relief that will redound to the benefit of the country at large, as well as of the timber growers and forest owners.

In that part of the Southeastern States known as the Turpentine Belt it is no exaggeration to say that the pine tree is the principal crop. It grows in a type of soil unsuited for annual crops, while on that land pine trees grow in profusion, and, were it not for those pine trees, many millions of acres of the land would be a barren waste. The care and cultivation of these trees virtually amounts to a reclamation of that land.

With all that this Government has done to publicize, with funds supplied by this Congress, critical shortages of lumber, pulpwood, gum turpentine, and rosin and other forest products, it would be idle for me to dwell upon those shortages here. If the fact of those shortages be accepted, the essence of my message to this committee is that those shortages have been and will continue to be aggravated by the present discriminatory tax provisions. Similarly, I believe that the modification of those provisions would go far toward releasing a wealth of timber that is now of no immediate benefit to this country or to its owners.

Timber growing is, of course, essentially a long-time enterprise. Even in the Slash Pine Belt, where it grows faster than it does in any other place in this country, the cycle is estimated at 30 to 40 years. Even the most stalwart patriot will hesitate to sacrifice the accumulated product of 30 to 40 years. In the case of annual crops, the producer is able to charge off the expense of his production against current income. Obviously the timber grower is able to do no such thing. A stand of timber of the years must be preserved and protected with an inconsequential return. So, far from producing income, it actually accumulates indebtedness. Upon the ultimate marketing of that timber, the accumulated indebtedness, plus taxes, leaves the producer an empty nothing for his many years of work. Existing provisions virtually force the producer to sell his timber holdings "lock, stock, and barrel" and just as surely prevent his making of his timber holdings the sustained yield project that is the ideal of every conservation program.

It is my sincere belief that the proposed modification will make substantial quantities of badly needed forest products immediately available to the Nation; that it will make for a sound conservation of vital national resources; and, last—and even least, if you please—it

will remove a discriminatory and unjust hardship now resting upon a substantial number of our citizens.

I would like to submit also for the record a letter that was written by a timber grower of my town addressed to the Senator, in which he gives an example of how the tax affects him.

The CHAIRMAN. I recall the letter. You may put it in the record.

(The letter referred to follows:)

VALDOSTA, GA., *November 19, 1945.*

Hon. WALTER F. GEORGE,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: You are aware that timber growers and land owners of the South are asking that profits from the sale of timber held for more than 6 months be considered capital gains for income-tax purposes.

I talked this morning with Wayne Miller of the Forest Farmers Association and also with Mr. Harley Langdale about a tract that I own, and I promised them I would write you the full particulars as to how the tax affects my operations.

I am in the cross tie and lumber brokerage business, and for the past several years I have averaged from this business net profits of around $50,000 a year. I also own 24,000 acres of good timber which I want to harvest and make available for the war effort. This will cut at least 50,000,000 feet of good lumber.

Now consider the way the tax situation will affect any such timber sale. If I cut at the rate of 5,000,000 feet per year, using my own small sawmills, I can easily make a net profit of $10 per thousand board feet, or around $50,000 additional income.

My Federal tax on $50,000 this year	$28,311
Georgia State taxes	2,000
Total income tax	30,311

In other words from my regular business next year I expect to pay $30,311 in income taxes but if I cut 5,000,000 feet of timber, which the Government very much needs and which is ready for harvest, I will make another $50,000 and at the present tax rate my tax picture will be as follows:

Federal taxes on $100,000	$69,641
Georgia State taxes	5,500
Total	75,141
Deducting the tax on first $50,000	30,311
Balance	44,830

I will thus have to pay $44,830 in taxes.

As a consequence of cutting 5,000,000 feet of timber, which the Government needs, my net receipts from this 5,000,000 feet of good saw timber will be only $5,170.

You can readily see that I cannot afford to cut my own timber as it would be destroying my assets without a return to justify. Any accident resulting in litigation might throw the entire operation very far into the red. I have no relief because this timber was purchased several years ago and stands on my books of not more than $2.50 per thousand board feet cost.

I want to get to this point: If the Government desires to encourage production of timber, any profits from sale of timber held more than 6 months should be treated as a long-term capital gain.

I will appreciate your views on this matter, and if possible would like to know whether you think there is a shadow of a chance of getting the situation cleared up in the next tax bill.

Yours very truly,

J. E. MATHIS.

The CHAIRMAN. Your problem is the same as the lumber producers will outline later to us.

Mr. LANGDALE. It is.

The CHAIRMAN. That is to say, in principle, it is the same problem?

Mr. LANGDALE. The same principle, exactly.

The CHAIRMAN. And under the present tax program, the cutting off or the utilization of the timber by the owner over a long period, places him at a very great disadvantage.

Mr. LANGDALE. That is right. In other words, a man that has grown this forest, if he utilizes it himself, cuts it himself, or on some contract basis, he doesn't get the benefit of the capital gains treatment. He can sell it outright and do that. In other words, it is a discrimination against the owner of the forest doing the selecting, the cutting, and having a sustaining yield forest.

The CHAIRMAN. So that it results, where a man has carefully timbered over a long period, and brought it up to the soft state or gum state, he is not going to let that timber go with this discrimination standing against him, because his capital assets would be absorbed by the tax treatment which he receives.

Mr. LANGDALE. Absolutely.

Senator DAVIS. And he is allowed no deduction for expenses of reforestation?

Mr. LANGDALE. That is right. A lot of these forests had no income for many years, and if he had had anything to which he could have charged off back there, he might have done so, but now he owes a big indebtedness, and unless he gets this capital gains treatment he will just be disposing of his assets without any return at all. I know of some cases where if he cuts his timber himself, although it is valuable, the return will not be sufficient to pay the indebtedness, much less leave him anything.

The CHAIRMAN. And the real value of the land in thousands of instances in our area is the timber stand.

Mr. LANGDALE. That is right.

The CHAIRMAN. The land becomes a worthless asset, subject to local taxes; without the timber it really puts the burden on the owner.

Mr. LANGDALE. That is right. We have a large section there that is not good for anything but growing these trees. A lot of our landowners are planting the fields they formerly endeavored to cultivate in trees. I am planting a quarter of a million trees on land that we heretofore tried to grow crops on but couldn't do it profitably.

The CHAIRMAN. Thank you very much.

Mr. LANGDALE. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Blendow.

STATEMENT OF A. W. BLENDOW, REPRESENTING THE ARCADE OWNERS ASSOCIATION

Mr. BLENDOW. Mr. Chairman and gentlemen of the committee: My name is Alfred W. Blendow, president of the Arcade Owners Association, New York City. I am here at the invitation of your committee to represent the association which is national in scope, and to lay before you the opinion and recommendations of our membership with reference to section 3267 as amended by section 617 of the revenue laws of 1942 which refers to the excise tax on coin-operated amusement and gaming devices. The interest of our membership is solely in coin-operated amusement devices, and they have no interest in gaming devices whatsoever.

When section 3267 and its amendment, section 617 became law, it was unfortunate that the penny arcade was not considered as a separate entity.

This section deals with coin-operated amusement devices from the standpoint of individual devices being operated singly in retail establishments. As you gentlemen undoubtedly know, a penny arcade is a business in itself, and we believe should be treated as such. An arcade should not be confused with those who place individual machines with retailers, paying them a percentage of the gross receipts. The Arcade Owners Association defines a penny arcade as a place of business wherein 10 or more coin-operated amusement devices are located, all of the machines in such an establishment being operated as a unit, and played by the public for amusement only—no gambling being permitted.

With this definition of an penny arcade in mind, we recommend that an amendment be added to this section that would apply solely to amusement devices insofar as this tax should apply to penny arcades.

Let me say at this point, that a majority of penny arcades are individually owned and operated by men not subject to the draft, and in these times of stress is usually an individual who does practically all of his own work, and in many instances is assisted by his wife and other available members of his immediate family in the operation of the business. His only source of revenue is the income that he derives from his personal efforts in operating his business.

The CHAIRMAN. How much is the tax?

Mr. BLENDOW. The House made no change in the tax of last year—please we are not asking for a change in the tax.

Senator DAVIS. You want to include certain types of machines?

Mr. BLENDOW. No; we are asking for relief for the seasonal trade, where a man is operating not for the full year, but for only a part of a year.

The CHAIRMAN. It is difficult to see how we could differentiate between one type of machine and another kind.

Mr. BLENDOW. We are not asking for a definition of the machine, Senator. The tax on the machines is $10 per year, per machine. Further a good many penny arcades are today located in cities and towns where no other source of amusement is available to the general public, and civilian war workers. In other instances, penny arcades located near Army and Navy camps are the only source of amusement available to members of our armed forces, and we sincerely believe that our membership and all other operators of penny arcades are more than doing their share in helping maintain the morale of both our civilian population and members of our armed forces. Besides which, the public is able to secure hours of entertainment in penny arcades at a nominal cost to themselves. In other words, gentlemen, a penny arcade is exactly what the name implies—it deals in pennies and offers cheap, clean entertainment to the public.

My reason for appearing before this committee is to ask for some measure of relief for what is commonly known as the seasonal penny arcade. There are well over a thousand such arcades operating throughout the United States who only operate from 3 to 6 months each year. Such arcades are operated in summer resorts, seaside resorts, amusement parks, and picnic groves.

These arcades open their doors for business on Decoration Day, and close immediately after Labor Day. There are also arcade operators who are open for business only during the winter season, located in winter sport centers and southern winter vacation spots

where a good many members of our armed forces are in training. Under the present law, these arcades are compelled to pay a full year's tax on each amusement machine within their place of business. This is obviously unfair to the taxpayer. Under the present tax law he is actually paying a triple or double tax as he only enjoys from one-third to one-half a year's business while being compelled to pay a full year's tax. He is naturally paying more in taxes than the taxpayer who operates his penny arcade 12 months each year.

Our membership does not object to paying taxes—on the contrary, they are all patriotic, reputable American businessmen who are only too glad to bear their just burden of taxes, but they do object to being asked to pay an inequitable tax and in many cases, being forced out of business because of such taxation.

Senator DAVIS. You don't object to the tax on these machines, but you want different treatment given to operators who only operate these machines for certain months of the year.

Mr. BLENDOW. That is correct.

Senator DAVIS. What relief do you ask for?

Mr. BLENDOW. I am coming to that. I would also like to call your attention to the fact that penny arcade operators are also required to bear their share of taxes by the States, counties, and cities in which they operate, and in some cases, are also required to pay a gross business sales tax, which in most instances amounts to 2 percent of their total gross receipts. We ask, therefore, that the present law be amended so that a taxpayer will only pay this tax for the actual length of time he is operating his business. This can be very easily accomplished by merely permitting payment of this tax every 3 months, payable, of course, only when the taxpayer is actually operating his taxable amusement devices. As the fiscal year for payment of this tax begins July 1, it is recommended that if it is the pleasure of this committee to grant our request that this tax for penny arcades be payable every 3 months, that these periods be divided so that the tax may be paid the 1st of July covering the months of July, August, and September; that the second taxable period shall be payable October 1 covering the months of October, November, and December; the third taxable period shall be payable January 1 covering the months of January, February, and March, and that the fourth taxable period be payable April 1 covering the months of April, May, and June.

Senator DAVIS. $2.50 each quarter?

Mr. BLENDOW. That is right. I might interpose here that, taking the New York City arcades that operate in the summertime, they run practically from April through September, so that in this period if they paid their April to September taxes, they would pay 6 months and just cover their period of operation.

Senator DAVIS. I think we see your position and you can just submit the rest of your statement for the record, if you wish.

Mr. BLENDOW. Thank you.

At this point, I would like to call your attention to the fact that most other excise taxes are payable on a monthly basis.

Another factor to be considered in the payment of taxes under the present law whereby this tax is collected for a full year in advance, is the fact that at times a penny arcade operater will open a new business with the thought in mind that he will be successful and finds after several months of operation he was wrong in his assumption and has to close his doors. As I stated before, under the present law.

he has already paid a full year's tax and under the law, he has no recourse nor is he entitled to any refund when he is forced to go out of business for reasons beyond his control.

Let me repeat that a penny arcade is a penny business and when taxes become too heavy, the operator is forced out of business, which is something I am sure you gentlemen would not approve of. A man who is forced out of business does not pay income tax during any period of idleness.

At the conclusion of the 1943 summer season, just passed, quite a few penny arcades located in seaside resorts, particularly in those sections where black-outs have materially hampered the operation of their business, have already gone out of business, finding it impossible to pay this tax for a full year and show a profit.

I am quite sure that your committee is going to grant us some measure of relief so that other penny arcade operators are not forced to make this same decision before the 1944 season opens on Decoration Day.

In conclusion, let me say that we are only asking for a fair adjustment of the coin-operated amusement section of the 1942 Revenue Act so that our membership and other penny-arcade operators may remain in business, pay their just share of taxes, and be able to pay their income taxes at the end of the year.

The CHAIRMAN. Well, sir, we thank you for your appearance.

Mr. BLENDOW. Mr. Chairman, if I might interpose here, Mr. Perry, who was to appear on the calendar with me, evidently could not get here, and he is one of our members who was injured, as I have stated in this brief.

The CHAIRMAN. Has he sent in a brief?

Mr. BLENDOW. I don't believe he has. I will have him do so, if you wish me to.

Senator DAVIS. I suppose he coincides in your view?

Mr. BLENDOW. Yes, sir; he is an actual member who has been injured.

The CHAIRMAN. All right; thank you.

Mr. BLENDOW. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Braunstein.

STATEMENT OF NOAH L. BRAUNSTEIN, REPRESENTING THE CAFE OWNERS GUILD, INC.

The CHAIRMAN. What is this on?

Mr. BRAUNSTEIN. I am a representative of the Cafe Owners Guild, and we are here in connection with the proposed increase in admission tax from 5 to 30 percent.

My name is Noah L. Braunstein. I am a practicing attorney in the city of New York and have been for the past 16 years. I am counsel for Cafe Owners Guild, which is an association comprised of the outstanding theater restaurants in the city of New York, and we have as associates groups throughout the country who are engaged in the general line of business that the members of our association are engaged in.

We are extremely grateful for this opportunity afforded to us to discuss and outline our position with respect to the proposed increase in admissions taxes from 5 to 30 percent as contained in the Revenue

Act of 1943. This bill affects all places that offer any kind of entertainment or music, with food or drink.

At the outset, we are fully cognizant of the fact that our industry might very well be considered a luxury business. However, we believe in times such as the present, our industry offers good amusement and relaxation—a very important factor for morale. The theater restaurant of today is a place where a person is able to see an outstanding show, have dinner, dance, and have a few drinks and obtain real relaxation.

We are likewise very cognizant of the fact that those who are employed by us are engaged in a nonessential industry, and in this connection, a great number of our people currently engaged in night clubs, cabarets, and theater restaurants are also in defense work, and in many instances, working 18 hours a day in order that they may live up to the necessity of essential employment, as so ordered by the Government, and still retaining their night-club engagements with the sincere desire to keep this field of entertainment alive, so that when, God willing, this war is over and victory is ours, that these, our people, will have a live active field of employment to return to.

We believe that the present tax rate of 5 percent should be increased in order to raise additional revenue to aid the war effort and to bring about victory as speedily as possible. But this new tax at 30 percent is most discriminatory and prohibitive, both with respect to the members of our industry and the ultimate consumers who are our patrons.

The theater restaurant industry today is a most substantial industry. The gross income throughout the country is approximately $600,000,000. Many businesses, small business, depend on our industry as suppliers and purveyors. Many people are employed in our industry. More than 70 percent of the members of the American Guild of Variety Artists which represents all the actors and artists of America, which has a membership of 25,000, are employed today in theater restaurants. The actor and performer in theater restaurants are vitally interested in the success and continued operation of these theater restaurants.

The theater restaurant owner has many problems and complex ones today with rationing, shortage of liquor, and the many attempts to make theater restaurants the butt of sensationalism.

If the present portion of the bill, insofar as it affects cabarets or theater restaurants, becomes a law, it will mean the closing of more than 50 percent of these establishments. It is important to bear in mind that under the new law 30 cents on every dollar spent will be added to every check in addition to the tax on distilled spirits that finds its way into the selling price of the whisky that is sold, and in addition to the sales tax which exists in certain cities and States throughout our country.

For a simple illustration of how this proposed admissions tax of 30 percent will work, we may take the case of a couple who partake of a $2 dinner. Their check for the dinner will be $4, plus $1.20 for the proposed 30-percent tax, plus whatever local sales tax might be in effect. It is safe to assume that this patron will never return, where he is compelled to pay a tax of 30 percent. Likewise the man who partakes of drink with his dinner will not only be paying a tax on the dinner and on the total cost of the food and liquor, but will indirectly be paying a tax on the liquor served.

Let us take a look at the record as it now stands on the amount of taxes under the present law, that have been paid and the proposed amount of revenue desired under the new law. An increase of $91,000,000 is now sought, which we respectfully believe is high. All of the proposed increases embodied in the new law are an average increase of 97 percent and yet, theater restaurants or cabarets are singled out to be taxed at this increased rate of 500 percent.

For the period commencing July 1, 1942, and ending June 30, 1943, there was collected throughout the entire country in general admissions taxes in theaters, concerts, prize fights, and cabarets, $154,450,722.80. Of this sum approximately $30,000,000 was collected from theater restaurants based on a 5-percent tax. The report of the Ways and Means Committee of the House of Representatives sets forth that by the proposed increase, the sum of $91,000,000 in additional revenue is sought for cabarets, which would therefore mean that a 15-percent tax would be sufficient to achieve the goal in revenue desired by the Government. However, we still feel that the $91,000,000 sought is excessive.

If the people of the country who frequent theater restaurants, of whom 20 percent are servicemen, are called upon to pay such a tax, they will suffer a great hardship which will unquestionably result in a fall-off of business by reason of such a discriminatory and prohibitive tax. The owners of these establishments and the artists and actors who perform will suffer because, with the fall-off of business, there will be a most general decline of employment in these various establishments throughout the country. Many places in order to avoid payment of the tax will do away with entertainment and music entirely. In some isolated instances throughout the country, types of places will spring up where the only entertainment is a juke box, which places will be dives and hangouts and encourage bootlegging. On the other hand, many places will convert to pure restaurants and no tax at all will be paid, because music and entertainment will be dispensed with. The theater-restaurant industry of today enjoys a fine reputation because of the high standard of entertainment and relaxation they offer, and this proposed tax will only break down that which has been built up through investments of thousands of dollars and hard work.

If more than 50 percent of these places close because of lack of patronage, the doctrine of diminishing return must necessarily be invoked. The very purpose of the proposed tax bill will be defeated by its own terms and in effect we might very well invoke the old adage that the tax bill will "kill the goose that laid the golden egg."

The theater restaurant industry is very proud of its share in the war morale effort. We make mention of this so that the honorable members of this committee might know of the contribution toward the war effort, not only of the owners, but of the actors who are employed in our industry. More than $65,000,000 worth of bonds have been sold throughout the country in the various theater restaurants and purchased by employees and owners. Floor shows are being sent day in and day out to entertain our soldiers at Army camps, naval training stations, canteens, and Army and Navy hospitals.

In closing, if on a 5 percent tax $30,000,000 has been paid into the Government in the last year and $91,000,000 is now sought by increased taxation, the increase of the tax to 30 percent is not a fair and proportionate increase. The added and additional revenue sought

can be realized from a fair tax provided that the members of our industry continue in business, but they will not be able to continue in business if the tax is a prohibitive and discriminatory one.

We favor an increase, but we respectfully ask that the increase be in a proper ratio to the other increases sought in the tax law of an average of 97 percent and in proportion to the taxes received by the Government on the present rate of 5 percent.

The CHAIRMAN. How is this tax paid, Mr. Braunstein?

Mr. BRAUNSTEIN. I will explain it to you. Every restaurant that has any form of entertainment, either music, live, or what we know as juke boxes, and every restaurant that has any form of entertainment, artists or performers, must pay a 5 percent tax today on the total checks of either food or beverages consumed, and since it is an excise tax the owner of the business is authorized to pass it on to the customer. In other words, he can absorb it if he wants to, and he is not charged with any duty of collecting it from the patron, but whether he collects it or not from the patron, he must pay it.

Senator DAVIS. He becomes liable for it.

Mr. BRAUNSTEIN. He becomes liable for it, that is right, but the Government gives him the authority to pass it on to the ultimate consumer, so that if a person enters a place today and there is a charge of $1 or $2 or $5, there is 5 percent added to the check for the Federal Government, and in some States they have also a sales tax.

Senator DAVIS. On the food?

Mr. BRAUNSTEIN. And on the beverages. I know in the city of New York we have heard a lot up there about our 2 percent city sales tax.

In the past fiscal year, in gross admissions, concluded in June of 1943, on all general admissions, received from prize fights, theater tickets and concerts, all types of admissions, including cabarets, there was collected throughout the country $154,454,722.80, of which, on the basis of 5 percent, $30,000,000 was collected from theater restaurants and cabarets throughout the entire country.

Now, the recommendation of the House Ways and Means Committee to the House of Representatives, there they set forth that by this increased taxation of 30 percent they wanted to raise $91,000,000. Now, I most respectfully say to you gentlemen that it is merely a mathematical proposition that, if at 5 percent they collected $30,000,000, where is the justification for saying that they want $90,000,000, and raising the tax 500 percent, to 30 percent?

I say that the $91,000,000 they seek might be excessive, still if they wanted that $91,000,000, there is no necessity for raising the tax to 30 percent.

The CHAIRMAN. Did the Treasury recommend this increase?

Mr. BRAUNSTEIN. The Treasury Department, I might say, asked that they receive $91,000,000 from cabarets. Whether it was in the form of a recommendation or not, I am not in position to tell your honors, but I say this, that the $91,000,000 based on the 5-percent tax today, might be raised, if they raised $30,000,000 on 5 percent—if it is only 15 percent, they will get their $91,000,000.

The CHAIRMAN. Yes, we get your point on that.

Mr. BRAUNSTEIN. Now, with respect to the 500 percent increase of this excise tax. Enumerated in this new House bill there are some 28 excise taxes. If you will look at the schedule, if you won't take my

word for it, the percentages of increase vary from 10 to 500 percent, and the average increase is 97 percent. Yet they single out cabarets and theater restaurants and increase their tax 500 percent.

Now, I say that is most serious, not only to the members who are engaged in the theater restaurant industry, but it is most serious today insofar as the people who frequent those places. If business falls off because of this tax, it would be a very easy thing for some restaurant keepers to put a carpet over what was formerly the dance floor, have no music, no entertainment, and there would be no necessity for any tax, and then there will be no revenue, and the thing that brings the people into these places is the entertainment. People go to theater restaurants for entertainment. If there is no entertainment people won't go there. There will be no tax, there will be no revenue, and if there is no entertainment, then there is another very serious aspect to the problem——

Senator DAVIS. Is dancing to music entertainment?

Mr. BRAUNSTEIN. Yes.

Senator DAVIS. So that if an athletic association had a dance in the hall, there would be another charge?

Mr. BRAUNSTEIN. There would be an admission charge of 10 percent on the tickets. That is not the 5 percent that exists today.

Senator DAVIS. You have no 10-percent charge now?

Mr. BRAUNSTEIN. No, there is a 5-percent charge now.

Senator DAVIS. None to get in?

Mr. BRAUNSTEIN. No, sir.

Now, to the person who frequents one of these places, and I might say to you now I am speaking for the men, the servicemen, of whom 20 percent are our customers today, the serviceman who comes home on a furlough, who wants to take his wife, his sweetheart, or his family out. They go to the place and they have a dinner. Let us assume their check is $5. Thirty percent will be added on that check if they go to a place where there is entertainment, and, after all, they probably do want to go to a place where there is entertainment so that they can relax for that one night.

The same thing applies to a man who goes into a place and merely has dinner with his wife or his sweetheart, and his check is $4. He will be compelled to pay an additional tax of 30 percent on his check for food. Now, the man who has a drink, in addition to the 30 percent tax, will be compelled, indirectly, on the new tax that has been proposed on the sale of distilled spirits, which must go into the price of each drink——

Senator DAVIS. Is that tax deducted from his check?

Mr. BRAUNSTEIN. No, sir; it is not deducted from his check.

Senator DAVIS. In some States it is, on the theory it is double taxation.

Mr. BRAUNSTEIN. It is double taxation in a sense, but if a man doesn't pay it directly, the owners of these places will be compelled to raise the prices in conformity with the tax, so that he will be indirectly paying the tax on the liquor, plus this tax and any sales taxes there may be in any particular locality.

Now, it is a very important thing, as I have stated, so far as the entire industry is concerned. If these places go out of business, there will be no revenue. It will be the old case of the adage that you have heard here since you started these hearings, and I am hesitant to remind you of it—it is the case of killing the goose that lays the golden egg.

The CHAIRMAN. We get your point on it and it looks like it is a rather hard tax. Do you make any suggestion as to what you can pay, what would be a proper tax?

Mr. BRAUNSTEIN. In all fairness, and I have made a research in this industry, I have made a research of this particular law, I believe that if $30,000,000 can be raised in taxes at 5 percent, the $91,000,000 that the Government through the Treasury Department requests today can very easily be raised by a 15-percent tax, yet I believe this is high.

Senator DAVIS. That is a fair trading proposition.

Mr. BRAUNSTEIN. I don't think I could be any fairer than that.

The CHAIRMAN. We thank you.

Mr. BRAUNSTEIN. I have with me here Mr. Seigal, who is president of the joint board of all restaurant and hotel locals in the metropolitan area of New York. He is head of the hotel and restaurant workers, and I would like to present his statement for the record.

The CHAIRMAN. Very well.

STATEMENT OF DAVIS SEIGAL, PRESIDENT, JOINT BOARD, RESTAURANT AND HOTEL LOCALS IN METROPOLITAN NEW YORK

Mr. SEIGAL. I appear in opposition to the proposed increase in amusement taxes as a representative of the workers employed in the restaurant industry.

My opposition stems from the fact that the penalty of such drastic increases as proposed by H.R. 3687 will be the loss of employment to hundreds of these workers.

At the outset, I desire to point out that a majority of the so-called night clubs in New York City are in reality restaurants where food is primary and music and entertainment secondary. Innumerable of such restaurants serve a full course dinner for as little as $1.25. The music and entertainment has served merely as a "loss leader" in most instances to attract diners.

The imposition of the proposed increase indicates that this portion of the food industry thereby affected is hereby divorced from the restaurant industry, that these establishments are no longer restaurants but merely places of entertainment. This is not the fact.

The unions for whom I speak have upward of 12,000 members employed as cooks, chefs, waiters, busboys, bartenders, and captains in these restaurants.

The average wages of these workers are: Waiters, $18 per week; busboys, $20 per week; bartenders, $45 per week; and captains, $40 per week. These wages are standard in the restaurant industry, irrespective of whether music accompanies the meal served. The great majority of these workers are beyond the draft age, and for this reason have been unable to secure employment in war industries where wages are relatively higher. There is no labor shortage in the restaurant industry.

The proposed 30 percent levy will, without question, seriously affect restaurants with entertainment. Any loss of patronage will immediately be reflected in the number of these workers employed, and will inevitably result in the discharge of a considerable number thereof. This will affect their well-being and the living standards of thousands of persons comprising the families of these workers.

These employees are patriotic and have participated fully in the purchase of War bonds amounting to millions of dollars. The unemployment resulting from the enactment of the proposed levy would leave these discharged employees with no alternative but to obtain funds with which to support their families through the medium of War-bond redemptions.

Furthermore, the enactment of the proposed increased levy with its resultant unemployment, would result in a huge loss of income revenue to our Government which would more than offset any increased revenue which may be contemplated by this proposed levy.

That a small group of entertainment-restaurant catering to a select clientele would not perhaps be seriously affected by the enactment of the proposed levy may be conceded. These, however, constitute a very small minority. The overwhelming majority of this type restaurant caters to the large bulk of our population who seek relaxation from the rigors and pace of war work by patronizing such restaurants that can provide relaxation in the form of music, both instrumental and/or vocal.

This type of restaurant which provides entertainment with food for a large number of war workers, as well as thousands of servicemen, has made a forthright contribution to the morale of our people, and should be permitted to continue to so do. The enactment of this prohibitive and confiscatory levy will put an immediate end to this contribution.

It is, therefore, respectfully submitted that the enactment of this proposed increased levy will render the entertainment restaurant inaccessible to the great majority of our people to a point of elimination, thereby affecting the morale and—yes, the health and well-being of these people with its resultant effect on the war effort, so vital to our Nation in these difficult and trying times. The certain result flowing therefrom will be to reduce this large group of Americans working as waiters, waitresses, busboys, bartenders, chefs, cooks, and many others to a deplorable economic state. This is our concern and from this inevitable result stems our opposition.

The CHAIRMAN. Mr. Briggs.

STATEMENT OF CHARLES W. BRIGGS, REPRESENTING THE NATIONAL LUMBER MANUFACTURING ASSOCIATION

Mr. BRIGGS. Mr. Chairman, my name is Charles W. Briggs. I am a practicing attorney in St. Paul, Minn., and a member of the firm of Briggs, Gilbert, Morton & Macartney. Our firm represents many corporations which under section 714 of the Internal Revenue Code take excess-profits-tax credits based on invested capital. Many of these are what may be termed larger corporations using that method. I am making this statement at the request of Mr. A. W. Clapp, vice president of the Weyerhaeuser Timber Co., and on behalf of that company. I would like to file his statement in connection with this subject.

We wish to protest against section 205 of the House revenue bill, amending section 714, which increases the discrimination against the larger corporations with respect to the allowance of the excess-profits credit in computing excess profits. This continued and increasing discrimination is wholly unjustifiable.

Let us look at the history of the invested capital credit.

In the second Revenue Act of 1940, the credit was 8 percent of invested capital for all corporations.

In the 1941 act this was changed to 8 percent of the first $5,000,000 of invested capital and 7 percent of all invested capital over that amount.

In the 1942 act the discrimination was carried further as follows: On the first $5,000,000 of invested capital, 8 percent; on the next $5,000,000 of invested capital, 7 percent; on the next $190,000,000 of invested capital, 6 percent; and on all over $200,000,000 of invested capital, 5 percent.

Now, in section 205 of the pending House bill, the discrimination is increased again as follows: On the first $5,000,000 of invested capital, 8 percent; on the next $5,000,000 of invested capital, 6 percent; on the next $190,000,000 of invested capital, 5 percent; and on all over $200,000,000 of invested capital, 4 percent.

If this discrimination is correct in principle (which we deny) then what is to prevent the unjust result of reducing these percentage rates applicable to corporations having invested capital of more than $5,000,000 so that they would have little or no invested capital credits, thus increasing their excess-profits taxes inordinately and disproportionately out of all reason.

After all, a corporation is but a group of individuals who own the corporation and participate ratably in its profits. The effect of the discrimination we are criticizing falls upon the stockholders because in reality the burden of corporation taxes rests upon them.

The Federal individual income taxes are based on the theory of ability to pay. There is now widespread opinion among economists and tax authorities that taxation of a corporation's income violates that theory and principle. At present there is very burdensome duplicate taxation on corporation earnings. These earnings are taxed heavily in the hands of the corporation; they are again taxed heavily when distributed to the stockholders, according to the progressive rates applicable. Stockholders with substantial incomes now get small returns from corporate earnings after the impact of all the taxes that are levied on them. This in itself distorts the whole principle of ability to pay. There is enough discrimination here without compounding the discrimination against stockholders in the larger corporations by progressively decreasing the percentages of invested capital credits according to mere size of invested capital. There is no more justification in fixing such credits on a progressively decreasing percentage rate basis than in taxing excess corporate profits at progressively increasing rates. In either case, the effect on the stockholder is the same.

Why penalize a stockholder who invests his money in stock of a larger corporation? A dollar invested by him in a corporation with an invested capital of $5,000,000 is no different than a dollar invested in a corporation with a $10,000,000, a $20,000,000, a $100,000,000, or a $300,000,000 invested capital. Is not a stockholder entitled to have a dollar of his invested capital in a corporation earn for the corporation a percentage of return regardless of the size of the corporation? Section 205 of the House bill says "No", when it graduates the rate of excess profits credits based on invested capital downward from 8 percent on $5,000,000 to 6 percent on the next $5,000,000, to 5 percent on the next $190,000,000, and 4 percent on all over

$200,000,000. The House committee's answer is wholly unwarranted.

After all, a $5,000,000 corporation is a large corporation. Its invested capital is no different in essence from that of a $10,000,000 or a $100,000,000 corporation. The stockholders, who in reality bear the brunt of corporate taxation, may be large or small in either; and they may own the same proportions of stock in either.

We represent one corporation with an invested capital of about $90,000,000. Section 205 of the House bill reduces its invested capital credit below that allowed in the 1942 act by $850,000, which in turn, increases the total tax expense by a very large amount. If the 95-percent excess-profits tax rate of 95 percent stays in the bill that increase would be around $700,000 or $800,000. This discriminatory burden is increased again when the stockholders pay individual income taxes on dividends distributed to them. A lot of the stockholders are in the class of small stockholders with a large part of their life savings tied up in the stock. In all of the larger corporations there are thousands of small stockholders. In the case of this one corporation, a timber and lumber company, it is exhausting its trees and paying the enormously high normal, surtax, and excess-profits rates of taxation on the wide difference between the present market value of those trees and the depletion rates. This results in leaving with the company but a small proportion of the gains from the cutting of timber with which to replace that asset.

The discrimination inherent in section 205 we are talking about means that in the cases of two corporations, one having an invested capital of $5,000,000 and another an invested capital of $300,000,000, each having income of 15 percent of its invested capital, the effective rate of the latter's total tax expense on its income is 71.1 percent and that of the former 60.6 percent giving rise to a difference of 10.5 percent, which is a penalty on those who happen to be stockholders in the larger corporation.

The only argument advanced by the Ways and Means Committee for section 205 is that a corporation using the invested capital method of taking its excess-profits credit can plow earnings back into the corporation and thus increase its invested capital, whereas, a corporation using the average earnings basis cannot do so.

This reasoning is unsound for the following reasons:

1. It overlooks the effect of section 102 which furnishes a powerful deterrent to accumulations of currentearnings.

2. It bludgeons unfairly the corporation which actually has distributed its earnings.

3. The remedy does not fit the evil feared by the House committee, if such an evil exists—which we deny. It apparently never occurred to the House committee that if its fears are warranted it could have dealt with corporations of all sizes using the invested capital method by allowing to all a reduced rate such as 4 percent on the part of their invested capital represented by such accumulations.

I might interpolate here to explain what I mean. Suppose a corporation has invested capital of $100,000,000. In 1943 we will say it accumulates earnings of $2,000,000, thus raising its invested capital to $102,000,000. The effect of the House bill would be to reduce the invested-capital credit of that corporation $870,000. Now, by applying this suggestion, if any suggestion should be adopted; that is, applying the 4-percent rate to the amount of accumulated earnings

that have been kept in invested capital, then you would apply 4 percent to the increase of $2,000,000, which would amount to $80,000.

4. A $5,000,000 corporation can plow back earnings just as well as a larger corporation and it is just as likely to do so. But the committee overlooks this and penalizes the larger corporation which may in fact not have increased its invested capital through accumulated earnings at all, or may have so increased its invested capital only to a slight extent.

5. It overlooks the fact that corporations using the average-earnings basis can increase their excess-profits credit by reconstructing their normal earnings in the base period because of abnormalities under relief sections such as section 722.

It is our position that all discrimination arising out of the progressively decreasing rates of excess-profits credits based on mere size of invested capital should be eliminated from the law. If this is not done, then we earnestly ask this committee not to increase the discrimination again by leaving section 205 in the revenue act to be enacted. This section of the House bill should not become law.

The CHAIRMAN. Thank you very much, Mr. Briggs.

Mr. BRIGGS. I appreciate your courtesy very much.

STATEMENT OF A. W. CLAPP, VICE PRESIDENT, WEYERHAEUSER TIMBER CO.

Mr. CLAPP. We protest earnestly against the inclusion of section 205 in the revenue bill as passed by the House and now pending before the committee. The section has to do with excess-profits credit based on invested capital and is in the form of an amendment to section 714 of the Internal Revenue Code. The history of the invested capital credit under section 714 is as follows:

In the second Revenue Act of 1940 (the first one imposing an excess-profits tax of the present series) the credit was 8 percent of invested capital.

In the Revenue Act of 1941 this was changed to 8 percent of the first $5,000,000 invested capital and 7 percent of all over that amount.

In the Revenue Act of 1942 the credit was reduced to: On the first $5,000,000 of invested capital, 8 percent; on the next $5,000,000 of invested capital, 7 percent; on the next $190,000,000 of invested capital, 6 percent; and, on all over $200,000,000 of invested capital, 5 percent.

The effect of the proposed section 205 in the pending bill is to further reduce the rates of credit as follows: On the first $5,000,000 of invested capital, 8 percent; on the next $5,000,000 of invested capital, 6 percent; on the next $190,000,000 of invested capital, 5 percent; and, on all over $200,000,000 of invested capital, 4 percent.

This continued decrease in the amount allowed as a credit for those using the invested capital method constitutes a wholly unjustifiable discrimination against the larger corporations using that method. The effective rate of the excess-profits tax upon net income is substantially larger in the case of all corporations the amount of whose invested capital falls within the last three brackets than in the case of these corporations in the next preceding bracket. This is vividly illustrated by the following comparison between a company (A) with $5,000,000 invested capital and another (B) with $300,000,000 invested capital; each company has an income equal to 15 percent of

its invested capital—that is, A has an income of $750,000 and B an income of $45,000,000. Applying the credit rates and the new excess-profits tax rate as proposed in the House bill, the effective credit rate in the case of A is 8 percent on invested capital and that of B is 4.73 percent. Solely because of this difference in the effective rates of credit on invested capital the effective rate of A's total tax expense, including excess-profits tax, normal and surtax, after post-war refund, is 60.6 percent and that of B is 71.1 percent, a difference of 10.5 percent.

In the illustration given, corporation A is not a small corporation. All that you can say about that is that it is not as large as corporation B.

Corporations are nothing but groups of individuals—their stockholders. Whenever there is tax discrimination based only on size, the actual discrimination is against the stockholders in the larger corporations, because, realistically, the burden of corporation taxes falls upon the stockholder. Taxation of a corporation's income violates the principle of taxing according to ability to pay. That has been pointed out many times by eminent economists testifying before the House Ways and Means Committee and before this committee. We realize that the collection of a large part of our taxes from corporations has become so imbedded in our tax system that it is probably impractible to make any change. However, there is no reason whatsoever for Congress to further distort the equities of those who bear the burden of taxes by taxing bigness (of corporations) itself.

It is one thing that a stockholder owning, say, 100 shares of a corporation should be (indirectly) taxed upon his share of the corporation's profits (which may be $500) at exactly the same rate as the owner of 10,000 shares in the same corporation whose share of the profits would be $50,000. That is the result of any tax on corporations, and if justifiable at all is justified by convenience and certainty of collection. But it is quite another thing to provide, without the slightest necessity related to either the raising of adequate revenue or simplicity and certainty in the method of doing so, that a taxpayer who owns 25 or 100 shares in one of the largest corporations should be compelled to bear the burden of a higher rate on his share of its profits than a taxpayer owning the same number of shares in a smaller corporation which actually earns the same rate on its invested capital as the larger corporation.

We think it is about time that Congress recognized the fact that there are millions of investors in equity stocks, most of them in the largest corporations; and that it is not true that our large corporations are composed exclusively, or even largely, of a group of wealthy stockholders and the medium sized and small corporations exclusively of stockholders in the lower-income brackets.

It is said that there are 11,000,000 stockholders in American corporations. Treasury Department data show that at least 36 percent of all dividends paid by corporations are received by those with net incomes of less than $6,000, and at least 67 percent by those with net incomes under $10,000.

Consider, also, the following statistics (compiled as of December 31, 1937, all from Investigation of Concentration of Economic Power, Temporary National Economic Committee, monograph 29):

In the 200 largest nonfinancial corporations in the country there were 948,717,572 shares of common (equity) stock outstanding.

These were held in 7,026,793 shareholdings which averaged only 135 shares per holding.

Of the total of 7,026,793 shareholdings in these 200 corporations 6,689,235 or 95.2 percent had a market value of less than $10,000 each. The average annual income from holdings of $10,000 would probably not exceed $600.

It is apparent that these small shareholdings are those of individuals in the lower and lower-middle income brackets. We know of no statistics with reference to the size of average shareholdings in all corporations, but I think it can be said with confidence that there is no such proportion of small shareholdings as above mentioned in medium sized or even smaller corporations. The fact is that many millions of our people, desiring to invest part of their money in equity stocks, naturally go to the stock market to buy, and, quite as naturally, invest in the better-known stocks. Of the 200 corporations referred to above the common stock of all but 21 are listed on a national exchange. Now these small investors in the large corporation have committed no crime for which they should be penalized. And yet such a stockholder is just as surely discriminated against and penalized by indirect diminution of his income as if he were directly taxed more heavily than a stockholder in a smaller corporation the rate of whose net income (before taxes) to invested capital is exactly the same.

What has been said so far constitutes an objection to any discrimination against the larger as compared with the (only comparatively) smaller corporation. The small corporation—small business—is amply favored by variance in rate of normal, surtax, and excess-profits taxes and by the specific excess-profits exemption. The rate of exemption for corporations using the invested capital method, other than those so considered and favored as small, should never have been changed as it was in 1941 and 1942. The discrimination is as direct and as distinct as would be graduated excess-profits tax rates—a graduation based not upon the extent to which profits are excessive, but the mere size of the corporation. Instead of increasing the discrimination, it should be removed.

The only reason for section 205 given by the Ways and Means Committee in its report is as follows:

> However, there is a change which we believe should be made at this time. Under the invested capital method, corporations are permitted to increase thir invested capital by plowing back into the business earnings which have not been subject to taxation in the hands of the individual shareholder. However, corporations using the average earnings method are not permitted to increase their earnings base by plowing back into the corporation profits which have not been subject to taxation in the hands of the shareholders.
>
> Earnings after January 1, 1939, are not permitted under the Canadian law to increase the invested capital of the corporation until they have been capitalized by being subject to taxation in the hands of the individual shareholder. The reason for such a rule was very obvious, for otherwise a company would stop paying dividends and leave its profits in the business in order to obtain the additional invested capital credit. Moreover, the Government would lose not only excess-profits taxes but also individual income taxes from the individual shareholder. In view of this obvious advantage of the invested capital method over the average earnings method, it does not seem unreasonable further to reduce the invested capital credit, particularly with respect to capital in excess of $5,000,000.

The committee fails to point out that while the average earnings credit of corporations using that method has not been reduced since 1940 (on the contrary it has been somewhat liberalized), the effective exemption rate on invested capital has been already reduced from 8

percent, in the case of a corporation: With $10,000,000 invested capital to 7.5 percent; with $50,000,000 invested capital to 6.3 percent, with $200,000,000 invested capital to 6.075 percent, and, with $500,000,000 invested capital to 5.43 percent.

The Ways and Means Committee seemed to be concerned by a fear that the allowance as invested capital of earnings plowed back into the business affords a reason (in addition to legitimate business reasons) for nondistribution of earnings. In the first place they seemed to forgot that section 102, Internal Revenue Code, still penalizes severely improper accumulation of current earnings. In the next place, if there had been any necessity for correction of the tendency which the committee feared, why was a bludgeon used which does not reach the evil (if there is one) but severely penalizes the corporation which has made distribution—has not plowed its earnings back into the business? Seemingly it did not occur to the committee that it might have disallowed such accumulations as invested capital to all corporations using the invested capital method, irrespective of size, or allowed to all a reduced rate such as 4 percent on the part of their invested capital represented by such accumulations.

The effect of section 205 on our own company will illustrate the injustice and inequity which will result. Our 1942 invested capital was almost exactly $90,000,000. Section 205 would, therefore, reduce our exemption almost exactly $850,000. Such a reduction in exemption has exactly the same effect upon our tax liability as a reduction in invested capital of $14,066,667. In 1941 our dividends ($9,000,000) exceeded profits after taxes by $458,000; in 1942 dividends ($6,000,000) were $2,259,000 less than profits after taxes (and after renegotiation). Our distribution record for the 2 years has resulted in an increase in invested capital of $1,801,000, approximately 2 percent of our original invested capital, but we are to be taxed as though we had plowed back into the business $14,066,667—approximately eight times as much, or 15 percent, of the original invested capital.

We do not know that the present reason given by the Ways and Means Committee for the proposal to increase the discrimination between the larger corporations and the (comparatively only) smaller corporations has heretofore been advanced to justify the previous progressive discriminatory reductions in invested capital credit. It might be well to point out that under present law reductions from the 1940 law in exemption rates has in the case of our company been equivalent to a reduction in invested capital of approximately $16,500,000 or 18.4 percent, and that the reductions in exemption rates as provided in section 205 added to previous reductions are equivalent to a total reduction in invested capital of approximately $25,000,000 or 27.8 percent.

Now it may be that there are corporations which have plowed back substantial sums in 1941 and 1942 which have increased their invested capital. Certainly that is just as likely in the case of a $5,000,000 corporation, which we repeat is not a small corporation, as in the case of a larger corporation, and yet the Ways and Means Committee ignores that, and, ignoring it, again proposes a wholly unjust and discriminatory plan based on size alone, and one which penalizes the saint to reach the sinner.

The statistics we have presented with respect to the measure of increase in invested capital of our company occasioned by retention of earnings are illustrative. We are quite certain that there are many

of the larger corporations of which our situation would be typical. We are, of course, unfortunately unable to present any all-inclusive corporation picture. We do find statistics assembled by the National Association of Manufacturers for 2,040 corporations having in 1940 capital stock and surplus of $16,935,734,000, and they increased their capital and surplus by the end of 1942 to $18,444,751,000, or a total increase of 8.9 percent. This increase, however, includes not only increase by reason of retained earnings, but new capital which is allowed as increase of invested captial both for those corporations using the income Wethod as well as those using the invested capital method. As the average capital and surplus of these 2,040 corporations was approximately 8½ million dollars it is apparent that there were many large corporations included in the list.

It is not entirely accurate to say that corporations using the average earnings method are not permitted to take into account earnings plowed back by them in their business. In cases where very substantial amounts of undistributed earnings have been by corporations of that class used to build up their facilities and their productive capacity, such corporations would be entitled to relief under the relief sections of the law.

In conclusion, if it could be demonstrated that there are individual cases of the larger corporations who have built up their invested capital by plowing back undistributed earnings to such a vast extent that some discrimination exists between them and corporations using the average-earnings method (and we cannot admit that a discrimination still exists after the previous reductions in the invested capital credit), the Ways and Means Committee has gone about a correction of the situation by a method which is wholly inequitable, unjust, and discriminatory as between corporations using the invested-capital method. The method not only continues and perpetuates the injustice of distinction based upon size of corporations, but it penalizes most severely those corporations which have not indulged in the practice of withholding earnings from distribution. Such discrimination and penalty is wholly unnecessary because if any remedy is necessary it would be perfectly simple to apply it in such a manner as to reach only those who have failed to distribute, and penalize them only to the extent that they have so failed.

The CHAIRMAN. Mr. Karpess.

STATEMENT OF LAZAR KARPESS

The CHAIRMAN. There is nothing in the bill that you are speaking to?

Mr. KARPESS. No, sir.

The CHAIRMAN. You are afraid there will be?

Mr. KARPESS. I am going to be perhaps the most unpopular person today, Mr. Chairman and members of the committee, because I come here to ask for a new tax.

I just want to point out that the new bill proposed by the House covering increases mostly in excise taxes for 1944 does not include a provision for raising new revenues of about $250,000,000, as I estimate them, from a tax that is very easy to administer, quite inexpensive to collect, a Federal check tax.

I think the record will point out that a similar tax was in effect during the First World War.

The CHAIRMAN. Yes.

Mr. KARPESS. And also from 1932 through January 1, 1935. It seems ironic that such an excise tax has been overlooked at this time when, according to Federal Reserve System's estimates recently published, the amount of money which will change hands in the United States by check in 1943 is expected to total well in excess of one trillion dollars, one thousand billion dollars, the highest level since 1928.

In 1934, the last year that the Federal check tax was in effect, the Federal Reserve System reports that a check tax was paid on approximately 2,115,000,000 checks at the rate of 2 cents, or a yield, comparatively small, but nevertheless amounting to $42,000,000.

Today, with the greatest volume of commercial and personal checking accounts and activities in the history of our country, nothing is being done to reinstate this painless excise tax which for some strange reason existed during the depression years through 1934.

I estimate that a provision for the adoption of a Federal check tax at a level rate of 5 cents per item in 1944, when the bank deposits will be the greatest in our history, should yield approximately $250,000,000, based on the assumption that 5,000,000,000 checks will be exchanged in 1944.

Senator WALSH. What is the rate of your tax?

Mr. KARPESS. Five cents, either a level rate or a progressive rate. In 1934 the Federal Reserve system reports, I repeat, that 2,115,000,000 checks were exchanged.

Senator DAVIS. Yes, we get that.

Mr. KARPESS. Yet the total amount involved did not reach one trillion dollars, as it will this year, and no doubt next year, from the activity as great as it is in checking accounts. Therefore, I recommend that at least for the duration of the war and possibly, if necessary, for the first stages of the post-war era, we enact this tax, since it is very inexpensive to collect and easy to administer, just as it was in the years 1932 through 1934, and 1917 through 1920.

The CHAIRMAN. We thank you for your appearance.

Mr. KARPESS. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Foreman.

STATEMENT OF H. E. FOREMAN, REPRESENTING THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

Mr. FOREMAN. My name is H. E. Foreman, managing director, Associated General Contractors of America.

This statement is made in behalf of the Associated General Contractors of America, representing general contractors who perform construction contracts of all kinds. The association's membership of more than 3,000 firms has performed by far the greater part of the war construction program executed by contract not only in this country but in our outlying bases and in foreign lands. The purpose of this appearance is to discuss title VII of H. R. 3687, that title being an amendment to the renegotiation of contracts law.

On September 21, the association testified before the House Ways and Means Committee with respect to the renegotiation law as now in effect and made certain recommendations with respect to it. As that testimony is already available to the committee, there is no need to repeat it, but it is desired to again affirm the comments made

therein. The testimony to be given now is, therefore, supplementary to this previous statement and is made in view of the proposed amendments now passed by the House. This testimony is with respect to the renegotiation of construction contracts, as it is in this field alone that the association has first-hand information.

When the law was first proposed, it was urged strongly that it was needed as a curb on inflation; that the tax law did not operate soon enough; that one of the principal purposes of the renegotiation law would be defeated unless it were possible to adjust prices in the midst of a contract, the new prices to apply on future products. It is entirely possible that this could be done on some types of contract, but the fact remains that it has not been done on construction contracts, and this is necessarily so because it is not possible to ascertain whether a construction contract will be a profitable or a losing venture until all of it has been completed.

At the present time, contractors are rapidly completing their assignments in connection with the war effort, yet as of this date only contracts completed within 1942 are under renegotiation; 1942 business is not yet being surveyed and renegotiated, but certainly the tax law is operating and has been draining off excess profits from 1942 business. Therefore, any validity which attached to the argument that the tax law was too slow is certainly not applicable when applied to the construction industry, as the tax law is operating infinitely faster than the renegotiation procedure.

Note has been taken that the proposed Revenue Act of 1943 would increase the top tax bracket from 90 to 95 percent. Thus the proposal is to cut in half the latitude within which the renegotiation law can operate. We regret exceedingly that we have no way of knowing how much has been recovered from construction contracts as a result of renegotiation, but it would be extremely interesting to know how much more was obtained considering the operation of the renegotiation law and the tax law together as compared with the operation of the revenue law alone.

In other words, the net income gain to the Government by reason of the operation of the renegotiation law. We do know, however, that the contractors of this Nation are being put to substantial expense and that the Government is itself making substantial expenditures in administering the law.

Even though a given contract may not show excessive profits, the fact is that the contractor is called upon to prepare detailed records and caused to attend conferences at considerable distance from his place of operation, which means that he is incurring expenses which are deductible as business expenses and will result in a decrease in the tax that he would otherwise pay.

Furthermore, the development of these records and the time spent in the various operations requires the expenditure of manpower when this is at a premium.

Thus we have a situation that the tax law is operating faster than the renegotiation law in the construction field, thereby presenting an open question as to the net result to the Government irrespective of the problem that is presented to the construction contractor.

One year ago, this association recommended that if it was determined that the law must be retained, exemption be granted to fee contracts as the fee is fixed and the income to the contractor is known from

the very beginning, and also that contracts obtained as a result of competitive bidding should likewise be exempt.

The same recommendation was repeated to the Ways and Means Committee of the House and is emphasized here again.

Previous to the time that the language of the present bill was known, a statement was issued by the subcommittee of the Committee on Ways and Means setting forth an outline of the intended contents of title VII which are, in general, designed to be remedial to the present statute. It is sincerely to be hoped that the result is remedial and would correct some of the inequities to which Government contractors are now exposed. It is difficult to be certain that this is being accomplished, as the proposed amendments cover 30 pages in the bill and a careful study leaves one considerably confused as to the net result. The fact that the committee labored for 30 pages is indication of the extreme difficulty, if not impossibility, of administering such a piece of legislation justly and equitably under circumstances that vary extremely.

It is noted that provision is made in the House bill for an appeal both to a newly created over-all board and also to the Board of Tax Appeals. It is believed that this should have a salutary effect upon all those administering the law.

A further definition of the term "excessive profits" and a statement of the factors to be considered in determining them should be helpful. It is hoped, however, that the establishment of the one super board will not result in inflexible regulations, as we have found that it is highly essential that boards handling construction contracts be in a position to draw regulations suitable to the construction industry which are in many instances substantially different than those necessary in other industries.

We note also that in the outline released by the Ways and Means Committee it lists as one of the main features that the amendments would require the computation of profits in the same manner as for income-tax purposes including amortization. This would seem to imply in handling the renegotiation that it would necessarily have to be done on an over-all basis. If this is the case, it should be changed, as in the case of construction contracts it is desirable to handle the renegotiation on an individual contract or group of contracts basis rather than on the over-all basis and to develop the gross profits under the single contract or group of contracts rather than the net profits as are developed under the income-tax laws.

As heretofore stated, the construction industry is finishing its job building the Nation's war plant. It is now seeking markets in lines of production in connection with the war effort and it is hopeful that some other lines of construction will shortly be eased and permitted to go ahead. Construction is rapidly tapering off and is entering a period where it must carry along at a low volume and endeavor to maintain itself in a proper condition to serve the Nation when hostilities cease. Firms are already drawing upon such meager reserves as they may have, as most of such reserves were readily invested at the start of the emergency in order to have the equipment available to accomplish the results that are now in being.

Tax laws are already operating extremely harshly, particularly with respect to individuals. It is high time that there be a careful appraisal of the net result of the operation of this law, both financially

and morally. The House bill calls for the renegotiation provision to be dropped on contracts awarded after the cessation of hostilities. We urge that a definite date be fixed and that contracts awarded thereafter not be subject to the law. We believe that this could well be January 1, 1943, as competition has been fully established throughout this year.

Senator WALSH. Is competitive construction being carried on by the Army and Navy now?

Mr. FOREMAN. Yes, sir. The Navy switched over to the lump-sum proposition within the last 3 or 4 months. The Army has been on a competitive basis for, I would say, a year and a half.

Senator WALSH. All the earlier contracts were negotiated contracts?

Mr. FOREMAN. They were on a fee basis, fixed fee, and the amount the contractor was to get was known from the very beginning.

Senator WALSH. Yes; and there were charges that the prices on lumber and materials were padded.

Mr. FOREMAN. That had nothing to do with the price the contractor got.

Senator GUFFEY. Wasn't there a sliding fee?

Mr. FOREMAN. No, sir.

Senator GUFFEY. The Maritime Commission had a sliding fee, and I had the notion that both the Army and Navy had a sliding fee, in other words, giving the contractor some benefit for completing the work for less than it was estimated, and charging him, within certain limits, if he didn't.

Mr. FOREMAN. There is a misconception on that point. I am very glad that this has come up, because the laws very definitely state that the construction contracts must be on a fixed-fee basis and there is no variation for any reason, except that the size of the contract might be changed.

Senator GUFFEY. The maritime range was within, I think, six or 7 or 8 percent. I haven't the exact figures. In other words, it was a definite fee of 4 or 5 percent and that was increased or decreased according to whether the contract cost more or less than the amount that was estimated.

Mr. FOREMAN. That is not the case in construction. You are talking about ships, while I am talking about construction of the facilities, the shipyards and things of that kind.

Senator WALSH. In the last 3 months, practically all of your contracts are competitive?

Mr. FOREMAN. That is right.

Senator WALSH. But previous to that it was a fixed fee?

Mr. FOREMAN. Not to exceed 6 percent.

Senator GUFFEY. And was that varied according to whether it cost more or less than was estimated?

Senator WALSH. It was fixed, and as an inducement to complete the contract at less than the estimated amount, if the contractor was able to show a saving to the Government below a certain amount, he would get a higher fee.

Mr. FOREMAN. That might be in ships, but I don't have the understanding that it applied on any of the actual construction contracts other than ships. I don't know what the situation is in ships. I am not speaking of shipbuilders, but in the construction of the facilities, the airports and that sort of thing—that is what I am talking about.

Senator GUFFEY. Isn't it natural to offer some inducement to the contractor to do the work at less than contemplated?

Mr. FOREMAN. The estimates were made by the Government departments.

Senator GUFFEY. But even then there should be some range of discretion. It would seem to me very desirable that there should be some inducement and possibly something in the nature of a penalty if the work is not completed on that basis. Certainly, the Maritime Commission has found it very helpful.

Senator WALSH. Of course, in the beginning there was a shortage of material and shortage of labor, and they went out everywhere and bought up all the materials and supplies they could and paid any price at all, and because of that there was this charge of big profits and big fees.

Mr. FOREMAN. I would like to point out that you had testimony here from some of the Government departments that early estimates for Army camps and that sort of thing were based on a wholly inadequate amount of $400 per man. That is what the fees were fixed on. If they wanted a ten thousand-man camp, they multiplied $400 by 10,000 and set the fee on that basis, and it couldn't possibly be built at that figure. They admitted that later. The fee was fixed based on that, and perhaps it was adjudged to be 4 percent, whereas it actually worked out at 1¼ percent. We have had plenty of situations of that kind.

The CHAIRMAN. We thank you very much.

Mr. Rice.

STATEMENT OF MILLARD W. RICE, REPRESENTING THE DISABLED AMERICAN VETERANS

Mr. RICE. I appear before you, Mr. Chairman and gentlemen of the committee, on two propositions of a great deal of interest to the disabled American veterans. I have previously appeared before this committee on behalf of less fortunate disabled veterans and their dependents, but on this occasion I must appear before you on behalf of our congressionally chartered organization, the D. A. V., which is composed exclusively of service-connected wounded and disabled veterans. Our ability to continue to render needed service to disabled veterans is threatened by some of the provisions of this bill.

May I first insert in the record a statement from the Deputy Commissioner of the Internal Revenue Department, setting forth the fact that our organization and our service foundation is exempt from any income tax and that donations to it by individuals may be deducted from their income in determining net income for income-tax purposes.

The CHAIRMAN. Yes, sir; you may insert it.

(The document referred to is as follows:)

MARCH 19, 1943.

DISABLED AMERICAN VETERANS SERVICE FOUNDATION,
Care of Millard W. Rice, Executive Secretary,
Walnut Hills, Cincinnati, Ohio.

SIRS: It is the opinion of this office, based upon the evidence presented, that you are exempt from Federal income tax under the provisions of section 101 (8) of the Internal Revenue Code and corresponding provisions of prior revenue acts.

Accordingly, you will not be required to file returns of income unless you change the character of your organization, the purposes for which you were

organized, or your method of operation. Any such changes should be reported immediately to the collector of internal revenues for your district in order that their effect upon your exempt status may be determined.

Since any organization which is exempt from Federal income tax under the provisions of section 101 of the Internal Revenue Code also is exempt from the capital-stock tax pursuant to the express provisions of section 1201 (a) (1) of the Internal Revenue Code, you will not be required to file capital-stock tax returns for future years so long as the exemption from income tax is effective.

You will be required, however, to file annually, beginning with your current accounting periods, an information return on Form 990 with the collector of internal revenue for your district so long as this exemption remains in effect. This form may be obtained from the collector and is required to be filed on or before the 15th day of the fifth month following the close of your annual accounting period.

Contributions made to you are deductible by the donors in arriving at their taxable net income in the manner and to the extent provided by section 23 (o) (4) of the Internal Revenue Code and corresponding provisions of prior revenue acts.

The collector of internal revenue for your district is being advised of this action.

Bureau letter dated January 12, 1943, is hereby revoked.

By direction of the Commissioner.

Respectfully,

T. MOONEY, *Deputy Commissioner.*

Mr. RICE. I call your attention to the contents of that letter to show that there is no similar specific provision as to the donations made by corporations to veteran organizations or to one of their service foundations or trusts. On the basis of the recent interpretation by the Collector of Internal Revenue, various veteran organizations and their local units have found they can not be the recipients of donations that corporations have had in mind, because of the fact that such corporations can not be privileged to deduct such donations from their income, up to 5 percent thereof, in determining net income for Federal income tax purposes.

I believe that this must have been an oversight on the part of Congress. It is something that we had not previously noted, and I believe that the committee would be agreeable to the Internal Revenue Act being so amended as to make veteran organizations, and their respective posts and auxiliaries and trust funds and foundations, eligible for the same exemptions as to donations made by corporations as has previously been provided for as to the donations made by individuals to such similar organizations.

To that end, I propose that there should be an appropriate section, probably to be called section 505 of this bill, which would read about as follows:

That section 23, paragraph (q) (2) of the Internal Revenue Act, be amended by adding the words "veteran rehabilitation service" after the words "scientific, literary," and preceding the words "or educational purposes," and also that another paragraph to be known as section 23 (q) (3) be added, to read as follows:

"Post or organizations of war veterans or auxiliary units of, or trusts or foundations for, any such posts or organizations, if such posts, organizations, units, trusts, foundations or societies are organized in the United States or any of its possessions, and if no part of their net earnings inure to the benefit of any private shareholder or individual."

Such amendments, gentlemen, would make it possible for corporations to make donations to veteran organizations, and to their auxiliary units and trusts and foundations, on the same basis as individuals are now privileged to do, and to consider such donations as deductible in determining their net income for Federal income-tax purposes. I sincerely hope the Committee can see its way clear to inserting such amendments.

Another matter of equal importance to our organization, which threatens to make it impossible for us to continue to maintain our Nation-wide set-up of national service officers, is in the postal rates concerning third-class mail.

May I preface that by stating that in spite of the fact that we have a comparatively small organization of disabled veterans, we have for many years been maintaining the largest staff of full-time service officers of any veteran organization—in most of the regional offices of the Veterans' Administration—to advise, assist, and counsel disabled veterans in the technical prosecution of their equitable claims for compensation, pension, disability allowance, hospitalization, medical treatment, vocational rehabilitation, or domiciliary care, and so forth.

We have been able to maintain these national service officers through our national organization by reason, partly, of the service fees collected from our own members, and partly by reason of various kinds of finance projects.

About 2 years ago, we were fortunate in discovering a finance project that renders a splendid service to the public and at the same time gives us a small margin of profit which has enabled us further to expand our national service set-up—not to the extent that it needs to be expanded as yet, but a considerable expansion—and we were very hopeful that on the basis of improved conditions next year, there might be such a further expansion of the opportunities under such finance project as would enable us much to expand our present service set-up. I refer to the fact that our organization has, during the last 2 years, been sending out to the public so-called unordered merchandise, consisting of identotags, or miniature automobile license plates, to be attached to key rings.

Perhaps you all have received one. This is sent out under third-class permit-mail on a cost basis, and, therefore, retention of the present third-class postage rate is a very important item in determining whether or not we are going to be able to continue this finance project.

We are able to send these identotags out on a mass-production basis at the cost of $62.50 per thousand using third-class postage, necessitating a 25 percent return to break even on the first cost, without considering other incidental costs. If the third-class postage be increased from 1 cent up to 2 cents, that cost will be increased from $62.50 to $72.50 per 1,000 identotags sent out, necessitating a 29 percent return to break even. The average return—and mind you, this is unordered merchandise, and we solicit 25 cents for each identotag to be returned—is $75 per 1,000 sent out, on the basis of an average of 30 percent of return of the solicited quarters. That gives us a margin of average profit of only about $12.50 per thousand, which would give us a total net of $125,000 on the basis of 10,000,000 identotags being sent out.

We were not able to send out that number this year because of shortage of steel and plastics, but we have anticipated being able to to send out about sixteen or eighteen million such identotags next year. An increase in the third-class postage from 1 cent to 2 cents would mean an increased cost to us of between $160,000 to $180,000, which would absorb practically all of the net profits on the basis of past averages, and if the percentage of return should go down just a little bit, we would have all profit wiped out, because there is also a cost in opening the envelopes and counting the money. Therefore, it

is highly important to us that the third-class postage rate should remain as is—and this matter is also of great importance to other service outfits—but if the committee feels that it must concur with the House amendment, then we pray that the Senate at least provide an additional amendment to section 403 of H. R. 3687, as follows:

Provided, however, That this increase shall not be applicable as to any third-class mail sent out by any nonprofit organization or corporation that is exempted from Federal income tax.

I submit to the committee a list of the national service officers that are now being maintained by our organization, largely out of the profits from our ident-o-tag project during the last 2 years which would be impossible if the cost of third-class postage is increased.

Incidentally, may I say that this project is very desirable for the public for it really provides a saving of critical material, because we return about 200 sets of lost keys each week by reason of our ident-o-tag insurance. If this third-class postage as to our project were to be increased, we fear it might make such project prohibitive, as a consequence of which we might have to discontinue many of our service officers, with the result that we would not be able to render the service to disabled veterans that they so seriously need after they return from service in this war.

We hope the committee can see its way clear to adopting these three proposed amendments.

(The paper referred to is as follows:)

DISABLED AMERICAN VETERANS, NATIONAL SERVICE DEPARTMENT, WASHINGTON, D. C.

National Service Director, Millard W. Rice.
Assistant National Service Director, Thomas J. Kehoe.
National Service Bureau: John N. Egense, Kenneth C. Bradley, William E. Tate, Earl G. Hendrick.

NATIONAL SERVICE OFFICERS

Alabama.—William M. Weston, S. S. O., William G. Hayslett, S. S. O., P. O. Box 1509, Montgomery; G. C. Boner, 400 Barley Building, Birmingham.

Arizona.—C. C. Bierman,[1] Veterans' Administration facility, Tucson; Edward R. Page (D), Veterans' Administration facility, Tucson; B. B. Shimonowsky, S. S. O., State Office Building, Phoenix.

Arkansas.—Byron A. Brooks, S. S. O., Carl L. Thompson, S. S. O., Joe L. Hearne, S. S. O., Arkansas Service Bureau, Little Rock.

California.—H. Earl Pinney,[1] Veterans' Administration facility, Los Angeles 25; J. Earl Merifield (C), Veterans' Administration facility, Los Angeles 25; James M. Carlsen (C), Municipal Auditorium, Riverside; George J. Kelly,[1] Veterans' Administration facility, San Francisco 21.

Colorado.—Brian J. Thornton,[1] Franklin A. Thayer, Old Customshouse, Denver 2; Goddard Shackelford, S. S. O., 337 State Office Building, Denver 2.

Connecticut.—Edward W. Kelley,[1] Veterans' Administration facility, Newington.

District of Columbia.—Earl G. Hendrick,[1] 156 Arlington Building, Washington.

Florida.—B. Y. Palmer,[1] 1000 Seventh Avenue, South, St. Petersburg; John Falkenburry, S. S. O., Veterans' Administration facility, Bay Pines.

Georgia.—O'Glen Ray, Veterans' Administration facility, Atlanta.

Illinois.—Lyman J. Zimmer,[1] Veterans' Administration facility, Hines; Lewis J. Murphy,[1] Veterans' Administration facility, Hines.

Indiana.—Omer Stevens,[1] 327-328 Lemcke Building, Indianapolis 4; Charles B. Lines (D) 327-328 Lemcke Building, Indianapolis 4.

Iowa.—E. E. Blegelid,[1] Veterans' Administration facility, Des Moines 13.

Footnote on p. 519.

Kansas.—William E. Lawson,[1] Veterans' Administration facility, Wichita 2; H. A. Calkins, S. S. O., 801 North Harrison Street, Topeka.

Kentucky.—Lee R. Lyons,[1] Veterans' Administration facility, Lexington.

Louisiana.—Roland A. Neyrey,[1] Masonic Temple Building, New Orleans.

Maryland.—Albert Meid, Jr., 611 Maryland Trust Building, Baltimore.

Massachusetts.—T. James Gallagher,[1] Post Office Building, Boston 9.

Michigan.—Sydney J. Allen,[1] Veterans' Administration facility, Dearborn; Walter Haedke, (D) Veterans' Administration facility, Dearborn; Morgan E. Siple, (C) First National Bank Building, Pontiac.

Minnesota.—James L. Monnahan,[1] Veterans' Administration facility, Fort Snelling; Frank L. Howard (CH), 208 Evanston Building, Minneapolis; John L. Golob, Congdon Building, Hibbing.

Mississippi.—H. V. Royston,[1] Veterans' Administration, Jackson.

Missouri.—Arch M. Hale,[1] Veterans' Administration facility, Excelsior Springs; William E. Leach,[1] Veterans' Administration facility, Jefferson Barracks; Louis Diebold, (CH), 4763 Milents Avenue, St. Louis.

Montana.—Eugene Callaghan, S. S. O., Veterans Welfare Commission, Helena; Warren H. Harlow, 317 LaVassuer Street, Missoula; Robert F. English, 324 Central Avenue, Great Falls.

Nebraska.—Ivan D. Marsh, S. S. O., Veterans' Administration facility, Lincoln; Elmer A. Webb, S. S. O., Veterans' Administration facility, Lincoln.

Nevada.—

New Hampshire.—T. J. Gallagher,[1] Post Office Building, Boston 9, Mass.

New Jersey.—John W. Bill,[1] Veterans' Administration facility, Lyons; Joseph A. Samelsberger, 220 Van Houten Street, Paterson; William E. McEvoy (C), 100 Williams Street, Newark 2.

New Mexico.—Charles A. Sloane,[1] Post Office Box 1643, Albuquerque.

New York.—Abraham Janko,[1] Veterans' Administration facility, Bronx 63; Edwin W. Momberger (C) 45 North Street, Hamburg; Floyd A. Evenden, (C), Courthouse, Binghamton; Frank J. Powers, 290 Magee Avenue, Rochester; Wm. H. Stevens,[1] Veterans' Administration facility, Batavia; Nicholas Parnell (C), 34 Court Street, Room 325, Rochester.

North Carolina.—Robert Lee Smith,[1] Veterans' Administration facility, Fayetteville.

North Dakota.—Andy Nomland,[1] Veterans' Administration facility, Fargo; Romanus J. Downey, S. S. O., Veterans' Service Commission, Fargo.

Ohio.—George Farling,[1] Veterans' Administration facility, Brecksville; Bernard Southard,[1] Veterans' Administration facility, Dayton; Cicero F. Hogan,[1] 2840 Melrose Avenue, Cincinnati; Earl Z. Teeter, (C) 822 Ardmore, Akron; John N. Hewitt,[1] care of Veterans' Administration facility, Muskogee.

Oklahoma.—Harry F. Ladusau, Box 490, Enid; Paul C. Tarver, Post Office Box 705, Muskogee; Lucien E. Wilson, S. S. O., Veterans' Administration facility, Muskogee.

Oregon.—Lile Dailey,[1] Veterans' Administration facility, Portland.

Pennsylvania.—Frank S. Kline,[1] Customshouse, Philadelphia 6; John Cherpak,[1] Veterans' Administration facility, Pittsburgh 15; Curtis Haube, (D) 432 Market Street, Harrisburg.

Rhode Island.—T. J. Gallagher,[1] Post Office Building, Boston 9, Mass.

South Carolina.—J. J. Bullard, S. S. O., R. S. Sloan, S. S. O., State Capitol Building, Columbia.

South Dakota.—Arthur H. Muchow,[1] Box 434, Sioux Falls.

Tennessee.—P. V. Hamblen,[1] Veterans' Administration facility, Murfreesboro.

Texas.—DeWitt T. Kirby,[1] Veterans' Administration facility, Waco; Howell S. Palmer, S. S. O., Veterans' Administration facility, Waco; Robert H. Claypool, S. S. O., Veterans' Administration facility, Waco; A. O. Willman, S. S. O., Veterans' Administration facility, Legion; George C. Betts, S. S. O., Land Office Building, Austin; Granville Routh, S. S. O., Chamber of Commerce Building, El Paso.

Utah.—George A. Faust,[1] 6010 South Twenty-third Street East, Salt Lake City; Glen D. Watkins, Box 736, Ogden.

Vermont.—Byron A. Robinson, S. S. O., Bellows Falls.

Virginia.—G. L. Whitlow,[1] 1916 Melrose Avenue, SW., Roanoke; Nelson F. Richards, S. S. O., Veterans' Administration facility, Roanoke.

Washington.—William C. Morgan,[1] Federal Building, Seattle 4; August A. Waseca (D), City Hall, Spokane; Dan Hoshauer, (D), 417 Masonic Temple Building, Yakima.

Footnote on p. 519.

West Virginia.—A. C. Loiseau, 1910 Ohio Avenue, Parkersburg; H. G. Maloney, S. S. O., Veterans' Administration facility, Huntington; W. J. Cunningham, S. S. O., 403 People Exchange Building, Charleston; R. C. Hall, S. S. O., 615 Goff Building, Clarksburg.

Wisconsin.—Theodore Corrado,[1] Veterans' Administration facility, Wood; Lucille Kubal (D), Veterans' Administration facility, Wood; Adolph R. Libke, (C), Box 105, Tomah.

Senator MEAD. Mr. Chairman, I wish to present some statements for the record, and then to call a witness.

First of all, I appreciate this opportunity to appear before the committee, and I apologize for taking your time, and I will be very brief.

I want to present for the record a statement of facts about the proposed fur tax and its effect upon the income of the American farmer, and in there there is a statement on the proposed tax increase and its effect upon the income of the farmer, a statement with reference to furs and their not being a luxury but a practical necessity. Then, a summarization of the opposition that was placed in the record some time ago by the farm organization.

I also addressed a letter to the Department of the Interior for facts with reference to the size and scope of the trapping industry, and I ask that the reply to that letter be put in the record.

That letter shows that the fur crop in the United States is valued at from sixty to seventy million dollars per year and that twelve to fourteen million dollars of that goes to the fur farmers who produce silver foxes and minks in captivity, and that the number of trapping licenses in the United States is given as being 2,661,855, and that a good many of those licenses are issued to the children of farmers, owners, and operators of farms, and there are about 200,000 additional trappers, which comprises a group of individuals living in States where licenses of this character are not required.

I would also like to have inserted in the record a memorandum in opposition to the proposed increase in tax on furs by members of the National Federation of the Fur Industry, with which are associated some 36 organizations representing the fur industry in all its branches from farm groups on through stages of production to the retailer.

The CHAIRMAN. All those documents may be inserted in the record.

(The documents referred to are as follows:)

MEMORANDUM SUBMITTED IN OPPOSITION TO THE INCREASED TAX ON FURS BY THE NATIONAL FEDERATION OF THE FUR INDUSTRY, INC., WITH WHICH ARE ASSOCIATED THE FOLLOWING 36 ORGANIZATIONS REPRESENTING THE FUR INDUSTRY IN ALL ITS BRANCHES FROM THE FARM GROUPS THROUGH ALL STAGES OF PRODUCTION TO THE RETAILER

The American Fur Merchants Association, Inc.
American National Fur Breeders' Association
Associated Fur Wholesalers of Southern California
Associated Fur Industries of Chicago, Inc.
Associated M. & M. Fur Farmers, Inc.
Chicago Wholesale Fur Credit Association
Colorado Raw Fur Dealers' Association
F. D. Service Co., Inc.
Fouke Fur Co.
Fur Brokers Association of America, Inc.
Fur Cleaners of the Fur Industry
Fur Cuttings Dealers' Association of New York
Fur Dressers and Dyers Association, Inc.
Fur Dressers' Guild, Inc.
Fur Dyers' Trade Council

[1] Nationally paid by Disabled American Veterans.
S. S. O.—Indicates State-paid set-ups.
D—Indicates Disabled American Veterans department paid.
CH—Indicates Disabled American Veterans chapter paid.
C—Indicates county-paid set-ups.

Fur Institute of Philadelphia
Fur Stripers and Blenders Associates, Inc.
Great Lakes Mink Breeders' Association Inc.
Indiana Fur Buyers' Association
Inland Empire Fur Breeders' Association
Iowa Fur Dealers' Association
Southwestern Trade Associations and Groups
Midwestern Hide, Fur and Wool Dealers' Association
Minnesota Raw Fur Dealers' Association
National Grange, The
New York Fur Dealers Employers Association
North American Fur Auction Association
Pennsylvania Trappers and Dealers' Association
Oregon Fox and Mink Association
Puget Sound Fur Farmers' Association
Rabbit Dyers Institute, Inc.
Raw Fur and Wool Association of St. Louis, Mo.
Seattle Retail Furriers' Association
Silk Association of the Fur Industry, Inc.
Spokane Fur Merchants' Association
Washington State Fur Dealers' Association

THE FACTS ABOUT THE PROPOSED FUR TAX AND ITS EFFECT ON THE INCOME OF THE AMERICAN FARMER

The House of Representatives proposes to increase the tax on furs from the present rate of 10 percent of the retail sales price to a rate of 25 percent of the retail sales price (H. R. 3687). This would mean an increase of considerably more than 800 percent over the 1936–38 tax rate of 3 percent of the wholesale price and an increase of 150 percent over the present rate.

THE GREAT FARM ORGANIZATIONS, SUCH AS THE AMERICAN FARM BUREAU FEDERATION AND THE NATIONAL GRANGE, HAVE LONG RECOGNIZED THAT ANY TAX ON FURS IS A TAX ON THE AMERICAN FARMER

The American Farm Bureau Federation, in a letter to former Senator James P. Pope, of Idaho, dated May 7, 1936, and printed in the Congressional Record of June 1936, stated that it had passed the following resolution at its annual meeting:

> We favor the elimination or modification of the so-called luxury tax on furs, which now has a depressing influence on prices received by farmer-trappers for raw furs.

and further stated that the tax—

> forces the purchaser of raw furs to pay less prices for these products which are produced very largely by farmer-trappers in all parts of the Nation. In fact, I believe it is approximately right to state that between 75 percent and 80 percent of the furs of this Nation are gathered by farmer-trappers and their sons. Anything which tends to beat down the prices on raw furs is serious to a large list of farmers who, in the winter months mostly, when work is light, gather the fur crop of the Nation.

SIX FUNDAMENTAL FACTS ABOUT THE FUR CROP

1. Furs are a product of the farm, just as wheat and corn and cotton are.
2. Approximately 500,000 American farmer-trappers gather our national fur crop.
3. Every State in the Union is a producer of furs.
4. Furs add approximately $90,000,000 to annual farm income.
5. The fur crop is one of the most profitable from the standpoint of net cash return to the farmers, because it requires very little investment of labor or capital. In fact, outstanding farm authorities have stated that the farmers' net income from the fur crop is often greater than the net income from some of the more staple crops, such as wheat.
6. To a great extent, it is the young sons of the farmers, schoolboys under draft age, who do the actual fur trapping, so that there is no diversion of labor from the war effort.

The proposed tax increase would drastically reduce the income of the American farmer because it would result in a cutting of prices at each level of production, starting from the retailer and working down through the wholesaler, the raw-fur dealer and finally to the farmer, in order to absorb or shift back the tax and thus

overcome the increased sales resistance of Mrs. American Housewife to the higher retail prices that the tax would otherwise cause.

The end result of this price-cutting process would be that the price of raw furs to the farmer would be beaten down and the impact of the tax would ultimately fall almost entirely upon farm income.

The House Ways and Means Committee, in its report on the House bill, dated November 18, 1943, only partly recognized the serious effect of the proposed fur tax on the farmer when it conceded that:

"On cheaper fur coats and fur-trimmed coats, which compete with tax-free cloth coats, some of the tax might have to be absorbed, or shifted to the wholesalers" (H. Rept. No. 871, p. 28).

Unfortunately, the committee did not complete the picture. The tax-shifting process would not stop with the wholesaler, but would continue down the line from the wholesaler to the raw-fur dealer and finally to the farmers and their sons—the forgotten end men in the chain—who could not shift the tax and would be compelled to absorb it.

Furthermore, it is the "cheaper fur coats and fur-trimmed coats" mentioned in the House report that sell for under $100 and comprise approximately 60 percent of all fur garments sold.

THE PROPOSED FUR TAX UNFAIRLY DISCRIMINATES AGAINST THE FARMER-TRAPPERS BECAUSE—

No other kind of wearing apparel is taxed.

The increased tax would create a 25 percent price differential between fur and cloth coats of equal intrinsic value and would drastically reduce retail fur sales.

If the proposed tax becomes law, Mrs. American Housewife will still be able to buy an $80 cloth coat for $80, but if she should prefer to buy an $80 fur coat because of its greater warmth and durability, it will cost her $100, because of the tax.

Is this fair?

FURS ARE NOT A LUXURY, BUT A PRACTICAL NECESSITY

The proposal to increase the fur tax is based on the erroneous idea that furs are a luxury, to be classified with expensive jewelry and perfumes, etc. Nothing could be further from the truth.

From the viewpoint of the grass-roots farmer, they are certainly not a luxury, but just another crop, gathered in the gray dawn of cold winter mornings from a far-flung line of traps.

From the standpoint of the consumer, approximately 60 percent of fur garments sell for under $100 and are bought largely by the working class—and of all fur garments sold 82.4 percent sell for $200 or less, 15.9 percent sell between $200 and $500, 1.7 percent sell for over $500.

In the majority of the States—and especially in the cold-climate States—fur garments are a practical necessity and have a far greater utility value than cloth from the standpoint of warmth and durability. Although, in many instances, the purchase of a fur coat will require a greater initial investment, it is common experience that the average fur coat will far outlast the cloth coat. Whereas the average cloth coat might be wearable for two or three seasons, the wearable life of a fur coat ranges between 4 and 10 years, depending on the usage. Actually, the cost to the wearer of a fur coat purchased in the moderate price range is less, on a usage basis, than that of a cloth coat.

WHAT HAPPENED TO THE FUR TAX IN THE HOUSE WAYS AND MEANS COMMITTEE

Strangely enough, the House reduced the Treasury Department's proposed rate on jewelry (having a sales volume over twice that of furs) from 30 to 20 percent, but left the proposed rate of 25 percent on furs stand, although jewelry is clearly a luxury, while the great majority of furs bought by Mrs. American Housewife are necessities acquired for practical, everyday use.

The Treasury Department proposed the following excise tax increases (see hearings, pt. 1, pp. 31, 38):

	Present tax	Proposed tax	Present yield	Proposed yield	Estimated increase
	Percent	*Percent*	*Millions*	*Millions*	*Millions*
Jewelry	10	30	80.2	235.2	167.3
Furs	10	25	33.7	93.0	54.3
Toilet preparations	10	25	35.0	86.4	51.4

It will be observed that, except in the case of jewelry and then only to an insignificant extent, no consideration was given by the Treasury Department to the law of diminishing returns in estimating the additional revenue to be obtained by the proposed increases. It was simply assumed that revenue would be increased in direct proportion to the increase in the rate.

FROM THE STANDPOINT OF INCREASED FEDERAL REVENUE, THE PROPOSED FUR TAX WILL DEFEAT ITS OWN PURPOSE

By killing—or at least seriously injuring—the proverbial goose that lays the golden eggs.

It is clear from the foregoing tables that the Government's estimate of increased revenue to be derived from the proposed fur tax entirely ignores the factors of increased sales resistance to higher retail prices and the increased competition of tax-free cloth coats that will be created by the tax. Taking these vital factors into consideration, it is apparent that the increased revenue, if any, will fall far short of the Government's optimistic estimate. And certainly the greater part of any increased revenue will come out of the pockets of American farmer-trappers.

Furthermore, the tax would cripple or destroy the fur industry, which directly employs 75,000 workers, most of whom are not fitted for other employment. The increased tax would cause the usual beat-the-tax buying spree on the part of the public, but this would be followed by a disastrous and permanent slump in sales volume, with bankruptcy for many of the employers and unemployment for thousands of fur workers. Tax evasion would be highly rewarded and black markets would flourish. The resultant loss to the Government of income and excess-profits taxes would be enormous and would more than offset any increase of revenue that might be derived from the proposed tax.

THERE SHOULD BE NO INCREASE IN THE TAX ON FURS

To summarize.—(1) The great farm organizations have taken the position that any tax on furs is a tax on the farmer-trapper and reduces his income; (2) the proposed fur tax unfairly discriminates against the farmer-trapper; furs are not a luxury, but a practical necessity; (3) the tax will not increase the Federal revenue, but will kill the goose that lays the golden tax eggs.

DEPARTMENT OF THE INTERIOR,
FISH AND WILDLIFE SERVICE,
Chicago, Ill., November 25, 1943.

Hon. JAMES M. MEAD,
United States Senate,
Washington, D. C.

MY DEAR SENATOR MEAD: Receipt is acknowledged of your letter of November 19 addressed to Dr. Gabrielson.

The lively demand for all kinds of fur puts into the pocket of the American trapper millions of dollars a year. Until trapping begins these furs have not cost them a single effort. Speaking generally, fur animals transform uncultivated and useless materials into valuable peltries without expense or attention on the part of the landowners. They are doing this throughout the United States. When the grain and hay harvest is over, farmers, their sons, and tenants take down their traps and set out to get the crop of fur. This fur crop in the United

States has a value from $60,000,000 to $70,000,000 per year. Twenty percent of this amount, or approximately $12,000,000 to $14,000,000, goes to fur farmers who produce silver foxes and minks in captivity and a considerable portion of it is also received by professional trappers.

Enclosed you will find hunting and trapping license data distributed by States for the year 1941–42. The number of trapping licenses is given as 2,661,855. Three-fourths of this number may be considered as farmers and farm boys who spend part of their time trapping fur animals. This is not the whole story, however, for under State laws the number of licensed trappers does not include resident landowners, their children or tenants and boys under 15, 16, or 17 years of age, who, in many States, are not required by law to purchase a trapping license. There are at least 200,000 more trappers who comprise this group of individuals and a large portion of them are farmer-trappers. It is reasonable to believe that because of the labor situation, a greater number of farmers and farm boys will be trapping this season than previously.

Enclosed also you will find a copy of Agricultural Circular No. 636, Game and Wild-Fur Production and Utilization on Agricultural Land. This will furnish additional information reltive to the farmer and the fur crop.

You might wish to contact the Washington office of the American Farm Bureau Federation, and also correspond with Mr. Chester M. Woolworth, president of the Animal Trap Co. of America, at Lititz, Pa. Mr. Woolworth and his associates are in a position to furnish additional information regarding the number of trappers that operate annually in the United States.

Sincerely yours,

ALBERT M. DAY, *Acting Director.*

(U. S. Department of the Interior, Fish and Wildlife Service, Chicago, Ill., July 1943)

HUNTING AND TRAPPING LICENSE DATA FOR THE YEAR 1941–42

(Compiled by Harold T. Smither, in charge of apportionments and statistics, Division of Federal Aid in Wildlife Restoration)

During the year ended June 30, 1942, $13,921,974 was paid for licenses by 8,532,354 hunters, of whom 8,441,560 were residents and 90,794 were nonresidents, including aliens. In the previous year the total number of licenses was 7,924,822 of which 7,847,992 were residents and 76,830 were nonresidents and the revenue reported totaled $14,464,478. The increase over the previous year in the number of licenses issued was 607,532 but there was a decrease in revenue reported of $542,504. The decrease in revenue is due to the fact that the previous year's figures included the total revenue from the combination licenses which permit fishing as well as hunting, whereas the amount applying to fishing is not included in this year's report.

In the total number of licenses issued to hunters in 1941–42 Michigan led with 846869; Pennsylvania, 687,153; Ohio, 614,106; New York, 612,911; Indiana 400,896; Illinois, 342,832; California, 329,643; Wisconsin, 327,740; Minnesota, 295,665; and Washington, 233,764.

Fees paid for hunting licenses in Pennsylvania in 1941–42 totaled $1,515,664; in Michigan, $1,212,617; New York, $838,168; California, $818,815; Ohio, $773,681; Illinois, $531,933; Wisconsin, $473,984; Washington, $384,064; Colorado, $375,645; and Oregon, $368,095.

Federal duck stamps were purchased by 1,437,220 hunters in 1941–42 which is an increase of 176,410 over the 1,260,810 stamps sold during the preceding year. More than 2,600,000 persons were granted licenses authorizing the trapping of fur bearers. However, many of these were combination licenses which the holders obtained for the privilege of hunting and fishing and in those instances the privilege of trapping was not exercised.

The appended tabulations summarize by States the number of licenses issued and the revenue collected.

Trapping licenses issued by States July 1, 1941, to June 30, 1942

State	Number of licenses	Fees paid	State	Number of licenses	Fees paid
Alabama	2,680	$6,700	Nevada		
Arizona	604	100	New Hampshire	251	$3,964
Arkansas	64,603	270	New Jersey	197,061	
California	2,149	2,168	New Mexico	572	570
Colorado	3,719	7,307	New York	17,762	40,192
Connecticut	2,612	6,475	North Carolina	2,402	6,187
Delaware	16,632		North Dakota	9,448	9,448
Florida	1,749	5,516	Ohio	414,106	
Georgia			Oklahoma	1,884	2,320
Idaho	796	4,180	Oregon	2,048	6,518
Illinois	19,038	38,364	Pennsylvania	657,153	
Indiana	400,896		Rhode Island	10,508	
Iowa	18,003	18,478	South Carolina		
Kansas	13,377	13,377	South Dakota	4,619	9,700
Kentucky	309	309	Tennessee	3,185	1,593
Louisiana	12,442	26,884	Texas	17,795	17,795
Maine	2,221	15,560	Utah	821	4,105
Maryland	80,647		Vermont	2,426	3,130
Massachusetts	11,154	13,155	Virginia	2,057	3,605
Michigan	27,038	27,038	Washington	2,105	10,525
Minnesota	31,811	41,153	West Virginia	184,453	
Mississippi	3,661	19,220	Wisconsin	26,670	57,908
Missouri	214,600		Wyoming	75	75
Montana	2,057	23,128			
Nebraska	3,576	9,298	Total	2,661,855	455,465

Hunting-license and federal duck-stamp returns, July 1, 1941, to June 30, 1942

State	Resident	Nonresident	Total licenses	Fees paid by hunters	Federal duck stamps
Alabama	117,179	708	117,887	$189,441	6,999
Arizona	35,203	426	35,729	90,879	4,345
Arkansas	64,580	2,252	66,832	131,450	18,526
California	237,738	1,905	239,643	818,815	111,389
Colorado	174,942	2,130	177,072	375,645	27,384
Connecticut	40,774	459	41,233	115,528	8,434
Delaware	16,596	165	16,761	22,213	3,732
Florida	65,542	863	66,405	160,564	14,368
Georgia	79,723	940	80,673	150,758	8,737
Idaho	108,853	1,068	109,931	120,852	23,104
Illinois	341,322	1,310	342,632	531,933	84,997
Indiana	400,255	641	400,896	308,654	22,071
Iowa	231,826	201	232,027	208,665	51,268
Kansas	102,781	321	103,072	104,998	37,276
Kentucky	97,130	440	97,570	133,295	4,553
Louisiana	150,298	2,299	152,597	180,794	45,102
Maine	99,446	6,095	105,541	200,525	10,350
Maryland	78,458	2,189	80,647	200,734	11,184
Massachusetts	99,367	547	99,914	177,025	22,230
Michigan	840,961	5,908	846,869	1,212,617	103,796
Minnesota	295,168	497	295,665	307,597	121,032
Mississippi	137,631	954	138,585	235,266	9,767
Missouri	214,600	703	215,303	309,532	25,828
Montana	98,630	702	99,332	161,911	20,778
Nebraska	133,717	1,159	134,876	144,078	30,134
Nevada	12,031	2,234	14,265	42,463	6,656
New Hampshire	58,426	3,062	61,488	97,938	9,345
New Jersey	137,061	1,343	138,404	277,908	23,288
New Mexico	24,184	1,470	25,654	108,830	4,732
New York	608,597	4,314	612,911	838,168	50,822
North Carolina	157,482	2,879	160,361	286,586	11,066
North Dakota	51,846	279	51,625	83,994	28,087
Ohio	613,714	392	614,106	772,631	25,555
Oklahoma	111,627	442	112,069	144,014	28,769
Oregon	111,964	1,237	113,221	308,095	30,434
Pennsylvania	676,349	10,804	687,153	1,615,664	30,317
Rhode Island	10,373	135	10,508	23,978	3,997
South Carolina	86,054	3,264	89,328	170,580	4,180
South Dakota	97,637	11,136	108,773	353,915	25,977
Tennessee	131,665	537	132,202	137,373	12,226
Texas	136,511	562	137,073	287,079	83,593

Hunting-licenses and federal duck-stamp returns, July 1, 1941, to June 30, 1942—Continued

State	Resident	Nonresident	Total licenses	Fees paid by hunters	Federal duck stamps
Utah	76,280	4,200	80,480	$294,907	18,886
Vermont	46,046	2,155	48,201	78,236	2,365
Virginia	181,719	2,119	183,839	203,803	10,965
Washington	233,658	106	233,764	354,004	70,185
West Virginia	184,092	391	184,483	188,271	1,769
Wisconsin	326,807	933	327,740	473,984	89,195
Wyoming	33,716	1,429	35,145	160,596	8,510
Alaska	11,121	401	11,522	24,218	2,911
District of Columbia					1,848
Hawaii					23
Total	8,441,560	90,794	8,532,354	13,921,974	1,437,220

Senator MEAD. Now, Mr. Chairman, with the documents inserted in the record, with your approval I will ask the committee if they will hear Mr. Fred Brenckman, representing the farm groups who are in opposition to this proposed tax, and I appreciate your courtesy.

The CHAIRMAN. Very well, Mr. Brenckman.

STATEMENT OF FRED BRENCKMAN, REPRESENTING THE NATIONAL GRANGE

Mr. BRENCKMAN. Mr. Chairman, my name is Fred Brenckman. I am the Washington representative of the National Grange.

We desire to call the attention of the committee to what we regard as an inequitable adjustment of the tax proposed on furs, as compared with jewelry.

The present tax on both furs and jewelry is 10 percent. The Treasury proposed a 30-percent tax on jewelry and a tax of 25 percent on furs. However, the House reduced the Treasury's proposed rate on jewelry from 30 to 20 percent, but left the proposed rate on furs at 25 percent, as recommended by the Treasury Department. We consider this both unfair and illogical. Aside from watches and plain wedding rings, jewelry is a luxury that people can do without if necessary. On the other hand, in the colder sections of the country, furs are not a luxury and have been worn since the earliest times to provide warmth and to protect the health of the people during the winter months.

Approximately 60 percent of fur garments sell for less than $100 and are bought largely by the working class. During the days of the American Revolution, many of our soldiers wore coonskin caps, not as a matter of ostentation or display, but to keep their ears warm. We are told that when Gen. Daniel Morgan and his celebrated Virginia riflemen marched from Winchester to Boston to join Washington's little army, they all wore coonskin caps, and if any move had been made to tax those caps, we can be assured there would have been a counter-revolution instantly. I might be said that in those days the Continental Congress did not have the power of taxation. They could only request the States for such amounts as they were willing to give for the upkeep of the general Government.

About 82 percent of all fur garments sell at a price not exceeding $200; about 16 percent sell at a figure between $200 and $500; and less than 2 percent sell for $500 or more.

The present tax of 10 percent on jewelry yields aggregate revenues of $89,200,000 annually. The Treasury estimates that a 30 percent tax would produce revenues aggregating $256,500,000.

By way of comparison, the 10 percent tax on furs yields $38,200,000. According to the Treasury estimate, a 25 percent tax would produce $93,000,000.

From the standpoint of revenue, more is to be gained by increasing the tax on jewelry than upon furs. Our suggestion is that as a matter of equity and fair play, the tax on jewelry be placed at 25 percent, with a tax of 15 percent on furs. Such an arrangement would probably result in a larger revenue yield and would give due recognition to the fact that a necessary article of wearing apparel should not be taxed as high as jewelry, which is a luxury.

Briefly referring to the interest of agriculture in this matter, it may be said that about 65 percent of our domestic furs are produced by fur farmers and by farmer-trappers. In normal times, the fur crop of the farm has a value of approximately sixty to seventy million dollars per year. Under present conditions, the value of the fur crop to farmers may run as high as $90,000,000 per year. From $12,000,000 to $14,000,000 goes to fur farmers who produce silver foxes and minks in captivity. The number of trapping licenses issued annually total more than $2,260,000. About three-fourths of this number are farmers and their sons who spend part of their time trapping fur-bearing animals. Every State in the Union produces furs of some kind or another.

If the tax on furs is made too high, it naturally follows that there will be sales resistance, and the result will be that the price for raw furs going to farmers and trappers will be reduced.

For the reasons which have been enumerated, we think that there should be a readjustment of the tax rate as between furs and jewelry. We likewise think that this can be done without any loss of revenue to the Government, while vindicating the sound principle that the necessities of the prople should not be taxed as heavily as luxuries.

The CHAIRMAN. We thank you, Mr. Brenckman.

Senator DAVIS. How many fur-bearing animals are there in Pennsylvania?

Mr. BRENCKMAN. There are quite a few fur farmers in Pennsylvania and in other northern States. As I stated a moment ago, Senator, the value of the furs produced by farmers who grow silver fox and mink in captivity runs from twelve to fourteen million dollars per year.

Senator DAVIS. What is the present tax on furs?

Mr. BRENCKMAN. Ten percent, the same as on jewelry.

Senator DAVIS. What did they raise jewelry to?

Mr. BRENCKMAN. The Treasury proposed that the tax on jewelry should be raised to 30 percent, and the tax on furs increased from 10 to 25 percent. The House reduced the tax on jewelry to 20 percent, but left the tax on furs at 25 percent.

The CHAIRMAN. Thank you, Mr. Brenckman.

Mr. McLaughlin.

STATEMENT OF DONALD H. McLAUGHLIN, REPRESENTING THE TAX COMMITTEE OF THE AMERICAN MINING CONGRESS

Mr. McLAUGHLIN. Mr. Chairman, on behalf of the tax committee of the American Mining Congress, of which I am a member, I am speaking in support of the amendment introduced by Senator Johnson to the section of the revenue bill that pertains to gross income from the property for purposes of percentage depletion.

When percentage depletion was introduced in the Revenue Act of 1932, the Treasury Regulations under which it was to be administered were the subject of conferences between Assistant Secretary Douglas and others of the Treasury Department, and representatives of the mining industry among whom I was included. The regulations then adopted have been preserved essentially in their present form as far as definition of "gross income" is concerned except for a single amendment in 1940 with regard to allocation of a portion of the profits of a mining enterprise to certain processes or operations to which reference will be made later.

When the 1932 regulations were adopted, it was understood by the representatives of the mining industry that the omission of a complete recital of the many processes by which ores are beneficiated was simply to avoid burdening the regulations with a lengthy and possibly incomplete statement, and that the meaning of the act was met by the inclusion of phrases such as "other processes" which were deemed adequate to cover other common methods of treatment similar in their function to those specified. With the regulations in this form, it was believed that the administration of the law would not depart from what we had been informed was the intent of the Members of Congress who had sponsored the legislation.

This was clearly expressed later upon the floor of the Senate by Senator Thomas when in a discussion with Senator Johnson (p. 8291, vol. 88, Congressional Record, 77th Cong., 2d sess.), he said:

> When the amendments providing for percentage depletion were under consideration in 1932, it was our understanding that the ordinary treatment processes, which a mine operator would normally apply in order to obtain a suitable product, should be considered as a part of the mining operation.

That this understanding was well founded and expressed the agreement reached at this conference with Assistant Secretary Douglas is clearly borne out by the action of the Bureau of Internal Revenue for the next 8 years in accepting and settling tax returns based upon it. During this period, the law with regard to percentage depletion was repeatedly reenacted and the regulations remained essentially unchanged. For example, in the case of gold mines, common processes such as amalgamation and cyanidation were regarded as the equivalent of concentration by gravity or flotation, and no distinction was made between the tax return of a company employing the former as its major method of beneficiation and one that happened to find the latter better suited to its ores.

In 1941, however, the Bureau unexpectedly took a position that implied it had been in error in the preceding years and claimed deficiencies in the returns of a number of companies for the years 1938, 1939, and 1940, which were the only ones still open for adjustment, by requiring that the cost of processes such as cyanidation in the case of gold ores and furnacing in the case of quicksilver ores

must be deducted in calculating gross income, upon which percentage depletion was based, on the grounds that these processes were not specifically mentioned in the regulations. This current stand of the Bureau is not based on any public statements, so it is difficult to know just how far it is intended to go in excluding one after another of the well recognized processes of beneficiation from the group that was formerly accepted as the equivalent of concentration by gravity or flotation, but from the various cases that have now arisen, the taxpayer cannot avoid feeling apprehensive that the term "other processes" in the regulations is no longer of any significance in the eyes of the Treasury.

The question of allotment of profits to specific processes of beneficiation was discussed at the conferences in 1932, but it was ruled out on account of the difficulties of administering it in a simple and equitable way not subject to controversy. In spite of these considerations that were regarded as compelling in 1932, provision for allotment of a portion of the profits to processes subsequent to those mentioned was made in the regulations issued in 1940 and applied in the claims for deficiencies to which reference is made above.

As a result, the differences in treatment of taxpayers, even in the same type of mining operations, have been so great and inequitable that the wisdom of the early decision to keep the administration of the law on as simple a basis as possible has been confirmed in a most positive way.

The proposed amendment simply incorporates in the law the practices established by the Bureau under the 1932 regulations, and does not modify the existing regulations in any essential way except to limit the deductions in calculating gross income to the costs of the processes or services subsequent to those which are regarded as ordinary treatment processes and specifically stated as such.

The clarification of the law that would be accomplished by this amendment would relieve many taxpayers not only of uncertainties with regard to their tax liabilities but also with regard to choice of technical practices, for the present policies of the Bureau create such discriminations between processes designed to accomplish identical ends that a taxpayer might feel compelled to replace an entirely satisfactory plant with one of a type that now happens to be specifically mentioned in the regulations.

Consequently, I feel strongly that in the interest of fair treatment as between taxpayers in the mining industry and simplicity in the administration of the revenue act it is imperative to remove these sources of uncertainty and conflict by adopting the proposed amendment that restores Treasury procedure to that which was originally intended by Congress and that makes unmistakably clear just what can and what cannot be deducted from the value of the output of mines in calculating their depletion base.

(The amendment by Senator Johnson, referred to above, is as follows:)

[H. R. 3687, 78th Cong., 1st sess.]

AMENDMENT Intended to be proposed by *Mr.* JOHNSON of Colorado to the bill (H. R. 3687) to provide revenue, and for other purposes, viz: at the proper place, insert the following:

SEC. —. GROSS INCOME FROM PROPERTY FOR PURPOSES OF PERCENTAGE DEPLETION.

(a) Section 114 (b) (4) is amended by adding at the end thereof a new subparagraph, (B), to read as follows:

"(B) Definition of Gross Income From Property.—As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining', as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term 'ordinary treatment processes', as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulfur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, precipitation (but not including electrolytic deposition), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. In the determination of such gross income from mining, there shall be excluded the costs of any process or service which does not constitute an ordinary treatment process. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 731 and 735."

(b) The amendment made by subsection (a) hereof shall be effective as of the date of enactment of the Internal Revenue Code.

(c) Section 114 (b) (4) of the Revenue Act of 1938 and the corresponding provisions of the Revenue Acts of 1936, 1934, and 1932, as amended, are hereby amended by inserting therein the amendment contained in subsection (a), other than the last sentence thereof, such amendment to be effective as of the date of enactment of each of the respective Acts.

The CHAIRMAN. I believe that ends the list for today and the committee will adjourn until 10 o'clock tomorrow morning.

(Thereupon, at 5:20 p. m., the committee adjourned until 10 a. m., Friday, December 3, 1943.)

REVENUE ACT OF 1943

FRIDAY, DECEMBER 3, 1943

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

The committee met, pursuant to adjournment, at 10 a. m., in room 312, Senate Office Building, Senator David I. Walsh (acting chairman) presiding.

Present: Senators Walsh (acting chairman), Barkley, Bailey, Clark, Byrd, Gerry, Guffey, Johnson, Radcliffe, Lucas, Vandenberg, Davis, Danaher, and Taft.

Senator WALSH. The committee will come to order, please. Senator George telephoned me this morning. Evidently he is suffering from a severe throat trouble and also suffering from a high temperature. He is confined to his home by the doctor's orders, probably until Monday, and he has asked me to preside over this meeting.

Senator Pepper, have you any statement to present?

Senator PEPPER. Mr. Chairman and members of the committee, Senator Andrews and I would like to present to the committee Gov. Spessard L. Holland, of Florida, who would like to appear in opposition to the pari-mutuel tax.

STATEMENT OF HON. SPESSARD L. HOLLAND, GOVERNOR OF THE STATE OF FLORIDA

Senator WALSH. The committee will be pleased to hear you, Governor.

Governor HOLLAND. Thank you, Senator.

Mr. Chairman and members of the committee, today a year ago, as I recall it, I had the pleasure of appearing before this committee the doubtful pleasure so far as the necessity of coming to be heard on this particular matter is concerned, but the pleasure always of seeing the members of the committee.

Now here we are back again. Since the argument was so fully made before, and since we have the factual matter presented by way of brief not only from our State but also from the various national organizations that are involved so vitally in this matter, I shall not go into great detail.

There are about four points that I want to make. First, that it seems to me this is a field of taxation which rightfully belongs peculiarly to the States. The legalization of racing depends entirely on whether the State thinks it a matter of sound public policy to legalize racing within its boundaries. A few States have thought it was proper to legalize racing and have done so. The total number is 22; 19 con-

ducted racing this last year, but only 5 or 6 would agree that there is any important revenue either to the States or to the Federal Government involved.

It seems to us, in the first place, then, that here is a field of revenue existent solely because of the creation by State statute which should be peculiarly, as a matter of right, reserved to the States.

Second, that not only would it be discrimination as amongst the States, because every State has it in its power to make this set-up, if it chooses to do so, as a matter of its own sound existence, but that it is also a fact that each State that has taken this step realized when it did so that there is an important matter of policing and regulation which it must assume. Each State that has legalized racing has assumed that responsibility. It is a heavy one, and we in Florida have endeavored to discharge it in a decent way, and I believe we have, and I am sure that same comment can be made for all the other States. This proposed tax does not propose to assume any part of that responsibility or take any of that burden on behalf of the Federal Government, but to the contrary simply seeks to intervene to the extent of taking all, or in some cases more than all, of the revenue that has customarily gone to the States under this set-up.

In the third place, I want to call your attention to the fact that in those States where the revenue subject is an important one in this connection, it would involve and entail peculiar hardships, heavy losses, and in some States statutory and in others even constitutional changes to offset the injury that would be done to the State tax structure. In our State, for instance, the last normal year of operation the revenue was $4,390,000 from this source, representing between one-sixth and one-seventh of that portion of the revenue of the State which has to do with carrying on the general State government. Not only is that true, but in our State we have a constitutional provision, and it is the only one of the kind that we have, permitting the division of this revenue amongst the counties, whether large or small, on an equal basis. It is the only such provision in our constitution, and under that constitution there has been divided back to the counties nearly $2,500,000 a year on an equal basis. On the part of many counties in the State, constituting the great majority and all of the small ones, this is a very vital part of the revenue for the operation of the county government on which they depend. Inasmuch as this structure is built upon State sufferance and requiring, as it would in our State, not only an extraordinary session of the legislature to deal with the subject temporarily, but a constitutional amendment in the event this should become a permanent policy of the Federal Government, we think this imposes unnecessary severe hardships and hardships that we think are not commensurate at all with the advantages, if any, that would flow to the Federal Government out of the imposition of this tax.

Now, the next point that I would like to make is that each State in legalizing the set-up within its own boundaries has sought to express by an act of its legislature what it thinks is the maximum burden that can be sustained by this business and yet allow it to remain a profitable business. In our State I am pretty sure that we have gone the limit in this regard. Ever since legalized racing was set up we have had a 15-percent take applicable to the dog-race tax and to the Hialeah

Fronton, and ever since 1941 we have a 15-percent take applicable to the horse tracks. I have heard a lot of debate as to whether 15 percent can be sustained by any of the tracks, and it seems to be the best judgment by those who know best on the subject that, except in Florida and California, there is doubt whether 15 percent can be sustained at all by the horse tax, and most of the advised people do not think that in normal times we will be able to sustain it there, although we have as of the present time.

Now, this added 5 percent, which would increase that take under some interpretations of this proposed act to 20 percent would, we think, completely break down the structure and simply kill the goose that laid the golden eggs. Now, if it is planned that this 5 percent should be added to the legalized take already submitted in the various States, that would be the result. If, to the contrary, it is planned to have the tracks pay 5 percent then, in my humble judgment, the result would be to largely discontinue racing entirely. In our State, for instance, the horse tracks are allowed a 7-percent take on which they must pay the prices, pay all of the expenses of operation, pay their income and excess-profits tax which, by the way, is very heavy, and show a profit if they can. Now, to take 5 out of that 7 percent is indeed killing the goose that laid the golden eggs.

We think that there has been considerable of a golden egg laid in this matter. We have not had the chance, because of the speed with which this matter has come up, to get final figures which we could rely upon ourselves to tell you what has been the measure of income and excess-profits taxes paid to the Federal Government by the race tracks in Florida alone, but we do think the audits by the larger tracks show the amount reflected therein. We are safe in saying that more than $1,500,000 a year has been going from the tracks to the Federal Government by way of income and excess-profits taxes, which is more than 2 percent of the gross amount paid.

Senator VANDENBERG. You do not mean that only geese bet on the races, do you?

Governor HOLLAND. I do not mean that, but there is a golden egg in this proposition, and we think the continued reception of that golden egg will be heavily jeopardized if this proposed legislation could be enacted.

Senator BARKLEY. Only geese lose, Senator.

Governor HOLLAND. Since my lot has always been to lose, Senator, I must come within that category. I have never been able to successfully pick the winner.

Now, as to the dog tracks, we do not know what could be done in our State to permit them to sustain themselves. We could, by a special session of the legislature—and that would be required, at a heavy expense to the State, at a time when I think you agree no such expense should be involved—we could strike off the last 5 percent that we added on the take at horse tracks and allow this tax to become operative, if the tax is one that could be added to the take.

As to the dog tracks and Hialeah Fronton, the State gets only 3 percent out of the total take of 15, and several of the dog tracks had to fold up already, simply because of the exigencies of the military situation. After a careful check of the figures of the dog tracks we believe there are only two tracks in the State which could sustain this

5 percent out of the 12 percent they get. The other seven tracks now operating we feel would have to fold up, and we know four of them would have to fold up. It just seems like an idle thing to impose a tax of this kind when it means the destruction of the industry which it assumes to tax, and I cannot believe those responsible for the tax realize that it is so highly destructive and would result in killing the industry upon which it would hope to levy a tax and from which it would hope to get revenue.

Senator VANDENBERG. Was there any hearing before the House committee on this subject, Governor?

Governor HOLLAND. Not to my knowledge, Senator. I would not like to say, but if there was we were not apprised of it in Florida.

Senator BARKLEY. Has anything happened since a year ago when you and others appeared before the committee on the same subject to improve the situation in regard to racing that would justify this tax any more? Then it was regarded as being unjustified, you know.

Governor HOLLAND. To the contrary, as far as we are concerned, the picture has grown blacker, because the ban on pleasure driving was imposed just at the beginning of our horse-racing season. We had just a few days of racing, when we had to cut it. The situation is more precarious from that standpoint than it was at the time we were before you.

Senator BARKLEY. This racing situation is one in which the States that have legalized it have done it as a special privilege granted by legislative enactment of the State, and part of the incentive behind that was to raise revenue for its purposes in one form or another, either in percentages or as a license charge.

Now, the Federal Government proposes to come along and, in effect, take it away from the States.

Governor HOLLAND. That is right.

Senator BARKLEY. To add it on to what the State collects would destroy the business.

Governor HOLLAND. That is right.

Senator BARKLEY. There would be no incentive even for the State to continue to license it or to permit it if the State is not to receive any consideration from it, would there?

Governor HOLLAND. That is correct; there would be no incentive whatever.

There is one more point that I want to make. I touched on it in the beginning, but evidently Senator Pepper thinks I did not make it clear enough, and I want to make it clear. That is this: There is always a heavy problem of law enforcement in this field in connection with the suppression of bookies and the direction and bets through legalized channels, that its, through the parimutuel. It would be an attempt by this legislation to create even more of an incentive, more inducement to the operation of bookies without adding at all to the enforcement.

By the way, as a matter of fair play, there is no State in the United States that does not have bookies. Here, you seek to impose a tax against the States that have dealt with this thing as decently as they can, legalized it as far as they can control it and deal not at all with bookies in those States. I may also say in the State where there is legalization we have a constant battle there with bookies.

Senator LUCAS. If we pass this measure, where you have 1 bookie now, you would have 10 spring up overnight, provided you continued racing?

Governor HOLLAND. That is what we fear.

Senator LUCAS. That is the experience that we have had in the past.

Governor HOLLAND. There is another point I would like to call your attention to, that is on the strength of our laws and operating on the faith in their opportunity to continue to exist we have had heavy investments made. For instance, the Hialeah Fronton, and I know those of you who have seen the Hialeah will agree with me, it is very fast and furious, yet it can barely operate getting 12 percent of the 15 percent take. It has a very expensive brick and stone building. It operates indoors. That investment would be entirely lost.

Senator BARKLEY. I haven't seen it, Governor, but I am glad to accept your invitation.

Governor HOLLAND. Just give me the date, Senator, and I will personally take you down, because it is always a pleasure to see that game. That goes for all members of the committee.

With reference to the dog tracks, there are heavy investments in nine different tracks. With reference to the horse tracks, where the investments are by far the heaviest of all, I do not need to tell you gentlemen about them, and certainly not the Senator from Kentucky.

The Hialeah is probably the biggest investment, but if not the biggest, the horse-racing investment at least approaches that point.

Senator BARKLEY. I would have to reserve the Kentucky situation.

Governor HOLLAND. I would accept that, Senator, but with that reservation I hope you can go with me on it.

Senator VANDENBERG. I do not think we ought to bring up the Kentucky situation on this.

Senator BARKLEY. We are going to try to get you to eliminate it from this bill.

Governor HOLLAND. You can eliminate Florida along with that.

Massachusetts, for instance; I talked with Governor Saltonstall on this subject 2 weeks ago at the executive committee of Governors' meeting in Chicago, and I found that he felt kindly toward it; likewise, Governor O'Conor, of Maryland, and Governor Green, of Illinois.

Senator BARKLEY. How about Governor Dewey, of New York?

Governor HOLLAND. Governor Dewey was not at the meeting. He is not a member of the executive council, but I understand there is somebody to speak for him here—his chairman of the racing commission. I have no doubt you will hear from him shortly.

I do not want to take any more of your time, gentlemen. It does seem to me if there is any field in which the States would have the right to the protection of the Federal Government, it is this field. I want to call your attention to the fact that the State of Florida has tried to play very fair with the Federal Government in this general field of taxation. We withdrew constitutionally from the field of income taxation; we withdrew from the field of inheritance taxation, of estate taxation, except insofar as the Congress may allow us credit; we withdrew from the field of general sales taxation. We have tried to segregate our taxation into fields that peculiarly belong to the State because we have tried to foresee this difficulty with which you gentlemen are dealing at this time.

Senator VANDENBERG. That has been a pretty good business for Florida, has it not?

Governor HOLLAND. Yes, sir; it has been excellent business. The census showed we drew 29.6 the last 10 years covered and far more than that insofar as our assets and resources were concerned. However, other States are making great progress, too. We shall never set up any machinery that we think will take people away from other States.

Senator BARKLEY. Florida has other attractions besides exemptions from income tax.

Governor HOLLAND. Yes. Racing is one of them. We want to keep it. We feel very keenly about this matter.

Senator LUCAS. Governor, is there any limitation on the funds that go to the counties—as to how they can spend the money?

Governor HOLLAND. No, sir. It goes into their general revenue, except in those cases where the counties themselves, by special act, have directed it into the schools. All of the racing money which goes into the counties, amounting to nearly $2,500,000, is spent either on county operation or public-school operation. That is very vital. In the case of the majority of the counties, and in all the small counties, it is the most vital factor that they have.

Senator LUCAS. It is a real relief to the counties' operation?

Governor HOLLAND. Yes, sir; it is a real relief to the county.

Senator GUFFEY. How many counties have you in Florida?

Governor HOLLAND. Sixty-seven.

Senator GUFFEY. The same number as we have in Pennsylvania?

Governor HOLLAND. Yes; I believe it is the same number.

Senator GUFFEY. There are a number of very small counties, considering the population.

Governor HOLLAND. Yes. We have about 10 counties that are considered large counties and the rest are all small ones.

Senator BARKLEY. Is it your judgment, Governor, that this racing business is at this time bearing all the bumps it can really bear under these conditions?

Governor HOLLAND. That is my opinion.

Senator BARKLEY. If this tax is imposed, and to that extent the States and counties are deprived of the revenue in your State, for instance, what would be the result?

Governor HOLLAND. The result would be to knock the business out.

Senator BARKLEY. Even if it could continue, if the Federal Government collected the tax instead of the State, what would you have to do then in order to recoup your revenues?

Governor HOLLAND. We would have to immediately call a special session of the legislature; then, as far as the constitutional set-up is concerned, we would have to eventually amend our constitution and find other permanent sources of revenue to take the place of this.

Senator BARKLEY. Would that general situation apply to other States that rely largely on this income for some special purpose?

Governor HOLLAND. That is my opinion; yes, sir. Of course, I am best acquainted with our problem in our State.

Senator BARKLEY. I thought the other Governors you talked to have indicated their position to you?

Governor HOLLAND. They are very critically affected, I am sure. I am sure Mr. Swope and some of the other gentlemen here that have

communications from their Governors are authorized to speak for their Governors, as to the critical impact on their States from this act.

One more point, and I am through, and that is this:

If you are going to pass the legislation, which I sincerely hope you will not, I certainly hope you do not leave it in the shape it is in the bill now, where it is not at all clear whether it is added to the take or imposed against the business, and where it would just simply lead to litigation and all kinds of confusion and misunderstanding. The States cannot prepare to met the problem as they would have to prepare to meet it intelligently unless the legislation was so drafted as to make that point clear. If you have that part of the act before you, I think it will be clear from reading it just the point that I mean.

Senator LUCAS. Is this the first time that the Federal Government has ever attempted to invade this field for taxation or any other purpose?

Governor HOLLAND. As far as we are concerned in Florida, it is, since we legalized racing. If they invaded it, it was in years prior to our legalization about which we know nothing.

Senator WALSH. You had it before last year.

Senator LUCAS. I was here last year, and maybe before that.

Governor HOLLAND. If you will turn to the part of the proposed act that deals with this subject, you will find it on page 71, section 1653 of title III of the proposed act:

TAX.—There shall be levied, assessed, collected, and paid on the conducting of pari-mutuel or totalizator wagering on any racing or other sporting event a tax in an amount equal to 5 percentum of the total amount wagered and received, on and after the effective date of Title III of Revenue Act of 1943, into the pari-mutuel or totalizator pool, to be paid by the person conducting or having control of such pari-mutuel or totalizator pool.

In our State that would be the track itself. I say that leaves it absolutely uncertain and indefinite as to whether that 5 percent is added to the take already authorized, or whether it is 5 percent levied against the track out of that portion of the take which they are allowed to have under State law.

Senator VANDENBERG. How should it read, Governor, to meet your suggestion?

Governor HOLLAND. As far as I am concerned, I would of course want it eliminated, but my suggestion is this: If you do feel in your collective judgment and discretion that this burden should be imposed, that you call in some of the people who would know about this so there can be a wording suggested—I would not attempt to suggest it on such short notice—that would make it clear whether this 5 percent is added to the tax that is legally authorized in the several States or whether it is a 5-percent tax against the track out of that portion which they are entitled to receive, which it appears to be here. If that is what it means, that means death to racing in our State, and I suppose to most of the others.

Senator WALSH. The committee will be pleased to have your views.

Senator Barkley, do you have a witness?

Senator BARKLEY. It may be desirable to complete this pari-mutuel matter first.

The CHAIRMAN. Senator Pepper, who is your next witness?

Senator PEPPER. Mr. Connors, the chairman of the Massachusetts State Racing Commission.

STATEMENT OF CHARLES F. CONNORS, CHAIRMAN, MASSACHUSETTS STATE RACING COMMISSION AND PRESIDENT OF THE NATIONAL ASSOCIATION OF STATE RACING COMMISSIONERS

Senator WALSH. Your full name, please?

Mr. CONNORS. Charles F. Connors.

Mr. Chairman and gentlemen, I appear today as chairman of the Massachusetts State Racing Commission and also as president of the National Association of State Racing Commissioners, representing 22 States.

I might say at the start, I would like to introduce—it would probably not take more than 2 minutes—Secretary Underwood of the National Association of Racing Commissioners, and then Mr. Shawcross, chairman of the Rhode Island State Commission, who would only take a minute or two to be followed by Mr. Swope. My remarks probably will not take more than 3 or 4 minutes. With your permission I would like to read them. I will cut them down as briefly as possible.

Senator WALSH. I wish you would.

Mr. CONNORS. Twenty-two States would be deprived of revenue from racing without helping the war effort of income to the Federal Government, if section 1653 were to become a law.

Let me first speak to you in the interest of Massachusetts:

The enactment of this proposal will in my estimation seriously imperil the racing revenue to the Commonwealth of Massachusetts, which, during the calendar year of 1943, amounted to $4,273,000. The statutes provide how this money received from this source is collected and earmarked for old-age assistance. Pari-mutuel betting is authorized by a State referendum every 4 years. The racing law provides that associations conducting pari-mutuel wagering are required to pay to the Commonwealth sums stipulated by law.

No track in the Commonwealth, particularly Suffolk Downs, could operate with this additional tax of 5 percent. Suffolk Downs paid to the Commonwealth during the calendar year of 1943, $2,117,965.64, and the other tracks $2,146,149.65. The Federal Government, through taxes on admissions, capital stock, excess-profits tax, and so forth, will receive over $1,000,000 from Suffolk Downs and approximately $800,000 from other tracks, making a total to the Federal Government of about $1,800,000.

I believe that the enactment of this 5-percent tax on pari-mutuels will result in a loss of practically the entire racing revenue, amounting to $4,273,000, to the Commonwealth, and instead of being a source of revenue now collected by the Federal Government, will also result in a complete loss.

If, as stated above, the tracks are forced to discontinue racing because of this additional tax, the war relief agencies, as well as the Commonwealth and the Federal Government, will suffer.

Racing and pari-mutuel taxes have been a matter of careful and continuous study by various committees of the Massachusetts Legislature. Vital information bearing on the subject was available to these committees, and as late as last summer the legislature voted not to impose any additional tax on pari-mutuel wagering.

Racing has provided a source of substantial revenue to the various States where it is legalized. Action at this time by Congress will

imperil revenue to the Commonwealth of Massachusetts as well as the various other States.

Now, with your permission, I would like to leave a copy of these remarks with your committee so you might be able to refer to them if you care to.

Senator DANAHER. Question, Mr. Chairman.

Senator WALSH. Yes.

Senator DANAHER. What was the total income to the State of Massachusetts from horse racing this year?

Mr. CONNORS. For racing, $4,278,000.

Senator DANAHER. And of that sum, what tax did the State of Massachusetts receive?

Mr. CONNORS. The State got all of that. That went to the old-age systems.

Senator DANAHER. Now, then, what was the total amount wagered on which that tax was computed?

Mr. CONNORS. Practically $85,000,000.

Senator DANAHER. In the State of Massachusetts alone?

Mr. CONNORS. In the State of Massachusetts alone.

Senator DANAHER. It is the biggest year they ever had, is it not?

Mr. CONNORS. Yes; it is.

Senator DANAHER. What was the results in other States, Mr. Connors?

Mr. CONNORS. Well, I think proportionately the same in those States that operated. There was a great increase in the business.

Senator DANAHER. And you say that horse racing would stop and pari-mutuel betting would cease if there was an additional 5 percent levied?

Mr. CONNORS. Positively, in Massachusetts.

Senator DANAHER. Why would that be true?

Mr. CONNORS. Our legislature would have to meet to make special legislation, and we do not meet until January 1945.

Senator DANAHER. It is not that the public would not support it?

Mr. CONNORS. We would have to rearrange the law on racing.

Senator DANAHER. How would you have to rearrange it if we levied the additional 5 percent tax?

Mr. CONNORS. The way the bill reads we would have to change our law entirely, because under our laws 10 percent may be deducted from the amount wagered, and that is the way the license is granted.

Senator DANAHER. Does the general assembly meet in Massachusetts every year?

Mr. CONNORS. No, every 2 years. We do not meet again until 1945.

Senator DANAHER. If the State was threatened with this loss of revenue, do you think there would be a special meeting called?

Mr. CONNORS. No, I do not think so. I am quite sure it would not be.

Senator DANAHER. Thank you, sir.

Senator LUCAS. There is a limit as to what the fellow that goes into the pari-mutuel bets, that he can stand insofar as the chances of any return or reward are concerned.

Mr. CONNORS. That is true. That is particularly true of the large bettor. It would drive the bettor to the bookies, no question about it.

Senator LUCAS. In other words, if you keep adding the tax you reach a point where the individual will not go to the track and bet; he will

go to the illegal bookies that are set up here and there and do his betting at that point.

Mr. CONNORS. I believe that to be the fact, yes.

Senator LUCAS. There cannot be any question about it in my mind.

Mr. CONNORS. No.

Senator LUCAS. Eventually, if you keep on adding and adding you will finally break the racing down completely.

Mr. CONNORS. That is my honest opinion in the matter.

Senator LUCAS. There is such a thing in this country as civilian morale during this war, and I, for one, would want to see all the sports continued, the baseball, football, and racing, during the war period, in order to give the civilians some reaction and not to have a tax of this kind completely break it down.

Mr. CONNORS. That will bring to the realization of the public more than ever the taxes that they are paying.

Senator BARKLEY. What sort of additional problem would this impose on the State not only that legalized racing but that does not legalize racing if the number of illegal bookies should be increased, because of the impossibility of the State maintaining racing with this additional tax upon it?

Would it be more difficult to enforce the laws against gambling, not only in States where racing is legalized but in States where it is not legalized?

Mr. CONNORS. I think so.

Senator BARKLEY. The Federal Government under this legislation assumes no obligation at all for the enforcement of the laws against illegal betting.

Mr. CONNORS. That is true.

The CHAIRMAN. Have you completed?

Mr. CONNORS. Yes, I have, sir. I would like to introduce Thomas Underwood, Secretary of the National Association of Racing Commissioners, who has a short brief.

Governor HOLLAND. Might I make one additional statement?

Senator WALSH. Certainly.

Governor HOLLAND. The question of the Senator here is one that applies in this way to the different States: I would like to advise him, in the first place, while some States have had the largest operation this last year, because of the location of the tracks very close to our great defense centers, there are some that could not operate at all, and in the case of my State, Florida, the operation was reduced by cutting out two horse tracks and several of the dog tracks, so our revenue was cut from $4,390,000 to $1,100,000.

The second point I would like to make in that connection is that insofar as the added take is concerned, it would not only greatly encourage the bookies, but as to that amount of capital which would be bet with the pari-mutuel, it would eat it up sooner than would happen with the smaller take. The experience is there is just so much money that is fed into these pari-mutuels and the larger the take the sooner that amount is reduced, and therefore the smaller the amount of the take the greater the play on which the tax would be based.

Do I make myself clear?

Senator DANAHER. Yes. One question, please.

Governor HOLLAND. Yes.

Senator DANAHER. I notice from reading it in the papers that many of the tracks had so-called benefit days and they gave their entire receipts for a given day to the U. S. O., or similar organizations.

Governor HOLLAND. That was true. That was true in Florida before the war days. They have been very, very generous in that regard.

Senator DANAHER. Did the amount that was given represent the profits of the tracks for the day?

Governor HOLLAND. Only that. The State taxes could not be waived in our State.

Senator DANAHER. And in other States, on the other hand, the amount of the contribution to U. S. O. was deducted from the tax due otherwise to the State?

Governor HOLLAND. I am unfamiliar with what happened in other States, but in our State when they had the benefit days, of which they had several last year, at the dog tracks, for instance, the State tax had to be paid, but the take of the track was a donation, maybe a very generous one to the various charities and to the servicemen's welfare organizations particularly, such as the U. S. O.

Senator LUCAS. Do you know many tracks closed last year throughout the country due to transportation problems?

Governor HOLLAND. No. I know 3 States did not operate at all, out of the 22. The 19 that operated, the figures will show in a brief filed here by the racing commission, but they will show that they operated on a reduced basis,, except some 5 or 6, in which the amount of revenue was appreciable, and that the problem as a whole applied to the average State very much as it applied to us.

STATEMENT OF THOMAS R. UNDERWOOD, SECRETARY, NATIONAL ASSOCIATION OF RACING COMMISSIONERS

Senator WALSH. Your full name, please.

Mr. UNDERWOOD. Thomas R. Underwood, secretary of the National Association of State Racing Commissioners.

Senator BARKLEY. Mr. Underwood, what office do you hold with reference to the Kentucky State Racing Commission?

Mr. UNDERWOOD. I am secretary of the Kentucky State Racing Commission, too. I have a brief here that I think answers a good many of the questions that have been asked, if I may leave it here.

Senator WALSH. Yes.

Senator LUCAS. May I ask a question of Mr. Underwood?

Mr. UNDERWOOD. Yes.

Senator LUCAS. How many tracks were closed last year throughout the country?

Mr. UNDERWOOD. Approximately half of the tracks were closed due to wartime restrictions. Some of them consolidated tracks that could meet requirements of the O. D. T. and other agencies. Delaware, Florida, Washington, and practically all of California except the small Bay Meadows track were closed and in New Hampshire the spring meeting was abandoned. Only one of four tracks had a meeting in Maryland in the spring and in the fall there was one consolidated meeting; in Kentucky Keeneland's fall meeting was moved and the spring meeting was conducted at Churchill Downs. In Illinois meetings were held at tracks which could operate by the two associations whose tracks closed.

Mr. CONNORS. Three States.

Senator WALSH. Was that by law or by reason of financial difficulties?

Mr. UNDERWOOD. Both in Florida and California racing was suspended, and, for instance, Keeneland had one spring meeting.

Senator BARKLEY. Keeneland being a track in Kentucky?

Mr. UNDERWOOD. Keeneland being a track in Kentucky.

In New York, several tracks shifted their meetings to downtown tracks, that is, they curtailed the meetings, changed the entire racing program, and gave charity meetings primarily.

Senator LUCAS. In other words, they complied with the orders of the Office of Defense Transportation in respect to not interfering with the war effort in any way?

Mr. UNDERWOOD. That is right, and only those could run that were on transportation facilities, where they got together wherever they could. They had probably as many days of racing as they had before, except probably in California and Florida.

(The brief referred to and submitted by Mr. Underwood is as follows:)

BULLETIN

PROPOSED TAX ON PARI-MUTUEL BETTING

A Federal tax on pari-mutuel bets would raise very little in revenues except what it would take from the States that are now taxing pari-mutuel betting to the full extent that they believe racing can stand.

Such a tax would create many problems beyond duplication of State taxation because:

1. It would drive wagering into illegal handbooks.

2. It would reduce the money available for stakes which attract the higher class stables to racing.

3. It would conflict with State laws and constitutional provisions specifying what racing associations can withhold from public pools.

4. No definite plan for imposing or for collecting the tax has been devised.

5. Regulation, now a State function, would become most difficult.

6. If racing could produce any large sum in Federal taxes the tracks would certainly welcome this opportunity, but the proposed measure would jeopardize taxes now being paid and endanger decent racing.

The tax bill adopted by the House of Representatives contains a proposal for a 5-percent tax on all pari-mutuel wagers at race courses located in the United States.

A similar proposal was included in the tax bill as adopted by the House of Representatives last year but was eliminated by the Senate Finance Committee. The Senate Finance Committee no doubt was actuated in eliminating this proposal last year, following a hearing on the subject, by the belief that such a measure would not provide any appreciable amount of revenue for the Federal Government.

This proposal is set up in a table of tax suggestions as offering a possibility of raising $27,000,000. No such taxes could be raised from this source without complete destruction of the present safeguards which protect the public from crooked racing. The only way that any large amount of tax money could be obtained from a source would be for the Federal Government to snatch such revenue directly from the States that are now counting on it.

The only way the Federal Government could receive any considerable sum from a tax on pari-mutuel betting would be to take the taxes that are now being collected by these States that have legalized racing, set up State racing commissions for its control and that have counted upon racing revenues in their budgets for this year.

The testimony of Governor Spessard Holland on this subject, which is thoroughly convincing, appears in the hearings of the Senate Finance Committee of last year on the same measure.

SERIOUS QUESTIONS INVOLVED IN PARI-MUTUEL TAXATION

A substantial tax based on pari-mutuel wagers cannot be added to the tax program of the United States with a dash of the pencil. It is apparent that

this suggestion has not been carefully thought out and that the complications it will involve and the duplication it will cause have not been contemplated.

The State constitutions of some of the States and the statutory enactments in others provide the amount that can be taken out of the total pari-mutuel or public betting pool for the use of the track association, which must pay therefrom stakes and purses to owners and the expenses of racing, and for the State governments in taxes.

No clear statement has been made of how such taxes will be collected or what steps will be taken if the Federal tax law runs directly contrary to the statutory provisions of the States.

Further, the fact that legalization of racing and regulation of it as a sport has been retained in the hands of the State governments leaves the question of the legalization of racing one of option for the individual States and some State laws provide for local county option in regard to whether racing shall be conducted.

STATES ARE IMPOSING ALL THAT TRAFFIC WILL BEAR

In most of the States having percentage taxes on pari-mutuel betting, wagering was legalized for the purpose of providing State revenues. In view of this, it appears, obviously, that the States having such taxes are taking the highest revenues from racing that they can. There is a clear line above which a take-out from the total wagering pool starts reducing the wagering. Because of this fact, that is very obvious to all who have made a study of the features of the subject in practical application, if the attempt is made to take more than is justifiable the source will shrivel.

There are instances, at Santa Anita notably, where the racing association has taken a smaller percentage than that allowed by law because it felt that the larger percentage of take-out was causing diminishing returns.

Florida imposed an 8 percent tax based on a take-out of 15 percent of the total pari-mutuel pool. After the higher take-out was inaugurated less was bet than had been wagered the previous year.

Of the total amount bet in the United States 70 percent represented the pari-mutuel pool of tracks in the five States of New York, Illinois, Maryland, Massachusetts, and Rhode Island.

In these States New York now takes 6 percent, plus a share in the breaks, Maryland takes 5 percent, Illinois takes 2 percent plus a heavy daily license tax; Massachusetts takes 3½ percent plus all the breaks to 5 cents; and Rhode Island takes 3½ percent of the pari-mutuel turn-over in addition to licenses.

Herbert Bayard Swope, chairman of the New York State Racing Commission, explained at last year's hearing of the Senate Finance Committee that the total pari-mutuel betting represents a cumulative turn-over and that no one has proved mathematician enough to discover how much original capital is involved. It is the same money being bet over and over again and the question of how much can be withdrawn from the total public pools, which do not go to the tracks but are distributed back to the bettors after each race, represents a complicated problem for which no one of the States has found a formula that exactly fits the other.

In 1942, which is the last year for which complete figures are available, the 17 States that collected a percentage tax on pari-mutuel betting collected from this source a total of $19,061,650 therefrom. In addition some other States collected approximately $3,000,000 additionally from daily license and admissions taxes. There are 22 States that legalize racing and have created racing commissions.

No one can question that these State governments would levy and collect all the taxes that they could from this source which heretofore has been left wholly in the province of the States. In California, where most of the revenues were set aside for agricultural enterprises including county fairs, and in Florida, where the taxes from this source went to social security and reverted to the counties, there was no racing at most of the major tracks last year. The loss was a major blow to those States.

To what extent will the States, which have developed this source of revenue, continue to legalize and to sustain racing if the Federal Government grabs from these States the revenues which they have anticipated from this source?

The estimates that a 5 percent tax on pari-mutuel wagers would raise an amount much above that originally estimated may be based on the prediction that New York State may receive this year nearly $19,000,000 in taxes from racing. This State has been in a very singular position with regard to racing this year and has had the most exceptional racing season ever known. This year's exceptional experiences in New York's large season and Florida's and California's black-outs emphasize the local character of racing which makes it an unsuitable subject for Federal rather than State and local taxation.

LARGE PORTION OF PROFITS DONATED FOR WAR RELIEF

The aim that racing should be conducted primarily through the war period for the purpose of raising money for the funds for war relief and for the recognized war agencies officially designated by the Government was established early in 1942. In that year a total of approximately $3,000,000 was raised for war relief and this year the subscriptions and donations to such funds have totaled $5,000,000.

All who are interested in racing throughout the country have joined with the Turf Committee of America in creating and developing these funds.

In addition to the voluntary contributions to war relief and charities, racing associations and their individual owners pay heavy Federal taxes now in the form of Federal corporation income and personal income taxes and capital gains and excess-profits taxes. From this source the Federal Government will receive the most of whatever profits are made, through taxation, without jeopardizing the continuation of racing by trying to run the well dry at a single pumping.

Figures showing the high totals of other types of taxes now paid by racing associations have been gathered by the Thoroughbred Racing Associations (T. R. A.), but we are sure that this fact is apparent without statistical proof to members of the Senate Finance Committee.

In addition to income and excess-profits taxes, tracks pay Federal taxes on admissions, capital stock, social security, and unemployment compensation. On the current year's operations one track, Suffolk Downs, anticipates paying the Federal Government over $1,080,000, in above five tax divisions, of which $988,000 will be income taxes. A compilation shows that 30 tracks paid approximately $6,800,000 in 1942 in income and excess-profits taxes alone.

An estimate as to the taxes paid by the tracks in Federal taxes for 1943 runs as high as $15,000,000, based upon the higher rates and phenomenal seasons, especially in New York State.

BOOKMAKING WILL FLOURISH; STANDARDS WILL COLLAPSE

The National Association of State Racing Commissioners is an organization composed of the 22 State racing commissions that have been created by the legislatures and appointed by the Governors of these States. Its concern is chiefly with the interest of the States in this proposal and with the regulation and control of racing.

Illegal, off-the-course bookmaking or simple word-of-mouth betting by individuals would flourish if the attempt were made to extract an impracticably large amount from the pari-mutuel pools. This would be destructive to racing. It would be impossible to continue the sport upon a high plane.

The Federal Government, having blithely entered into this venture unthinkingly without having studied carefully all the possibilities and hazards involved, would wake up with a bumper crop of turf scandals on its hands. This unsavory condition would be the direct result of the attempt to take more money, through duplication of taxes, than the source can bear.

Experience has shown that control of the wagering feature alone has been a sufficient safeguard by which the States could regulate racing and continue it as a sport worthy to be perpetuated.

Proper supervision of racing by the States would be very difficult if betting were driven by a high take-out into illegal channels, and this would be aggravated by the lessening of the State's interest in safeguarding racing in order to furnish State revenues.

It is also true that whenever the receipts of the track associations have begun to decline one of the first steps has been to reduce purses and stakes and this always has made for cheap and at times for corrupt racing.

Many of the breeders of thoroughbreds and leading owners of racing stables already are thinking seriously of curtailing operations. If they discontinue their activities they will turn into tobacco or other crop production many thousands of acres of grass that constitute a tremendous conservation program, privately financed.

These breeders are now raising sheep and cattle in large numbers on the pastures of farms which are only partly in use for thoroughbred and other blooded horses.

The United States Remount Service uses 90 percent of thoroughbred horses for sires for Army mounts and thoroughbred stallions are in use for producing many types of riding and hunting horses.

RACING CONTRIBUTES $5,000,000 TO WAR AND CHARITY THIS YEAR

[From newspaper dispatches]

Unofficial figures, including an estimated $750,000 from Bay Meadows, indicate that racing this year will raise for war relief and charity $5,000,000, and should the season's total reach $5,300,000, racing will have made relief gifts of $8,500,000 in less than 2 years.

Besides California's Bay Meadows which, according to officials of the track will raise from $750,000 to $900,000 this year, other large amounts came from Suffolk Downs in Massachusetts, the New York Victory meeting held at Jamaica, the Fair Grounds at Detroit, Sportsman's Park in Chicago, Churchill Downs in Kentucky, Pimlico in Maryland, and other tracks.

Suffolk Downs made a contribution of $635,884, the Victory meeting produced $628,818, the Detroit track gave $464,649, Sportsman's Park $375,000, and Churchill Downs $248,290. A total of $267,142 was raised at Pimlico.

Other associations that raised $100,000 or more include Narragansett Park in Rhode Island; Aqueduct, Belmont Park, and Empire City in New York; Washington Park, Hawthorne, Arlington Park, and Lincoln Fields in Chicago.

Those which were able to give between $45,000 and $100,000 were the Jamaica and Saratoga associations, also in New York; Laurel, Bowie, and Havre de Grace, in Maryland; the New Orleans Fair Grounds; Rockingham Park in New Hampshire; and Garden State Park in New Jersey.

Further contributions have come from Wheeling Downs and Charles Town in West Virginia, Oaklawn Park in Arkansas, Beulah Park in Ohio, Dade Park in Kentucky, Pascoag in Rhode Island, and others.

N. A. S. R. C. TABULATIONS SHOW AMOUNT STATES RECEIVED IN RACING TAXES

The tabulations of the total pari-mutuel turn-over and revenue by States are made each year by the National Association of State Racing Commissioners. The following tabulation gives the totals on all State revenues for the past 4 years:

Year	Number of States reported	State Revenues
1939	17	$10,909,807
1940	16	16,145,182
1941	18	21,128,173
1942	19	22,005,278

THE NATIONAL ASSOCIATION OF STATE RACING COMMISSIONERS,
P. O. Box 156, Lexington, Ky.

These figures include all State revenues from percentage taxes on pari-mutuel betting and all daily license, State admissions, and other State taxes.

STATEMENT OF HERBERT B. SWOPE, CHAIRMAN, NEW YORK STATE RACING COMMISSION

Senator WALSH. Mr. Swope, will you state for the record your name?

Mr. SWOPE. Herbert B. Swope. I am the chairman of the New York State delegation. I am the former associate of the gentleman who sits on your left.

Senator BARKLEY. I hope you refer to me.

Mr. SWOPE. I should have said, since this is wholly nonpolitical, I am chairman of the New York State Racing Commission, and I am here by authorization of the Governor of New York, of whom I think you have heard, Governor Dewey.

This is an annual indulgence which you gentlemen have been good enough to give the devotees of this sport, and I shall show my appreciation by my brevity.

It seems to me perhaps I may avoid overargument by addressing myself to a question the Senator from Connecticut asked, as to the effect of overtaxation. One point might be valuable for me to direct your attention to. A 5-percent tax seems almost insignificant, yet it amounts to 100 and 150 percent on the total. The tax rate throughout America today is perhaps 4 percent. It varies in the different States. It runs from as little as 2 percent in those States in which the sport has not been firmly established, to 6 percent in New York State and 8 percent in Governor Holland's and Senator Pepper's State. Obviously a 5 percent would be 100 to 150 percent, it comes to about 150 percent increment to the tax itself.

The effect of that extra taxation, as Senator Lucas brought out, is exactly the same, if I may imply a somewhat classic analogy, as a kitty in a poker game. I hope it is not necessary for me to begin an educational process on that point, but if it becomes too large, as I can testify, eventually the kity winds up with all the money.

We have today a situation in New York, which is more or less typical, in which $19,500,000 in direct revenues have been paid to the State general fund. That is inclusive of the admission-fee tax, which runs to 15 percent in New York, and which is, in addition to a 10 percent tax of the Federal Government, an admission tax. The excess-profits tax that the various tracks of America pay to the Federal Treasury totaled something like $16,000,000.

Senator CLARK. You mean that makes the admission tax 25 percent in New York?

Mr. SWOPE. Exactly that.

Senator CLARK. That is a greater admission tax than anywhere else that I know of.

Mr. SWOPE. It was concluded that racing could stand this extra taxation, and up to now it has done fairly well.

The tracks in New York, typical I think of most of the tracks in America, have not been the bonanza that so many have pictured them to be.

The zone of State taxability, that the political economists can argue better than I, is in this field. The political economist has found that this is definitely a proper reservation for State revenues and, if I may say so, the right to race is definitely a State function, granted by the State legislature only after a referendum in the various States.

In New York, as in at least 9 of the States, it required a constitutional amendment. It was passed approximately 2½ to 1. That has been somewhat similar to the experience of each of the other States where that expedient has been necessary. I would like to point out, too, in answer to the gentleman from Connecticut, that the contributions made by racing to the various national war-relief agencies has totaled more than $7,200,000 in cash, cash on the nail, since January 1, 1942, and this year the collections were almost $5,000,000. In no State where those contributions have been made was there any relief from the tax imposed upon the pari-mutuel, nor from the tax imposed on admissions. Over and above the fact that the tracks gave their money to these charitable organizations, they have to pay to the State.

I think it is not too much to say in behalf of racing that if it touches at all upon interstate commerce, it does so to a very, very slight degree. I direct your attention to the fact that a stable that may be sent to New York, where racing is continuous from April to November, requires none of the protection of the Federal Government. It rarely uses interstate-commerce transportation, and the method of transport from track to track is usually by van within the State itself. The conditions that apply to New York are equally true of New Jersey, Massachusetts, Rhode Island, Maryland, Delaware, and Florida. The necessity of preserving the circuit unbroken in the East is obvious, otherwise the eastern seaboard would lose their horses to the West, which was a very powerful competitor while the southern tracks in California were permitted to run.

That brings to my mind a point that you may find important, again going to the question of the Senator from Connecticut. Santa Anita, which was a conspicuous success, was granted the right by the legislature of imposing an 8 percent take for its own expenses and its profits. They discovered there is such a thing as a median line beyond which the public would not patronize it, so they voluntarily reduced their take to 6 percent, which, with the State's 4 percent, caused them to find that the handle, the pool, was very much greater under that reduced rate.

Senator DANAHER. A question at that point, sir.

Mr. SWOPE. Yes, please.

Senator DANAHER. What would be the percentage of breakage to the track under that situation?

Mr. SWOPE. That varies in the different States.

In New York, they permit 5 percent breakage. "Breakage", as you gentlemen know, is to a nickle. It is an ingenuous idea. I personally believe the breakage should be to a penny, but I have not been able to convince my legislature as to the virtue of that idea. Some of the States permit breakage to a dime. I think Senator Lucas' State does, California does, and Massachusetts does. We, in New York, permit breakage only to a nickle. Specifically, the answer is the 5 cent breakage amounts to about seven-eighths of 1 percent of the total handle. But—and it is a very important "but"—that breakage does not go to the tracks; 60 percent of it goes to the State of New York, and it is a grave question as to how long that 60 percent will remain 60 percent. I have an idea it will be increased.

I find most of the States have reserved action on the pari-mutuel tax, because they see facing them the need for extra revenues due to possible unemployment, and the needs of the returning soldiers, and in each of the tax commissions which I have come in contact with, there has been an effort to preserve this source for the purpose of developing it later on as the need may arise.

In New York the tax is now 6 percent which, as I said before, is higher than in any other State in the Union, of which New York is still a part, except Florida, which is 8 percent.

Senator DANAHER. What becomes of the other 40 percent of the breakage in New York?

Mr. SWOPE. It goes to the tracks.

Senator DANAHER. The seven-eighths of the 1 percent of the total handled in New York is on a 5 percent breakage?

Mr. SWOPE. Five-cent breakage; yes.

Senator DANAHER. Five-cent breakage, I meant to say. In the States where it is 10 cents, is it fair to say that the percentage would double?

Mr. SWOPE. Not quite, but just about. It is not quite 2 percent. It is an arithmetical progression, not a geometric progression, but it is roughly 2 percent, yes.

I need not explain to you that the 4 percent that the tracks are permitted to retain in New York is to pay the expenses of their overhead, their State taxes, outside of the pari-mutuel tithe, and the expenses of purses and of operating and keep the tracks open all the year 'round.

From the standpoint of efficiency, the tracks are not particularly strong, because they race only 30 or 40 days at each track. None of the racing men has been ingenious enough to know how to employ them efficiently, except in New York where we granted two of the tracks to the Army, which they used for training purposes for some of the troops, to be ready to go to embarkation, and they found it very satisfactory and effective. Santa Anita has been taken over completely by the Army, and none of southern California, none of the tracks south of San Francisco, have been operating.

There is one point that might bring some light into this already "light" place.

Twenty-two States have legalized betting. Three have never operated: South Dakota, Oregon, and Nevada. Three were completely stopped last year. Starting with Florida, where I assume the State revenue from racing is a larger proportion of the total than any other State in America, something like one-sixth or one-seventh; is it not, Governor Holland?

Governor HOLLAND. Of the operating tracks, yes.

Mr. SWOPE. The Delaware, Florida, and Washington tracks, that leaves 16 States that were operating, but within those States a number of tracks were forced either to abandon completely their meetings or to telescope them with other meetings, or finally to shorten their programs very considerably. Maryland, whose attitude, according to Governor O'Conor, is exactly the same as New York's, instead of running full meetings ran something like a 55-percent program.

It has been figured that 125,000 men, women, and children are dependent upon racing for a living—not betting, but racing—which would include necessarily those who engage in stabling (3 to 6 horses to a hostler), the farmer who is raising a particular type of feed, which is particularly true of Kentucky, and the various supply agencies whose existence is dependent upon the maintenance of racing.

I think I said before that the take in the various States differs according to their interpretation of what the traffic will bear. The legislatures have not been particularly shy about imposing as great a tax as possible, and these conditions vary in different localities. Florida, for example, which has a total take of around 16 percent, has been viewed as a guinea pig, because some believed that the take there is now at the limit, if not beyond it. In New York our total extraction

from the handle comes to 10 percent net, about 10½ to 11 percent in total. So any tax added to the State's average would be, as I said before, 100 to 150 percent. In New York it would be about 90 percent.

Senator DANAHER. Your 10½ or 11 percent, as you stated, does not include the admission tax?

Mr. SWOPE. No; it does not include the admission tax, nor the food, nor the drink when you can get it.

There is another point that we brought out last year that Senator Clark was interested in. It is illusory to say that America bets $600,000,000 a year. That is not fresh capital; that is a constantly rotated money that is played by the winners on each of the races as they come up. The New York program is 8, or 7 races per day. The amount of fresh money, original capital, in ratio to the total is a very difficult mathematical problem to solve, but we have assumed that it roughly runs about 35 percent. In other words, if a handle was $1,000,000 a day, it comes to about $350,000 that is brought there by the patrons.

Senator BARKLEY. In other words, we might take an example of a man who goes to the race track with $100 in his pockets that he thinks he can afford to bet cumulatively from time to time, and if he is lucky, he leaves with that same $100, no more, no less, but in the process he may have bet the total of maybe $400 or $500, but he has not put any additional money into it.

Mr. SWOPE. That is right.

Senator CLARK. And if he bets long enough, he will lose all the money on this take.

Mr. SWOPE. If he bets long enough and comes out even, he will be a marked man.

Senator CLARK. Assuming he comes out even on this take-out proposition, he loses all the money without losing any actual bet?

Mr. SWOPE. Precisely that. The tax, too, must take into consideration that fact. I would like to make this final point. Of course, I will be happy to answer any questions, but I think this final thought is worthy of your attention.

Senator Clark brought out last year the fact that invariably when the tax is increased, bookmaking increases in geometrical progression, because the bookmaker having no offices except in his hat, and hardly any overhead, can afford to lay a price higher than the track since he pays no taxes at all. In other words, we find when the take is increased, bookmaking, through criminal alliances with corruptible authorities, increases not merely at the point of racing but in neighboring States.

Senator CLARK. For instance, in our State racing is not legalized. Of course, handbooks are made, as no doubt they are made in many other States. Right across the river from us in Illinois racing is legal and pari-mutuel betting is legal and taxed there. If you take out too much from pari-mutuel betting, it throws their business in the hands of these illegal handbook proprietors on our side of the river.

Mr. SWOPE. Precisely that. In fact, they will give you a percentage back if you bet with them at the track's price.

Senator BARKLEY. Let me ask you this: If we might assume for the sake of the argument that the racing business could absorb this additional 5-percent tax, which you deny and which is not true but which

for the sake of argument we will assume they may do it, would that not preclude the possibility of the State itself increasing the tax for any purpose, whatever it might be, in order that it might expend that increased amount for local purposes, whatever that might be?

Mr. SWOPE. Exactly that, sir. It is a reserve, as I tried to point out before, that most States believe is definitely within the zone of State taxability.

I would like to leave this thought with you, and that is that this racing business is created by the State. There is no power inherent in the National Government that can compel racing or permit racing. Only the States can do it, and the States can do it only after a referendum. Since the States have permitted this enterprise, that some regard as nefarious—I am not one of those—I point out to you if the Federal Government was to cut corners, so to speak, and become a partner, racing would be of necessity maintaining two silent but very powerful partners in the form of a State and Federal Government. If the Federal Government chooses to advantage itself of this sort of thing, why doesn't it go directly into a national lottery? It is much the same thing.

Senator GUFFEY. Thank you very much.

Mr. SWOPE. I am in your corner, Senator. I suppose as a racing man I should not admit this, but the chances are not wholly dissimilar, although in one case we pore over the dope and in the other case we leave it to chance.

Senator GERRY. It takes away from the State and puts in the Federal Government the revenue that the State has been using, the source of revenue that the State has been using.

Mr. SWOPE. Precisely that.

Senator GERRY. In these trying times it is very difficult for the States to get the revenue. We have got to permit them to have some source of revenue.

Mr. SWOPE. There is about $31,000,000 that the States now derive from racing directly from the tax on the parimutuel system, plus an admission tax, and plus other little pies that they stick their fingers in, and that $31,000,000 would not remain if the Federal Government were to impose this tax.

May I add, the Treasury, much to my surprise and gratification, last year neither suggested nor approved this tax.

I should like also to add, if it be a moralistic influence that prompts the Ways and Means Committee of the House to bring this up, it seems to me there is a simple way of doing it, and that is to pass a national act forbidding racing.

It is better to do that than to tax it out of existence, because taxing it out of existence, as Senator Gerry says, would be robbing the States of an enormously important source of revenue, which must be maintained in these days of dwindling incomes.

Senator LUCAS. One final question: Does the witness know of any Federal law that imposes a tax upon a business that, in the first instance, depends solely upon its existence through State regulation?

Mr. SWOPE. I tried to answer that question last night.

I am flattering myself by saying our minds are working the same way. The liquor law is not analogous because there are three States in America where liquor is not legalized—Kansas, Oklahoma, and Mississippi,

I believe. There the Federal Government has given a right, which the States have not seen fit to avail themselves of. Here the situation is completely reversed. Here the State creates the business and the Federal Government comes in and attempts to take advantage of it.

Senator GUFFEY. Mr. Swope, do you know how much the State of New Jersey got out of racing last year, or the year 1942?

Mr. SWOPE. In 1942 I think it ran $1,035,000.

Senator GUFFEY. The Governor of the State told me that there was a $980,000 contribution to my State of Pennsylvania.

Mr. SWOPE. It is more than that. There is only one track now in New Jersey. I think there will be more.

I want to add this: I think there has been a very sincere effort on the part of the tracks to comply with the restrictions imposed by the O. D. T. and O. P. A. That limits my alphabetical vocabulary. In New York we ran no cars to the race tracks, nor did we have special trains. The tracks were on the main lines. We did not run any specials at all.

Senator BARKLEY. Does not there go along with the permission on the part of the State to conduct racing a very considerable obligation to control and regulate in regard to the unfortunate and observance of the law? That is a serious problem, as we all know.

Mr. SWOPE. Yes, Senator.

Senator BARKLEY. Now, this tax provision undertakes to let the Government of the United States come in on the benefits without undertaking any of the obligations of control and regulation.

Mr. SWOPE. I think that is very well put. It wants to come in on the benefits, Senator Barkley, to a larger degree than any of the States now enjoy, but there is no provision made for regulation. I do not know how such a tax would be collected, particularly, as Mr. Connors pointed out to you, there are certain ceilings in the various States beyond which the tax cannot go, and in those States, there will be a limit reached and I do not know what they will do. There has been no method set up for the purpose of collecting or regulating this tax.

Senator WALSH. The hearing on this subject will be closed.

Mr. CONNORS. Mr. Chairman, Mr. Shawcross, of Rhode Island, who represents the Governor, would like to say something.

The CHAIRMAN. Very well, Mr. Shawcross.

STATEMENT OF WILLIAM A. SHAWCROSS, ADMINISTRATOR OF RACING AND ATHLETICS OF THE STATE OF RHODE ISLAND

Senator WALSH. State your name for the record.

Mr. SHAWCROSS. I am William A. Shawcross, administrator of racing and athletics of the State of Rhode Island.

I am down here on the authorization of our Governor who has been unable to come down, but he has been very much interested in this tax bill due to the fact that Rhode Island raised this year or will raise over $2,250,000, and that is one seventh of our budget. If you take that away we will be be all out of gear. This racing revenue now is the second or third in importance. It was half a million more than last year. It has been an offset to our loss of the gas revenue.

Our law was originally set up by referendum of the people. We have always shied from making any amendments, in fact it was amended only once. We have amended a taxation bill where we took half the breakage.

I want to leave the fact with you that we will not know what we will be able to do if Rhode Island were to lose this revenue; we will not be able to know what to do to offset this revenue.

Senator BARKLEY. May I ask either Mr. Connors, Mr. Swope, Mr. Underwood, or Governor Holland to put into the record the purpose for which this tax in the States is expended. I think it would be very informative. Maybe you already have done that.

Mr. SWOPE. We will do it in more detail.

Mr. SHAWCROSS. May I also state one-half of our revenue received from this racing goes to cities and towns in Rhode Island.

Senator WALSH. A good deal of it comes to Massachusetts, incidentally.

(The following information was furnished in answer to Senator Barkley's request:)

DECEMBER 3, 1943.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: In answer to the suggestion made by Senator Alben Barkley, at a meeting of the Senate Finance Committee on Friday morning, December 3, as to the disposition of the pari-mutuel tax revenues made by the various States where betting has been legalized, the following statement is submitted:

In each of the 19 States that have been operating in the last 15 years, each State has earmarked the receipts from this source for specific purposes. The funds to which this revenue flows differ in the various localities, but a typical example is found in Florida where, according to Gov. Spessard L. Holland, of that State, it is as follows:

"The revenue is divided into three parts. Three percent of the take on all bets makes up a fund which is divided equally among the 67 counties, about $33,000 per county in the last year of normal operation. About one-third of the fund going to counties is earmarked, by special act, for public school operation. The added 5 percent is taken from horse bets in 1941, and since, goes to the State welfare, exclusively earmarked for old-age assistance. Three percent of the total goes to the State general revenue fund. Division for 1941 and 1942 showed the following amounts: $2,130,000 plus to the State old-age system fund; $1,901,000 plus to the State general welfare; total, $4,898,000.

"The amount divided among the counties deserves particular mention in that the equal division among all counties was not legally permitted until the constitutional amendment on this subject was adopted, which was the only provision of the Constitution allowing such equal distribution. This is a measure of untold importance to about two-thirds of the counties of the State, which are the smaller and weaker counties."

Charles F. Connors, chairman of the Massachusetts State Racing Commission and president of the National Association of Racing Commissioners, made the following statement:

"In Massachusetts the total receipts derived from legalized pari-mutuel system is devoted to old age assistance. This figure reached, in 1943, $4,273,000."

In Rhode Island, William A Shawcross, administrator of racing, pointed out that approximately one-seventh of the total revenue was derived from the pari-mutuel tax; 50 percent goes to the State general fund, and 50 percent is divided among various cities and counties of the State.

Herbert Bayard Swope, chairman of the New York Racing Commission, showed that the total revenue from the pari-mutuel tax and admission taxes of the State aggregated in 1943 approximately $19,250,000, this in addition to the State income taxes and the realty and corporation taxes. Of the moneys thus derived, which are put into the general fund, a fixed percentage is earmarked for agricultural purposes such as the maintenance of worthy agricultural help of various sorts and certain educational purposes.

The instances here set forth are fairly characteristic of each of the 22 States where betting has been legalized.

In several States there has been a declaration of purpose to use any increase in taxes that may be imposed by the State for the relief of possible unemployment and for the benefit of returning soldiers.

We add herewith a list of those States in which the pari-mutuel system has been legalized.

STATES IN WHICH PARI-MUTUELS ARE LEGALIZED AS OF MAY 1943

Arkansas	Maryland	Oregon
California	Massachusetts	Rhode Island
Delaware	Michigan	South Dakota
Florida	Nebraska	Washington
Illinois	Nevada	West Virginia
Kentucky	New Hampshire	
Louisiana	New Jersey	
Maine (harness racing only)	New York	
	Ohio	

Senator BARKLEY. Senator George yesterday authorized me to have Mr. Bulova of the Bulova Watch Co. to appear very briefly this morning in regard to the incrased taxes on watches.

Senator WALSH. Mr. Bulova, come forward, please.

Senator BARKLEY. Mr. Bulova is chairman of the board of directors of the Bulova Watch Co. with which we are all familiar.

STATEMENT OF ARDE BULOVA, CHAIRMAN OF THE BOARD, BULOVA WATCH CO.

Mr. BULOVA. Mr. Chairman and gentlemen, I come before you at this time to make a brief statement in opposition to the increased tax carried in the House bill on watches.

At present all jewelry, including watches, is taxed at the rate of 10 percent. The House bill proposes to raise this tax to 20 percent. I am not objecting to the 20 percent increase in the tax on jewelry. As a matter of fact, I think it might be raised to 25 percent without any great injustice to the trade or industry, but watches, in the real sense of the word, are not jewelry. They have been, in a sense, classified as jewelry because they are sold by jewelers but they are not jewelry in the sense that most articles referred to as jewelry come within that category.

Watches are not a luxury. We regulate our lives, our work, and our habits by timepieces. They are a necessity; they are as essential to the orderly arrangement of a man's life as a hat or any other untaxed article. I am sure that this statement cannot be successfully contradicted because we are men of experience and we know that a watch is absolutely essential to any normal man's life.

Although the Government issues wrist watches to air pilots in the Air Forces as a part of their standard equipment, it does not issue watches to the 10,000,000 men and women in our armed forces. Even in the case of air pilots the Government does not issue a second watch if the first one issued becomes useless from wear or otherwise.

Watches used by men and women in the armed services are either purchased by them individually or by their family or sweethearts as gifts. For example, the Navy specifies that an ensign must have a watch but the Navy does not provide the watch for the ensign. The watch must be purchased by the ensign or by his family or some friend. This watch and all similar watches would bear this increased tax under the House bill.

Senator WALSH. What is the increased tax in the House bill?

Mr. BULOVA. From 10 to 20. It was made 10 and it is raised to 20.

There are approximately one and one-half million of railroad workers in the United States practically all of whom are required to furnish and carry at all times standard and reliable watches. Hundreds of thousands of these men are subject to be discharged if they are found on duty without such a timepiece. To all these men a watch is not simply a luxury; it is an absolute necessity.

The women in our armed forces, such as WAVES, WAC's, nurses, and other affiliated services, as well as men and women defense workers, must have watches in order to be on time at their work, which is essential to the orderly production of war equipment.

All of these people, in addition to all the other millions of men and women in this country who regulate their lives by the use of watches, must bear the burden of this additional tax. We think this additional burden should not be imposed upon them. I do not recommend the repeal of the present 10 percent tax on watches; the industry has adjusted itself to that tax. As manufacturers of watches, neither the 10 percent or 20 percent affects us. It is a retail tax collected by the retail distributor and passed on to the consumer and does not affect the wholesale price of the watch to the retailer. Therefore, I have no personal or pecuniary interest in the levy of this tax, but as a lifelong manufacturer of watches and knowing the indispensability of this instrument or commodity in the regulation of the lives of our people, I know how burdensome this increased tax would be to millions of people.

I wish to add that the facilities of American manufacturers of watches are not and have not been for many years, if ever, sufficient to supply the American demand. On the whole, about one-third of the watches used in the United States are manufactured here; approximately two-thirds of them are imported. These imported watches already pay a heavy tariff duty in order to enter this country. They would also bear this increased excise tax as they are distributed by the retailers throughout the country.

Senator WALSH. Has the production throughout this country diminished since the war began?

Mr. BULOVA. It has been reduced about one-half.

The Waltham watch I think is converted almost entirely to war work. There are just four watch plants in this country, the Waltham, Hamilton, Elgin, and Bulova.

I have come before you with this brief statement in response to my sense of duty and in view of my long experience in the watch industry. I sincerely trust the committee will not impose this additional tax upon the users of watches in the United States.

Senator WALSH. Is Mr. Purdum, the representative of the Post Office Department, here?

(No response.)

Senator BARKLEY. I do not know what to do about this. There is nothing in the bill on this subject that I am going to mention, but there has been a suggestion dropped by Senator George, and there is also an amendment offered by Senator Overton, that he proposes to offer to the bill, in regard to the shortening of the period in which liquor may be kept in bonded warehouses and the tax paid upon it, or increasing the tax progressively as the time runs from 4 to 8 years. I spoke to Senator George about the matter and he asked me to have

these people here today. It is a little difficult for them to shoot at something in the air, because there is nothing in the bill on the subject, but they have stayed over, and I understand Mr. Van Winkle, who represents the Kentucky distillers, would like to testify, and there may be others who want to testify here. For some reason their names were not put on this calendar of witnesses, but I would like to have them have an opportunity to be heard either now or at some other time during the day.

Senator LUCAS. Mr. Chairman, when was this amendment given to the Senate?

Senator BARKLEY. The amendment which has been offered by Senator Overton, or proposed by him and intended to be offered to this bill, was on November 29, 2 or 3 days ago. It has been referred to the Committee on Finance, and I suppose in a technical sense is before us.

Is Mr. Van Winkle here?

(No response.)

Senator BARKLEY. Is Mr. Millard Cox here?

(No response.)

Senator BARKLEY. They do not seem to be in the room. I thought they were here.

Senator WALSH. We will hear them here this afternoon.

Senator LUCAS. It just strikes me, if I may have a word, that amendment is of such importance that I do not see how these fellows can come in here on a moment's notice and give testimony, the same testimony that they might be able to give if they had a chance to study it. I just know a little about it myself. If they are ready to testify, that is all right, but I certainly do not like the idea of having an amendment thrown in here on a couple of days' notice and have an industry that is as much involved as these people are to come in and testify.

Senator BARKLEY. The only reason is Senator George told me yesterday he wanted to conclude these hearings tomorrow.

The amendment that has been offered and the suggestion that has been made in the newspaper is of such a serious nature that the people in this industry tell me it will ruin them if it remains in the bill. This hearing ought not to be closed without every opportunity being given to them to present their views to the committee.

Senator WALSH. Are they in the city?

Senator BARKLEY. They are in the city; yes.

Senator WALSH. Will you consult them during the noon hour?

Senator BARKLEY. I will if I can get off the floor of the Senate.

Senator LUCAS. I, for one, am not in favor of closing the hearings even if they have to go over into next week, until the industry is given opportunity to be heard.

Senator WALSH. The committee will arrange to have them heard.

Representative Hagan, do you desire to be heard?

STATEMENT OF HON. HAROLD C. HAGEN, UNITED STATES REPRESENTATIVE FROM THE STATE OF MINNESOTA

Mr. HAGEN. Mr. Chairman and gentlemen, my name is Harold C. Hagen, Representative of the Ninth District of Minnesota, and as the only Farmer-Labor Member of Congress, I represent a group which

relatively is about the same size as I represent in the Congress, that is, the retired enlisted men in the Army, Navy, Marine Corps, and Coast Guard Services of the United States Government.

I want to briefly make an appeal for the retired officers and enlisted men of the Army, Navy, Marine Corps, and Coast Guard.

Senator WALSH. Is there anything in the bill dealing with this subject?

Mr. HAGEN. Yes, there is now an exemption to men in the armed forces, and these men that I plead for are left out of these exemptions. I want to ask you people to consider the exemption of this particular group of retired enlisted men who are not now included in this income tax exemption.

Senator WALSH. What is that group?

Mr. HAGEN. I will file a statement with you, Senator, if I may, on this subject. It will take about 2 minutes to go over this with you.

Senator WALSH. Very well.

Mr. HAGEN. We want to ask you to consider the exemption, or to grant in the pending bill the same income-tax exemptions for all retired personnel below commissioned rank, as the Congress during the past year extended to foreign veterans, members of the United Nations forces, retired railroad employees, and to American war veterans not retired. At the present time the aged, disabled, retired veterans of the armed forces, I have mentioned, are the only veterans who are not granted income-tax exemption. They are penalized by Congress because they served 30 years, while veterans who served only 90 days receive more pension or compensation than do the retired, enlisted men who served 30 years, and at the same time the veterans of short service are income tax exempted on the pension or compensation which they receive.

Just to give you one example, to quote you a very specific case, this is the case of Julius Heinze. This man was twice decorated for bravery and once wounded. He served 30 years to retire. Yet today he receives less retire pay than approximately 25,000 Spanish-American war veterans who served 90 days. Many of these veterans receive $100 per month pension, all of which is tax-exempt, while the lower retired pay of Julius Heinze is subject to income tax.

Now, I will not take up any further of your time, but I would like to file for the record here, Senator, if I may, this statement addressed to you, which gives the complete story.

Senator WALSH. That may be done.

Mr. HAGEN. I would like to file a suggested amendment to Public Law 68, Seventy-eighth Congress, in reference to the income tax exemption.

Senator WALSH. That may be done.

Mr. HAGEN. I also have an article by Damon Runyon which explains the situation very well.

Senator WALSH. That may go into the record. We will appreciate it.

Mr. HAGEN. Thank you.

(The matter referred to is as follows:)

NATIONAL DEFENSE,
Arcadia, Calif., November 26, 1943.

HON. WALTER F. GEORGE,
Chairman, and Members of the Senate Finance Committee,
United States Senate, Washington, D. C.

GENTLEMEN: This periodical which has been in publication since 1928, catering to the welfare and interest of retired officers and enlisted men of the Army, Navy, Marine Corps, and Coast Guard, respectfully appeals to you and the members of your committee, to grant in the pending tax bill the same income-tax exemptions for all retired personnel below commissioned rank as the Congress during the past year extended to foreign veterans, members of the United Nations' forces, retired railroad employees, and to American war veterans not retired.

Aged, disabled, retired veterans of the armed forces are today the only veterans who are not granted income-tax exemption. They are penalized by Congress because they served 30 years, while veterans who served only 90 days receive more pension, or compensation, than do retired enlisted men who served 30 years, and, at the same time, the veterans of short service are income tax-exempt on the pension, or compensation, which they receive.

Will you and your committee kindly consider the statements of truth and fact embodied in pages 7, 8, 9 and 10 (attached herewith) which are taken from our December issue.

The four cases shown on page 7 of Navy men, disabled in service, are typical of hundreds, or thousands, of similar cases. These men with their low retired pay, and with service-connected disabilities, are forced to pay income taxes on their small retired pay, while many Spanish-American War veterans who served only 90 days and who did not incur any disabilities in service today, because of age or disabilities, are receiving 60 and $100 per month pensions, all of which is income tax exempt. This is discrimination which merits your kind consideration for removal.

To amplify more specifically in this case, will you please refer to page 8, which shows the status of Julius Heinze, twice decorated for bravery, once wounded. He served 30 years to retire. Today he receives less retired pay than approximately 25,000 Spanish-American War veterans who served only 90 days and who remained here at home. Many of these veterans are personally known to us, receiving as they do $100 per month pension, all of which is tax-exempt, while the lower retired pay of Julius Heinze is subject to income tax.

In other words, the veteran who fought and served in combat and who put in 30 years is the real forgotten veteran, while many of the Spanish-American War veterans who never hazarded his life, and who incurred no disabilities during his service, is today munificently provided for, even though he is a wealthy man and has other income.

Will you and your committee, therefore, kindly favor us by offering the amendment proposed on page 10, or any other similar amendment, to the tax bill now before your committee so that hereafter aged and disabled retired enlisted men may receive the same benefits as foreign veterans, United Nations' personnel, retired railroad employees, and all other American war veterans of short service receive in regard to income tax exemption.

ADDITIONAL STATEMENTS

There are approximately 11,000 enlisted men retired from the Army, Navy, Marine Corps, and Coast Guard who served 30 years' actual time. All these men who are physically fit are again back in active service. Only those who are aged and disabled, or over 60 years of age, are not again back in the service. Because of their long years of service, it is a safe assumption that the disabilities which this group may have, may safely be considered as having been incurred during their long period of service—30 years. As illustrative of this, I mention one Sgt. William O. Cook, of Pasadena, who was decorated for bravery in Cuba. He had outstanding combat service in the Philippines and in one campaign never wore a stitch of dry clothing for weeks. His medical record does not show any disability incurred in service but today this aged veteran is paralyzed and suffering from cancer. Assuredly, no one could honestly say his disabilities did not have their incipiency in the suffering and privations of his service during and following the days of the Spanish-American War.

In addition to the approximately 11,000 enlisted men who served full 30 years, there are approximately 25,000 retired, enlisted men who served only 16 or 20 years' active service with the colors, putting in the balance of their time to make the 30 years, in the Reserve. Most of these men are again back in active service.

The Navy has recalled men 70 years or more of age. Only those who were too old, or disabled, have not been called back into active duty. And it is for this latter group that we appeal to you, and to the honorable members of your committee, to grant to the retired, enlisted men the same income-tax exemptions which officers and men in the active service receive.

TRUE FACTS AS TO PAY

The official records will show that over 50 percent of the retired, enlisted men of our armed service have not received 1 cent of increase in retired pay since 1922. Some few Navy and Marine Corps enlisted men received $1.74 per month increase since 1922. While over 50 percent of the retired, enlisted men have not received an increase in pay since 1922, the Congress in 1926, and again last year, has (twice) increased the pay of civil-service employees, many of whom receive pension, or compensation, plus their civil-service remuneration, and they are income-tax exempt on the pension, or compensation, which they receive. These individuals with two incomes are thus income-tax exempt on one, whereas the aged, disabled, retired enlisted men with only one income (their small retired pay), must pay income tax on that.

We relaterate, that the Pay Act of June 1, 1922, failed to give an increase in pay to well over 50 percent of the retired, enlisted men of the armed service, and that this 50 percent or more have not received an increase in pay since 1922.

PLIGHT OF RETIRED MEN DESPERATE

The plight of the aged, disabled, retired enlisted men is becoming increasingly desperate because of the ever-increasing cost of living plus the ever increase in taxes. Organized labor has been receiving increases to supplement the increased cost of living but the retired, enlisted men of our armed service, with no organization, have no one to appeal to but your own committee, relying upon your sense of justice to extend to them the same consideration which your committee has heretofore extended to all other veterans. Madam Perkins, Secretary of Labor, is authority for the statement that the cost of living has risen 23 percent since the annunciation of the Little Steel formula in 1941. This statement is conclusive proof that the retired enlisted men are the chief sufferers from our increased cost of living for their retired pay buys ever and ever less, and unless they are exempt from income taxes on parity with other veterans their final plight will be indeed desperate.

FURTHER CONGRESSIONAL ACTION FOR VETERANS

Legislation has passed the House and is now before the Senate which would provide 15 percent increase in compensation to World War veterans and their widows. Congress, through this action, recognizes that compensation paid to veterans buys ever and ever less and is seeking to combat the increased cost of living by increasing the compensation—a compensation which is income-tax exempt, too, to these same veterans.

We are not asking for an increase in retired pay for retired, enlisted men but we are appealing for the same treatment for the aged, disabled, retired veterans as is extended to all other veterans. We consider it highly discriminatory and unfair that the aged and disabled, retired, enlisted man should be discriminated against and penalized because he served his Nation honorably and faithfully in from one to five wars and then retired, which is indeed the case today where the veteran of short service is favored, and the retired man of long service is not.

We could continue to recite cases of various kinds showing the injustice perpetrated upon the aged and disabled, retired veterans of prior wars but we recognize that your committee is a busy one. Therefore, we rest our case in your hands, appealing to you to thoroughly consider the specific instances which we present on page 7, which could be multiplied by the hundreds or thousands.

In conclusion I mention just one additional discrimination which speaks for itself, to wit: My brother-in-law, a retired railroad employee, who never contributed a penny toward the railroad retirement fund, and who never served in war, is income-tax exempt on the retired pay he receives, while my husband, who served 30 years, much of the time at low pay (as low as $13 per month), is forced to pay income taxes on the Army retired pay which he receives, notwithstanding that he has disabilities incurred in war.

In accordance with the above facts, and the attached pages from our periodical, I respectfully appeal to you, and to the members of your committee, to include for income-tax exemption in the pending tax bill, all retired personnel (below

the grade of commissioned officers) through the inclusion of the amendment shown on page 10, or any other amendment advanced by your committee, so that in the future the retired, enlisted men of our armed service may have the right to retain all of their small retired pay for the purchase of necessary bread for themselves and families.

Thanking you for your favorable consideration, I am,

Sincerely yours,

(Mrs.) J. H. HOEPPEL,
Owner and Publisher.

SUGGESTED AMENDMENT TO PUBLIC LAW 68, SEVENTY-EIGHTH CONGRESS

(P. 26, sec. 7, subpar. a)

SEC. 7, ADDITIONAL ALLOWANCE FOR MEMBERS OF ARMED FORCES.

(a) IN GENERAL.—Section 22 (b) (13) of the Internal Revenue Code (relating to additional allowance for military and naval personnel in computing net income) is amended to read as follows:

"(13) ADDITIONAL ALLOWANCE FOR MILITARY AND NAVAL PERSONNEL.—In the case of compensation received during any taxable year and before the termination of the present war as proclaimed by the President, by a member of the military or naval forces of the United States for active service in such forces during such war, or by a citizen or resident of the United States who is a member of the military or naval forces of any of the other United Nations for active service in such forces during such war, and, for all disabled retired personnel of the military and naval forces of the United States (below grade of commissioned officers) who are veterans of any war in which the United States participated, so much of such compensation as does not exceed $1,500."

THE BRIGHTER SIDE—"FORGOTTEN MEN" OF OTHER WARS

By Damon Runyon

I receive regularly batches of press releases from the headquarters of the American Legion at Indianapolis disclosing the activities of the organization toward legislative relief for the veterans of World Wars I and II.

For example, a recent release announces that the Veterans' Committee of the House of Representatives in Washington has favorably reported H. R. 3356, a bill to increase the base rate of compensation for service-connected disabilities in these wars and an increase in the pension of widows of veterans who have had service-connected ratings but died of other causes.

Numerous other instances are reported from time to time in the releases of benefits for veterans brought about or planned by the Legion and I heartily applaud these activities and regret that the veterans of all our wars have not had their interests as well represented and protected as the men of the two World Wars. And much remains to be done for the soldiers of this war, notably provision for their future on discharge.

But the forgotten veterans of the Nation are the men who fought in the campaigns prior to World War I, whose service was voluntary and as important as that of the men of any war, yet who are denied many of the benefits bestowed upon the others. As far as patriotic service is concerned, it makes no difference whether a man fights for his country in a big war or a little war, and they should all be treated alike.

A bullet hits just as hard in a small skirmish in a remote Central American jungle as it does on a major battlefield in Europe. The after effects of a minor campaign that gets no more than a paragraph in the newspapers may be just as severe as the physical kick-back of a great operation in the Pacific that commands headlines.

But the men who served the colors in our past wars, veterans of the Regular and Volunteer Armies, are unfortunate in that they lacked powerful organizations such as the American Legion and such as the veterans of this war will surely have, and the politicians had no fear of them.

As an illustration of what I mean, I read a story the other day about one Charles H. Pierce, who won the Congressional Medal of Honor in the Philippines in 1899 for holding a bridge against superior numbers, though badly wounded, until the main body of troops came up, and who was a lieutenant in the Seventy-eighth Division in World War I, and was twice wounded, but who is required to pay for hospitalization if he goes into an Army or Navy hospital.

The same thing applies to other retired and disabled veterans of our past wars, however long their service. They must pay income taxes on their meager allowances, though nowadays veterans of 90 days' service are exempt from the income tax even if all their service was only in a training camp. This arrangement does not seem to make sense.

Now I do not say that just because a man serves his country in time of war that he is entitled to thereafter be a ward of the Government, or that he is entitled to more consideration than any other citizen. I am well aware that years after a war many veterans have attempted to obtain governmental relief for disabilities that had no connection with their service and that more likely were due to their own indiscretions, and I do not contend that such men are entitled to relief.

I know there have been, and will continue to be, many impositions upon the Government by war veterans, yet I say that the number of deserving cases will always vastly exceed the undeserving, and it is better that a few of the latter get by than that many of the former be deprived of their rights. But it seems to me that legislation in behalf of veterans should include all veterans and not just those of current power of organization and pressure.

Senator WALSH. Mr. Alvord.

(No response.)

Senator WALSH. Representative Arnold is not here.

Mr. Parker.

(No response.)

Senator WALSH. Mr. Shreve.

(No response.)

(The following letter and telegram were submitted for the record:)

FARMERS TELEPHONE CO.,
Milan, Mo., November 11, 1943.

Hon. WAT ARNOLD,
House of Representatives, Washington, D. C.

DEAR SIR: We are a small corporation protesting against higher taxes on the telephone industry.

Congress has picked communications out of the rest of the utility family for a tax burden in the revenue law enacted in 1941. This resulted in a 6-percent monthly tax on local exchange service, which was increased to 10 percent last year.

We accepted this tax cheerfully and have cheerfully acted as a tax-collecting agency for the Government. Now comes a proposed raise in this tax.

As you probably know—coming from this part of the country—that a large percentage of rural and small-town telephone users keep their phones mainly because they have sons or other relatives in the armed forces and feel that they must have their telephones.

However, many have told me that if taxes on telephone services are increased again they will be forced to discontinue their telephones, and that if this 15- to 20-cent increase goes into effect there is nothing else for them to do.

We feel that this proposed increase is a selective tax and a discrimination, and is unfair to the industry, and, in addition, it will weaken the morale of the rural and small-town people, who cannot afford telephones.

In large cities and large corporations this might work out, but small corporations are already tax burdened almost beyond our capacity to pay and still keep our service up to the standard we wish to have.

We maintain that a telephone in rural communities is a necessity and not a semiluxury.

I am writing to you, whom I feel understand conditions here, so that you can in our behalf protest to the members of the Ways and Means Committee.

We hope you will be able to help us.

Sincerely,

VENNIE G. LOVE, *President.*

GALLATIN, Mo., *November 20, 1943.*

Hon. WAT ARNOLD,
Congressman, First District, House of Representatives,
Washington, D. C.:

Please protect us from an increase in the selective sales tax on the telephone service of our Daviess and De Kalb County subscribers, of which approximately 85 percent are farmers. This service is not a luxury but a necessity with dwindling

gasoline and tire supplies. With your knowledge of these rural communities you know a 15-percent tax on telephone service is confiscatory. Anything you can do to block this tax increase will be greatly appreciated.

JOE M. ROBERTS,
President, Inter-County Telephone Co.

Senator WALSH. Mr. Bozell.

STATEMENT OF HAROLD V. BOZELL, REPRESENTING THE UNITED STATES INDEPENDENT TELEPHONE ASSOCIATION

Senator WALSH. Mr. Bozell, your full name, please.

Mr. BOZELL. My name is Harold V. Bozell.

Senator WALSH. You are representing whom before this committee?

Mr. BOZELL. The United States Independent Telephone Association, speaking for the independent telephone companies of the United States.

Approximately 1 out of every 5 telephones in the United States is owned and operated by an independent telephone company. In other words, of the 24,850,000 telephones in the United States at the end of 1942, about 4,837,000 were operated by independently owned companies and by rural or farmer lines and systems. These independent companies thus serve almost as many telephones as there are in Great Britain and France combined, and more than there are in Germany, Austria, and Czechoslovakia. The independent companies number some 6,350, and they operate about 12,000 telephone exchanges, as shown on the map on pages 4 and 5 of an accompanying document describing the independent telephone industry in the United States, in which also appears a list of some well-known places served by them. The independent companies actually serve almost twice as many communities in the United States as do the Bell companies, but the Bell companies are in all the largest cities, and therefore serve a larger number of telephones. About two-thirds of the United States is served by independent companies. Long-distance service is freely interchanged between independent companies and the Bell system.

Senator WALSH. What change has the House made in the telephone tax?

Mr. BOZELL. The House has made a change in excise taxes, long-distance telephone calls, raising the rate from 20 to 25 percent. The tax on local telephone service, including short-haul or neighborhood toll calls, is increased from 10 to 15 percent.

Senator WALSH. How much will the Treasury receive as the result of this increase?

Mr. BOZELL. It is estimated it will receive a gross of about $48,000,000.

Senator WALSH. From the increase on tolls alone?

Mr. BOZELL. That is correct. That is their estimate. I think that is a gross estimate and does not take into consideration the amount of this tax that will be paid back to war contractors and will be subtracted by business concerns as legitimate business expenses in calculating their own taxes.

Senator WALSH. What is the estimated increase on local calls?

Mr. BOZELL. $48,000,000, the same amount.

Senator WALSH. You may proceed.

Mr. BOZELL. There are two phases of the present code and of the House bill which we wish to discuss, namely, excise taxes and corporate taxes.

First, with reference to excise taxes:

The proposed tax bill as passed by the House of Representatives includes two increases in excise taxes:

1. The tax on toll calls of 25 cents and over is increased from 20 to 25 percent.

2. The tax on local telephone service, including short-haul or neighborhood toll calls, is increased from 10 to 15 percent.

These taxes, of course, are not taxes on the telephone companies themselves but are levied upon the users and are collected by the telephone companies. Our comments are thus largely a reflection of our customers' comments. Those who advocate the tax on long-distance toll calls urge that it is a logical wartime tax, particularly in view of the present overloaded conditions in the long-distance network of the country. But the amount of that tax can be too high, and it is our judgment that the present increases from 20 to 25 percent will be comparatively unproductive in many cases and overburdensome in others. To the extent that this tax is paid by war contractors it is reimbursed to them; to the extent that it is paid by business concerns it is deductible as a business expense, so that the estimated receipts from this tax are not fully realizable by the Treasury.

On the other hand, a very large part of the rest of the traffic from which the tax will be realized consists of calls between servicemen and their homes. A 25-percent tax is a heavy charge on these men. We ask you to give consideration to these facts, as well as to the gap between this tax and the 15-percent tax on transportation of persons.

With reference to the tax on local telephone service, we feel very strongly that it is a mistake to increase this tax by 50 percent. that is, from 10 to 15 percent. In the report of the House Ways and Means Committee on excise tax recommendations, it is stated that a most productive source of revenue is increased excise taxes, since, the committee states,

> by this method, it is possible to select those goods which are clearly luxuries and tax them at a rate in accord with the particular market situation.

An examination of the list of excise taxes shows it to consist mainly of jewelry, furs, liquor, amusements, toilet preparations, and so forth—all of which we believe are conceded to be luxury items. Local telephone service, however, is essential to the social and business life of a community and is not a luxury. By far the larger part of local exchange service is residential. To the extent that this local telephone service is business, it is deductible as a business expense and, therefore, not fully realizable to the Treasury.

Of the more than 4,000,000 telephones served by independent telephone companies, 80 percent are residential, and of this 80 percent about one-quarter are rural telephones. Residential service is similarly predominant in the Bell System. The local telephone service is a part of the everyday operation of the community—necessary to the social and business life of today.

A tax on local telephone service is simply a form of selective sales tax. Compared with transportation, this service is much akin to streetcar and bus service and to commutation service on railroads, which are properly not taxed at all. We believe an increase in this tax from 10 to 15 percent is entirely out of order. If we are to go in the direction of selective sales taxes, it would be more equitable to seek additional selected luxury items rather than to increase to exorbi-

tant rates the taxes on certain items merely because the collection is mechanically easy for the Treasury.

Again, may I emphasize the necessary nature of telephone service, and state that our remarks here are a reflection of widespread reaction from both customers and operators of telephone companies all over the United States.

One further point with reference to this whole question of excise taxes on telephone service. The House bill provides that the proposed increases will be canceled 6 months after the termination of hostilities. We believe that, whether these increases are approved or not, it should be recognized that all telephone excise taxes are indeed war taxes and provision should be made for their discontinuance 6 months after the termination of hostilities, and to that end we propose that in section 302 of the present bill section 1656 should be revised to read:

The taxes imposed by sections 1651, 1652, 1653, and 3465 shall not apply with respect to any period commencing on or after the first day of the month which begins 6 months or more after the date of the termination of hostilities in the present war.

Second, with reference to corporate taxes—but before discussing tax rates and structure there is one technical provision in the House bill upon which we would like to comment.

Section 115 of the House bill amends the Internal Revenue Code so as to provide that if the Commissioner of Internal Revenue finds that one of the principal purposes of the acquisition of corporations or property was the avoidance of income or excess-profits taxes through the securing of a deduction, credit, or other allowance, that the credits, deductions, or allowances shall be disallowed or allowed only in part.

We believe it is desirable to prevent abuses of the internal revenue laws, but the provisions of this section 115 as included in the House bill are extremely broad and vague and the application of the provisions is left to the discretion of the Commissioner of Internal Revenue, which, in practice, means to the multitude of internal-revenue agents who administer the law.

Many corporations make acquisitions of other companies or properties purely for sound, ordinary, and prudent business purposes. As a wholly incidental result of such acquisitions, some benefit of the nature referred to in section 115 may accrue to the acquiring company, but such incidental benefit as might have accrued was not a factor in the acquisition. Under vague provisions, the Commissioner or his agents might be led to invoke the provisions of the new section, however, even though it is contrary to the real intent of Congress. Litigation and accompanying expense will result which obviously will be burdensome both to the Government and to the legitimate taxpayer. Moreover, it will be entirely impossible for the taxpayer to determine in advance, unless he can secure an advance ruling from the Commissioner, whether or not the proposed transaction will be held to fall within the penalty provisions.

It is obvious from reading the report of the Ways and Means Committee that the intent is to remove the tax benefit from those who would make acquisitions solely or primarily for the purpose of tax avoidance through realizing losses. The principles of the section appear sound but the language should be clear so that its intent does not have to be drawn solely from the language of committee reports. The section should be directed at specific evils and not left in such vague language

that acquisitions which are the result of normal business transactions will become the subject of mistaken taxation and thereby cause unnecessary litgiation and burdensome expense to the parties involved.

Senator DANAHER. Mr. Bozell, question please.

Mr. BOZELL. Certainly.

Senator DANAHER. Did you take up that phase of your presentation with the Treasury?

Mr. BOZELL. No, sir.

Senator DANAHER. I just wondered if you had any reaction from them.

Mr. BOZELL. I did not take it up with Mr. Stam, myself. I did not have a chance to take it up with the Treasury people. It is really a technicality which can easily be cured by a very small change in language, just to make it specific and not too general and vague. I think it is going to be difficult for the Commissioner, with too vague language, sometimes to determine these things.

Senator DANAHER. You have suggested that change in your prepared statement?

Mr. BOZELL. Yes.

Senator WALSH. Somebody has asked Mr. Stam to consider changing that language?

Mr. BOZELL. Yes. Now, with reference to corporate tax structure and tax rates.

As is well known to this committee, most of the difficulties in arriving at what may be considered proper corporate taxes derive from the double taxation of corporate earnings, and the consequent tax discrimination against those people doing business through the corporate form. In addition there are the inequities between stockholders in the same corporation, some of whom are in the lowest income brackets and others who are in the highest of those brackets. It is not necessary to repeat to you the arguments for a complete revision of the method of taxing earnings from corporate business. The chairman of this committee has publicly presented able arguments for a revision of the system of taxing earnings produced by business in the corporate form. Other members of this committee, as well as your colleagues in the Senate and in the House of Representatives, have likewise with increasing frequency and emphasis called attention to the present inequities and the need for change.

We understand the chief of your joint staff has pointed to the inequities of the present system of taxing corporate earnings and has urged revisions. Likewise representatives of the Treasury in recent public addresses have urged such action.

Chairman Doughton of the House Ways and Means Committee in reporting the House bill to the House of Representatives on November 24, said:

> Some day I hope we may get back to sound and defensible principles in taxing individuals doing business in corporate form.

Similar criticisms of the present system and suggestions for its modification have come with increasing volume from tax authorities, economists, and managements of business.

I take time to mention this subject on which there seems to be such unanimity of opinion only as a basis for urging that since these inequities exist, but since they cannot at this time be completely eliminated, it is proper that their effects be not aggravated but rather be

minimized. One frequently suggested method has been to give credit to corporations for dividends distributed. The committee took the lead in making a proper but limited step in this direction last year by providing a credit for dividends paid on preferred stocks of public utilities in the calculaton of surtax net income.

In contrast to efforts to minimize the present inequities of corporate taxation, suggestion has been made that the corporate surtax be increased to 21 or 26 percent. We believe and urge to you that the total normal and surtax should not be increased. To do so would merely aggravate the present recognized inequities of taxing business done through the corporate form.

Also, section 202 of the House bill provides for an increase in the rate of excess-profits taxes from 90 to 95 percent. Whatever merit this increase might have if profits subject thereto were pure excess profits arising from the war, the increase is obviously unfair and aggravates the present inequities of the excess-profits tax provisions of the Internal Revenue Code in those cases where, because of the peculiarities of the present formulas, the income subject to tax does not constitute true excess profits. It is our opinion (1) that the increase should not be made and (2) that if such an increase is deemed generally advisable, it emphasizes the requirement that some alleviation of the inequitable incidence of excess-profits taxes on regulated utilities should be brought about. A method of doing so will be presented later herein.

Also, section 205 of the House bill provides for a decrease in the excess-profits credit under the invested-capital method of from 8, 7, 6, and 5 percent to 8, 6, 5, and 4 percent. It was stated by the House committee that the primary purpose is to offset increases in the invested capital credit obtained by retaining in the business earnings which have not been distributed.

Regulated public utilities have for many sound business reasons generally continued to distribute to shareholders all but a reasonable portion of their earnings. It appears unfair to penalize the many corporations who have not permitted earnings to accumulate merely to reach through this change in the credit percentages those corporations who have, under the present provisions of the code relating to the computation of invested capital, benefited by this process. Records have been presented to this committee and to the House Ways and Means Committee time and again showing how small are the average stock holdings in the large corporations of the country. In my own corporation, the average holding is less than $2,000. These are the holders who are most penalized by the present system of taxing corporate earnings and are most injured by this decrease in credit on invested capital.

As we urged before you last year, the excess-profits tax provisions of the code impose excess-profits taxes on many public utilities who have no true excess profits. The increase in rate of tax and the decrease in the invested capital credit previously mentioned would, in those cases, accentuate the inequitable incidence of those taxes. During the hearings before this committee last year certain members of the committee sought to bring out from ourselves and spokesmen for other utilities or utility groups why it is that public utilities, regulated to a fair rate of return by commissions, should have excess profits and excess-profits taxes. We appreciated the sympathetic dis-

cussions both in the committee and with individual committee members on this subject and we were encouraged to analyze the reasons and to suggest some equitable remedy.

Just before your committee made its report on the 1942 act you received a letter from the California Railroad Commission calling attention to the manner in which the varied effect of the excess-profits tax was impairing the credit of some of the utilities under their regulation and the commission suggested a possible approach to remedy the situation. At about the same time Chairman Peterson, of the Wisconsin Public Service Commission, in a round-table discussion at the convention of the National Association of Railroad and Utilities Commissioners, said—

> the tax, although called an excess-profits tax, is a misnomer, for although it will reach true excess profits, it likewise taxes income which is not ordinarily considered to be excessive.

The California commission, Chairman Peterson of Wisconsin, and other regulatory agencies were thus concerned with the problem of how to provide some proper limitation on taxes so that the credit of certain utility companies is not impaired and, as was expressed in one commission, the tax law does not effectively nullify the power of the State commissions to fix rates for certain utilities under their jurisdiction.

We devoted ourselves to the work of developing some plan within the existing tax structure and propose for your consideration the results of this work as a third alternative basis of calculating excess-profits net income. The language of that amendment has been placed in front of you in a two-page suggested amendment to the act which I would like to have included in the record.

In essence this provides that the rate of return on invested capital which a regulated public utility, as defined in section 26 (h) of the code, experienced in the base period be allowed as a rate of return on current invested capital in computing income subject to the excess-profits tax. The total net income would, under our proposal, be subject to the present higher normal tax and surtax.

Public-utility companies (telephone, electrical energy, gas, and water companies), are almost without exception subject to the regulation of State, municipal, or other regulatory bodies. These regulatory bodies have for years regulated these companies, and currently regulate and control them so that they cannot earn more than a reasonable rate of return just sufficient to produce the income necessary to the maintenance of a sound business, financial, and credit structure. Such rate of return is computed after allowance for taxes paid, including Federal income taxes. Many of these companies do not, of course, earn an amount equal to that deemed necessary by the regulatory bodies, and one of them over any extended period of time earns in excess of that amount, inasmuch as should they earn in excess of what is deemed necessary, the regulatory body takes appropriate action to reduce rates so that unreasonable earnings will not accrue. The public utilities will not at any future time be able to recover any part of the losses in necessary income which result from periods of extremely high taxation, nor can the regulatory bodies increase rates sufficiently to offset the high taxes in the current years.

Inasmuch as the regulatory bodies have restricted utility companies to a fair measure of return, we believe that the measure which has

resulted from this regulation should be used in computing any true excess profits that may occur and that other more or less arbitrary measures should not be set by the taxing statutes as applicable to public utilities. The excess-profits tax law should give recognition to established principles of utility regulation in determining excess profits of regulated utilities.

Our proposal, simply expressed, is, as stated before, to permit regulated public utilities to earn the same percent return on invested capital during the current taxable year as was actually earned by them on their invested capital during the base-period years, before becoming subject to an excess-profits tax. This method of computing income subject to excess-profits tax would still not allow the companies to earn the same percent return as was earned during the base period years, because of the greatly increased normal and surtaxes.

I would like to mention right here that we find that this third alternative method of computing the excess-profits tax is one which in principle and application is similar to one which was proposed in 1940 for all companies and contained in section 715 of H. R. 10413, August 27, 1940. For reasons controlling at the time this was not adopted for all corporations, but we believe that it is a method peculiarly adaptable to regulated public utilities.

I wish to point out and emphasize that this third alternative method is by no means a wholesale cure-all. It does, however, seem to give some alleviation to the excess burden of the excess-profits tax to many of those companies with respect to whom either of the present formulas is unfairly discriminatory. At the same time it effectively taxes any true excess or war profits which any of these companies may have.

In developing this third alternative method for calculating excess profits net income, we held discussions with members of the staff of the California Railroad Commission, and after the plan was developed the research department of that commission made an extended analysis of its effect upon California utilities and prepared a report showing its effect and giving excellent explanation of the philosophy back of it and why it was a measure which deserved the support of the regulatory commission. This report was in turn submitted to the National Association of Railroad and Utilities Commissioners in Chicago. I am submitting a copy herewith for the record and for the use of the committee in analyzing this proposal.

It is not the purpose of the utilities to seek an arbitrary reduction of their tax burden. They desire to and are willing to carry their fair share of the expense of prosecuting the war and financing the Government. It is inevitable that during times like these we must pay greater taxes and have less net income available to shareholders and investors in the business. We expect to pay greater normal and surtaxes and are willing to pay fair excess-profits taxes, but we do believe that excess profits should be fairly computed and only true excess profits be subject to tax.

We urge you to give serious consideration to this proposal in order that regulated utility companies, which have for years been permitted to earn only a fair rate of return, may continue to furnish vital services to the country and not have their credit and financial position severely injured so that they will not be in a position to take their proper place in our post-war economy.

The utility industry, as you know, is one requiring many times the average investment per employee required in most other industries. The utility industry is also one which is required to grow to provide services as demanded. A continuous flow of additional equity capital is absolutely essential. We believe this suggestion is an equitable one to help maintain the financial integrity of these utility companies so that they can continue to do their particular job of rendering service to the public.

We appreciate the opportunity of presenting our ideas and suggestions to you and hope that they will be useful to you in your consideration of the current revenue act.

(The matter submitted by Mr. Bozell is as follows:)

TAX COMMITTEE,
UNITED STATES INDEPENDENT TELEPHONE ASSOCIATION,
November 20, 1943.

WHY THE TAX ON TELEPHONE SERVICE SHOULD NOT BE INCREASED

GENERAL

The purpose of this memorandum is to point out certain reasons why the taxes on local and long distance telephone service should not be increased. These taxes at the present time are:

(1) On local calls and on calls under 25 cents, 10 percent.

(2) On long distance distance calls 25 cents and over, 20 percent.

Acting on recommendations of the Treasury Department, the House Ways and Means Committee has voted to increase these taxes as follows:

(1) On local calls and on calls under 25 cents, 15 percent. This is an increase of 50 percent.

(2) On long distance calls 25 cents and over, 25 percent.

The tax in each instance is paid by the subscriber or user.

MOST TELEPHONES ARE IN RESIDENCES

Local telephone service is essential to the social and business life of the community and is very rarely a luxury. The larger part of local exchange service and short-haul service (i. e. under 25 percent) is residential, not business. The independent telephone companies of the country operate in about 12,000 of the 18,000 communities which enjoy telephone service. Of the more than 4,000,000 telephones served by the independent companies (about one-fifth of the total telephones in the United States) over 80 percent are residential phones. Of this 80 percent almost one-fourth are rural telephones serving farmers.

Local telephone service and short-haul telephone business is very much akin to commutation rates on the railroad. Yet no tax on commutation fares has been proposed.

WHY DISCRIMINATE AGAINST THE TELEPHONE USER?

The tax on local exchange telephone service is more in the nature of a selective sales tax than an excise. Why should such service be singled out for application of a sales tax while many other items likewise essential to the public welfare are left alone? Essential telephone service should not for tax purposes be ranked with such things as cigars, liquor, jewelry, country club dues, and fur coats.

THE IMPORTANCE OF THE TELEPHONE

The telephone industry has been classified by the War Manpower Commission as 1 of 35 most essential to the prosecution of the war. The Senate Committee on Interstate Commerce has said:

"* * * adequate communications facilities and the maintenance of a strong, cohesive, and far-flung communications system are as vital to the prosecution of the war as is the production of guns, airplanes, tanks and ships."

Chairman Fly of the Federal Communications Commission and of the Board of War Communications has said:

"The telephone system of this country is one of the most essential of the war industries. It is vital to the national welfare."

THE MEANING TO THE FARMER OF AN INCREASE IN TELEPHONE TAXES

There are several reasons why the farmers of the country should not be shouldered with an increase in their telephone taxes.

One of the principal reasons is that a telephone is a vital necessity in connection with the operation of a farm. The farmer relies on his telephone for many purposes. Over it he is able to summon a doctor when some member of the family is sick or injured. Neighbors can quickly be reached in case of fire or other emergency. The telephone is essential in order to have ready access to local markets to acquire information relative to prices.

With the present gasoline and rubber restrictions it is no longer possible for the farmer to visit his friends and neighbors by automobile. The only substitute left for him is "hoofing" it or visiting by telephone. In these days of manpower shortages it is frequently necessary for farmers to exchange work, and a telephone is indispensable in making such arrangements. Certainly Congress should not, in the light of the genuine need and essential utility of the telephone, increase its cost to the farmer to whom it is almost as important as his plow or tractor.

In many farm communities and in the smaller towns the farmer has not enjoyed the acceleration in business activity which has been witnessed in the larger places as a result of the war. Farm prices have been held down by Government regulations. Hence the income of the farmer and the small-town resident has not kept pace with rising living costs. If the cost of telephone service is increased any further, by an increase in the tax on the use of that service, the subscriber in many cases may elect to go without a telephone because he can no longer afford it.

THE SUBSCRIBER COMPLAINS

It takes a considerable time for telephone companies to explain to the people the meaning of telephone taxes. Explanations had to be made when the local exchange tax was originally placed at 6 percent by the 1941 revenue bill, and new explanations had to be made when the tax was increased to 10 percent by the 1942 bill. The subscriber squawked when he paid 6 percent, and later 10 percent. What will he do if the tax on his local telephone bill goes up to 15 percent.

THE JOB OF COLLECTING

While these telephone taxes are paid by the subscriber, the telephone company is responsible for their collection. It takes a considerable part of the time of telephone personnel to attend to this and the resulting bookkeeping. The job of serving as tax collector—of computing, collecting, recording, and paying over to Uncle Sam—grows more onerous all the time.

TELEPHONE COMPANIES HAVE TROUBLESOME MANPOWER PROBLEMS

It was testified before the House committee that the turn-over of female help is almost 400 percent in some offices, and that if the 12 girls were hired on Friday, only 5 would show up on Monday.

The personnel problems involved should not be overlooked. It is easier and quicker for a girl to compute a 10-percent tax on local exchange service than it is to figure a 15-percent tax. In the latter case two mathematical operations are called for. Likewise it is easier to compute a 20-percent tax on long-distance service than it would be to figure a 25-percent tax.

Information as to the expense of collecting these taxes is not available covering the more than 6,000 independent telephone companies, but it has been estimated that the Bell System companies collect $385,000,000 annually in taxes of various kinds for the Federal Government. It costs the Bell System companies about 5 percent to do this work. If figures were available for the independent companies they would show a sizable amount of taxes collected by them, and they would also show that the independent companies likewise have to spend large sums to do the collection work. Such costs of course become a part of operating expenses which are ultimately paid by the same telephone users who are required to pay the sales taxes on the use of their phones.

THE PROPOSED INCREASE IN THE TAX ON TOLL CALLS

When the tax on long-distance calls was placed at 20 percent last year it was stated that one argument for putting it at that high level was that it would act as a deterrent to the use of overloaded toll lines. But there is a limit to which that reason applies. To increase this tax to 25 percent would be burdensome in many cases.

THE SOLDIER MAKES LONG-DISTANCE CALLS

A large number of the calls going over the long-distance facilities of telephone companies at the present time are made by the boys in uniform, who want to hear the voices of their relatives and friends back home.

For the reasons which have been mentioned—and others which could be added—there should be no increase in the present levels of the taxes on telephone service.

AMENDMENT TO PROVIDE FOR TERMINATION OF EXCISE TAXES ON TELEPHONES AND TELEGRAPH SERVICES

Submitted to Committee on Finance, United States Senate, on Behalf of the Independent Telephone Companies of the United States by Committee on Taxation of the United States Independent Telephone Association

Amend section 1656 to read as follows:

"SEC. 1656. TERMINATION OF CERTAIN MISCELLANEOUS TAXES. WAR TAXES AND WAR RATES.

"The taxes imposed by sections 1651, 1652, 1653, and 3465 shall not apply with respect to any period commencing on or after the first day of the first month which begins 6 months or more after the date of the termination of hostilities in the present war."

SUGGESTED AMENDMENTS TO THE INTERNAL REVENUE CODE TO PROVIDE A THIRD ALTERNATIVE METHOD OF COMPUTING THE EXCESS PROFITS TAX CREDIT

Submitted to Committee on Finance, United States Senate, on behalf of the Independent Telephone Companies of the United States by Committee on Taxation of the United States Independent Telephone Association

Amend section 711 (a) (2) as follows:

Subparagraph (C) of section 711 (a) (2) is amended to read as follows:

"(C) INCOME TAXES AND INCOME SUBJECT TO EXCESS PROFITS TAX.

"(i) In computing such normal tax net income, the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter) shall not be allowed;

"(ii) In the case of a public utility, as defined in section 26 (h) (2) (A), computing the excess-profits credit under section 714 (b) (2), the deduction for taxes shall be increased by an amount equal to the tax (not including the tax under section 102) under title I or chapter I, as the case may be, of the revenue law applicable to such year."

Amend section 714 as follows:

Insert immediately before the first sentence of section 714 the following:

"(a) GENERAL RULE.—"

Insert the following new subsections at the end of section 714 to read as follows:

"(b) PUBLIC UTILITIES.—In the case of a public utility, as defined in section 26 (h) (2) (A), the excess-profits credit for any taxable year computed under this section shall be whichever of the following amounts is the greater:

"(1) The excess-profits credit as computed under subsection (a), or

"(2) An amount which is equal to the invested capital for any taxable year multiplied by the average per centum return on invested capital.

"(c) DEFINITION OF AVERAGE PER CENTUM RETURN ON INVESTED CAPITAL.—For the purposes of subsection (b) (2) the average per centum return on invested capital shall be a percentage computed as follows:

"(1) There shall be computed for each of the taxable years in the base period, as defined in section 713 (b), the average invested capital for such year, as determined under section 716, reduced by an amount computed under section 720.

"(2) There shall be computed for each of the taxable years in the base period the excess-profits net income, or deficit in excess-profits net income, as determined under section 711 (b) with the following additional adjustments:

"(A) The adjustment for dividends received as provided in section 711 (a) (2) (A).

"(B) The adjustment for interest as provided in section 711 (a) (2) (B).

"(C) The adjustment for income taxes as provided in section 711 (a) (2) (C) (ii).

"(D) The adjustment for interest on certain Government obligations as provided in section 711 (a) (2) (G).

"(E) The adjustment for dividends received provided in section 711 (b) (1) (G) shall not be made.

"(3) The amount of the excess-profits net income, if any, computed under paragraph (2) for each year in the base period shall be divided by the amount computed under paragraph (1) for each year of the base period.

"(4) The percentages obtained under paragraph (3) shall be aggregated and multiplied by 12 and divided by the number of months in all of such taxable years in the base period.

"(5) If the aggregate of the percentages determined under paragraph (3) for the last half of the base period exceeds the aggregate of the percentages determined under paragraph (3) for the first half of the base period, subparagraph (4) shall not apply, but the following computations shall be made:

"(a) The percentages obtained under paragraph (3) for each of the taxable years in the last half of the base period shall be aggregated.

"(b) The percentages obtained under paragraph (3) for each of taxable years in the first half of the base period shall be aggregated.

"(c) If the percentage ascertained under subparagraph (a) exceeds the percentage obtained under subparagraph (b) the difference shall be divided by two.

"(d) The percentage obtained under subparagraph (c) shall be added to the percentage obtained under subparagraph (a).

"(e) The percentage obtained under subparagraph (d) shall be divided by the number of months in the last half of the base period and the result multiplied by 12.

"(f) The percentage obtained under subparagraph (e) shall be the average per centum return on invested capital, if greater than the percentage determined under paragraph (4) but in no case may the amount so determined exceed the highest percentage determined under paragraph (3) for any taxable year in the base period."

Amend section 26 (e) as follows:

Strike out the period at the end of the last sentence of section 26 (e) and insert the following "or to a public utility, as defined in section 26 (h) (2) (A), computing the excess-profits credit under section 714 (b) (2)."

ANALYSIS OF FEDERAL INCOME AND EXCESS-PROFITS TAXES APPLICABLE TO MAJOR UTILITIES IN CALIFORNIA FOR YEAR 1942 AND PROPOSED ALTERNATE METHOD FOR COMPUTING EXCESS-PROFITS TAX

Mr. E. F. McNAUGHTON,
Director, Public Utilities Department.

This report analyzes the effect of the 1942 Revenue Act upon the earnings of major California utilities for their 1942 operations as experienced and after adjusting the tax payments to exclude unusual or nonrecurring items. The latter calculation indicates the maximum tax liability under the provisions of the 1942 revenue Act.

Included as a part of this report is a proposed alternate method for determining the excess earnings of a regulated public utility for tax purposes. The need for a clearer understanding of the utility tax problem not only confronts the State regulatory commissions throughout the country but also Congress.

The report is not intended to criticize the action previously taken by Congress in prior tax legislation, but it is intended to advise and suggest a means of correcting an unreasonable tax burden seriously affecting financial security of one class of corporations—namely, the regulated public utilities.

(s) LOREN W. EAST, *Research Engineer.*

Analysis of Federal Income and Excess-Profits Taxes Applicable to Major Utilities in California for Year 1942 and Proposed Alternate Method for Computing Excess-Profits Tax.

A. PURPOSE OF REPORT

This report analyzes the effect of the 1942 Revenue Act upon the earnings of major California utilities for the calendar year 1942 and shows the maximum effect of the provisions of the 1942 Revenue Act upon these earnings after adjusting the tax payments to exclude unusual or nonrecurring items. The report also presents a third alternate method for computing an excess-profits tax applicable to regulated public utilities in order to more equitably determine the excess earnings and the tax liability on current income.

B. SCOPE OF REPORT

The report includes a discussion of the Federal tax returns filed by the major California utilities for the calendar year 1942, a discussion as to the rate of return these utilities may earn on the Commission's rate base before being subject to the excess-profits tax, together with a discussion of their maximum tax liability under the provisions of the 1942 Revenue Act.

The alternate excess-profits-tax method has been applied to the major California utilities in order to show the difference in the amount of total Federal taxes for which these companies would be liable and particularly the amount of excess-profits taxes these companies would be required to pay should this proposal be accepted by the Internal Revenue Department, and made a part of the 1943 Revenue Act. The rate of return at which these companies could earn before paying an excess-profits tax under the proposed alternative method has been included as a part of this study.

C. GENERAL

Federal taxes on income of a corporation consist of the normal income tax, a surtax, and an excess-profits tax. The method of computing the excess-profits tax as provided for in the Revenue Act of 1942 has created certain problems directly affecting the earnings of public utilities. Prior to the calendar year 1942 the major utilities in California generally escaped payment of the excess-profits tax due to a credit which was created substantially from the refinancing of the funded debt. It is expected that commencing with the operations for the calendar year 1943 that in practically every instance this credit will disappear and the companies will be confronted with the maximum provisions of the revenue act.

The fact that a regulated public utility is subject to the excess-profits tax creates a number of questions relative to the earning position of the company during the current year. If it was the intention of Congress to tax excess earnings of corporations it is also implied that the measure of these excess earnings would be reasonable and uniform as between companies and as between classes of corporations. An analysis of the major utilities in California has disclosed an unequal distribution in the tax burden due particularly in the application of the excess-profits-tax provisions. Assuming that these major utilities would have no excess profits carry-over credit and that other unusual or nonrecurring items were eliminated from the tax returns, one of the largest utilities would begin paying an excess-profits tax when the rate of return on the commission's rate base exceeded 4.67 percent and in another instance a utility rendering similar service in California would not be subject to the excess-profits tax until its return on the commission's rate base had exceeded a rate of return of 9.58 percent. Between these two rates of return 14 other major utilities begin to pay an excess-profits tax upon their earnings. This variation in the percentage of earnings on the Commission's rate base indicates the injustice accorded regulated utilities under the 1942 act. Certain utilities in California will be earning a rate of return at a point where the financial integrity of the company will be impaired.

From the analysis of the provisions of the present revenue act and the effect of the tax law upon the earnings of this group of utilities, it is impossible to make a general statement explaining the variation in the rate of return the company may earn before creating an excess-profits tax liability. In one instance it was found that a company which had refinanced its funded debt would be required to pay an excess-profits tax upon the savings it had consummated through the reduction of its bond interest in the magnitude of $1,000,000. In other words, it is possible without an increase in gross revenue that a company would be required to pay a substantial excess profits tax.

D. 1942 REVENUE ACT

Under the provisions of the 1942 Revenue Act a corporation has the option of selecting one of two methods for determining the amount of the excess-profits tax credit before determining the excess-profits tax. These two methods in nontechnical language are: (1) the excess-profits credit based on the average earnings of the corporation is computed by taking 95 percent of the average net income for the 4-year base period (1936–39 inclusive) plus an amount equal to 8 percent of the net capital additions as defined in the act or minus 6 percent of the net capital reductions: (2) the excess-profits credit based on invested capital is computed for the taxable year at the following rates: 8 percent on the invested capital for the first $5,000,000; 7 percent on the next $5,000,000 of invested capital; 6 percent on the next $190,000,000 of invested capital; and 5 percent on all invested capital in excess of $200,000,000.

The equity invested in capital as defined in the revenue act, stated in nontechnical terms, is equivalent to the money paid in for stock or as paid in surplus or as a contribution to capital plus an amount equal to 50 percent of the borrowed invested capital (usually bonds) plus an amount equal to 25 percent of the average new capital paid in to the corporation during the taxable year.

TABLE 1.—*Major California utilities, Federal taxes on 1942 income per returns and maximum under present law*

	Federal taxes on income per tax returns—1942 operations			Maximum Federal taxes on income under 1942 Revenue Act		
	Normal income tax and surtax	Excess profits tax at 90 percent	Total	Normal income tax and surtax	Excess profits tax at 90 percent	Total
GAS AND ELECTRIC UTILITIES						
Company A	$296,800	[1] None	$296,800	$275,100	$48,800	$323,900
Company B	10,353,400	[2] 4,829,600	15,183,000	10,843,100	5,829,400	15,672,500
Company C	868,800	[2] 1,135,400	1,994,200	751,200	1,508,700	2,259,900
Company D	6,806,000	4,982,500	10,158,500	4,494,700	7,402,100	11,896,800
Company E	3,147,300	[1] None	3,417,300	2,958,200	1,236,500	4,197,700
Company F	1,009,900	[1] None	1,009,900	767,900	619,500	1,387,400
Total	21,842,200	10,217,500	32,059,700	19,590,200	16,148,000	35,738,200
TELEPHONE UTILITIES						
Company G	365,000	775,000	1,140,000	367,600	756,700	1,124,300
Company H	39,400	39,900	79,300	39,400	39,900	79,300
Total	424,400	814,900	1,239,300	407,000	796,600	1,203,600
WATER UTILITIES						
Company I	178,200	[1] None	178,200	137,100	128,900	266,000
Company J	213,500	None	213,500	213,500	None	213,500
Company K	93,600	None	93,600	93,600	None	93,600
Company L	152,200	[1] None	152,200	141,600	21,900	163,500
Total	637,500		637,500	555,800	152,800	736,600
Grand total	22,904,100	11,032,400	33,936,500	20,553,000	17,097,400	37,680,400

[1] No tax due to unusual or nonrecurring deductions.
[2] Tax reduced by unusual or nonrecurring deductions.

Of the 16 major utilities analyzed in this study, 9 selected the excess-profits credit based on income and 7 selected the excess-profits credit based on invested capital in computing their returns for the year 1942. Table 1 shows by classes of utilities a summary of the Federal taxes on income for 12 major utilities in California. It was necessary to limit the comparison to these 12 for the reason that certain figures were not available for the complete analysis to be followed throughout the report. These 12 companies paid the following amounts for Federal taxes on 1942 income:

Normal income tax and surtax	$22,904,100
Excess profits tax at 90 percent	11,032,400
Total	33,936,500

Of these 12, only 5 paid any excess-profits tax and 2 of these paid only a part of their normal excess-profits tax liability for the reason that some excess-profits credit carry-over was available for the 1942 tax return. There is also shown upon table 1 the maximum Federal tax liability on income which could be created under the 1942 Revenue Act through the elimination of the excess-profits credit carry-over and other unusual or nonrecurring items. These 12 utilities would be subject to the following amounts of tax:

Normal income tax and surtax	$20,583,000
Excess-profits tax at 90 percent	17,097,400
Total	37,680,400

E. PROPOSED THIRD OR ALTERNATE METHOD FOR EXCESS-PROFITS TAX

The economic characteristics of a regulated public utility when viewed in the long-term trend of regulation would indicate that under effective regulation the earnings during any period of time may be assumed to be reduced to a level that has been determined reasonable by the rate-making body. Applying this principle to the California utilities, it will be recalled that during the period from 1937 to the close of 1942 the California Railroad Commission placed in effect rate reductions in the magnitude of $27,000,000 applicable to the service of the customers for gas, electric, telephone, and water utilities. This would indicate that earnings in California for the major companies were under close scrutiny by this commission and it is apparent that if the present-day earnings are subject to large amounts of excess-profits tax the application of this tax is not necessarily applied against excess war profit.

As a result of a series of conferences with certain of the larger utilities in California, it became apparent that a third method should be devised to measure the excess earnings, if any, of these regulated companies. Several proposals were submitted and analyzed until the final alternate method as will be explained had been thoroughly tested.

In any attempt to revise a portion of the revenue act it is required that such a suggestion be finally written as an amendment to the excess profits tax law. Many proposals have been made in the past, but the complex nature of the application of the proposal, together with the inability of the tax experts to write the proposal as an amendment were sufficient reasons for discarding them. The present proposal does not bring forward any new tax concept, but merely utilizes information now available in the Office of the Internal Revenue Department and in the files of the corporations preparing the tax returns.

Briefly stated, it is merely this:

(a) The excess-profits tax credit based on income after Federal income tax is determined for the 4 base years. The invested capital as defined in the revenue act is also determined for the same 4-year period. Using these two known figures a ratio is established by dividing the income for the year by the invested capital for that year. The average for the 4 years (1936-39, inclusive) is then determined and adjusted by means of the growth formula as applied in the 1942 Revenue Act under the income method.

(b) In order to obtain the excess-profits credit for the current taxable year, all that is necessary to determine is the amount of the invested capital for that year and multiply by the average ratio previously developed for the 4-year base period.

In event the proposal as outlined above would permit the utility under regulation to earn no more before excess-profits tax than was permitted by the regulatory commission during the base period. The proposal is not intended to supersede the two methods now available to all corporations, but because of the large amount of investment in plant and property in relation to the gross revenue, it has been deemed essential that the public utilities be permitted to use a modification of the present methods for determining the amount of the excess-profits credit.

This proposal was applied to the 1942 earnings of the 12 utilities shown by classes of service in table 2. In applying this proposal the excess-profits credit carry-over and other unusual and nonrecurring items were eliminated from the calculations. The results of the alternate method as proposed would require the 12 companies to provide for Federal taxes on income as follows:

Normal income tax and surtax	$27,531,400
Excess profits tax at 90 percent	2,805,100
Total	30,336,500

Referring to table No. 2, it will be seen that 4 of the 12 utilities would provide for an excess-profits tax. Of these 4, 2 would not select this proposal as the total Federal taxes based on income would be increased. The other 2 utilities would, however, use this alternate or proposed method although they would pay an excess-profits tax, because the total Federal taxes on income would be somewhat reduced. All other utilities shown on table 2 would select and use this method.

F. RATE OF RETURN BEFORE EXCESS PROFITS TAX

In order to compare the earning positions of the major utilities in California it is necessary to know at what rate of return on the commission's rate base excess-profits tax first becomes effective. This critical point is sometimes referred to by the public utility industry as the excess-profits tax entry point.

TABLE 2.—*Major California utilities—Maximum Federal taxes on 1942 income under proposed alternative method and net change from maximum under present law*

	Maximum Federal taxes on income, proposed alternative method			Net change from maximum Federal taxes on income under 1942 Revenue Act	
	Normal income tax and surtax	Excess-profits tax at 90 percent	Total	Amount	Percent
GAS AND ELECTRIC UTILITIES					
Company A	$296,800		$296,800	*$87,100*	*8.4*
Company B	12,500,000		12,500,000	*3,178,600*	*20.3*
Company C	1,421,700	$301,500	1,723,200	*536,700*	*23.7*
Company D	7,784,500	2,386,000	10,170,500	*1,786,900*	*14.9*
Company E	3,059,000		3,059,000	*1,158,700*	*27.1*
Company F	1,043,200		1,043,200	*944,800*	*31.8*
Total	26,105,200	2,687,500	28,792,700	*6,915,600*	*19.4*
TELEPHONE UTILITIES					
Company G	703,900		703,900	*480,400*	*37.4*
Company H	68,600		68,600	*10,700*	*13.5*
Total	772,500		772,500	*491,100*	*38.8*
WATER UTILITIES					
Company I	194,400	76,400	270,800	4,800	1.8
Company J	213,500	41,200	254,700	41,200	19.3
Company K	93,600		93,600		
Company L	152,200		152,200	*18,300*	*8.0*
Total	653,700	117,600	771,300	32,700	4.4
Grand total	27,531,400	2,805,100	30,336,500	*7,343,900*	*19.5*

NOTE.—Italic denotes decrease.

Table 3 has been prepared to show the rate of return or earnings that would be experienced by the company with the maximum application of the existing Revenue Act, and in addition the rate of return at which the excess-profits tax would first become effective (see columns A and B.) The second set of calculations in table 3 (columns C and D) analyzes the 1942 earnings under the proposed amendment and indicates the rate of return that the company would experience and the rate of return at which excess-profits tax first becomes effective. The third group of figures (columns E and F) shown on the table indicates the most favorable application either the present Revenue Act or the proposed amendment to the Revenue Act indicating the respective rates of return that would be experienced and the rate of return at which the excess-profits tax would first become effective. A study of these calculations would lead to the conclusion that 10 of the 12 utilities would experience a relief from Federal taxes on income

under the proposed method and 2 of the 12 utilities would continue to use the invested capital method as defined in the Revenue Act of 1942 for determining the excess-profits credit. The reason that these 2 utilities would continue to use the present invested capital method is due to the fact that the 1942 Revenue Act allows the smaller utilities a larger credit than was actually experienced during the base-year period.

6. CONCLUSIONS

Under the representative from of government such as we have here in this country there is a definite responsibility placed upon the citizens to advise Congress as to the detrimental effects of their laws upon the Nation. This is particularly true in the case of the State regulatory commissions which have been created under State rights to regulate public utility corporations within their respective States. These commissions have been established as authoritative bodies on the matter of public utility regulation, and as such are in a position to give expert technical advice to Congress in the matter of taxes applied to public utilities under their jurisdiction. From the viewpoint of constructive regulation one of the fallacies in the present law is the imposition of an excess profits tax on the income of a regulated public utility before allowance is made for normal income tax and surtax. This is substantiated by the fact that for many years the State regulatory commissions have determined the earning level of the utilities after taking into consideration Federal income tax. This policy was maintained throughout the base-year period 1936-39 as defined in the Revenue Act.

TABLE 3.—*Major California utilities—Rates of return and excess-profits tax entry points reflecting maximum tax under present law and proposed amendment based on 1942 income*

	Maximum under 1942 Revenue Act		Maximum under proposed method		Maximum under most favorable method	
	A	B	C	D	E	F
Gas and electric utilities:	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
Company A	6.53	6.47	6.76	7.06	6.76	[1] 7.06
Company B	6.23	6.13	6.72	7.09	6.72	[1] 7.09
Company C	6.79	6.30	8.00	7.90	8.00	[1] 7.90
Company D	4.95	4.67	5.38	5.29	5.38	[1] 5.29
Company E	5.91	5.76	7.03	7.33	7.03	[1] 7.33
Company F	5.47	5.20	6.67	7.46	6.67	[1] 7.46
Telephone utilities:						
Company G	5.86	4.96	6.99	7.13	6.99	[1] 7.13
Company H	6.33	6.04	6.78	7.82	6.78	[1] 7.82
Water utilities:						
Company I	6.56	6.39	6.44	6.35	6.56	[1] 6.39
Company J	5.73	5.75	5.82	5.49	5.73	[1] 5.75
Company K	5.27	5.57	5.27	6.34	5.27	[1] 6.34
Company L	7.07	7.03	7.20	7.28	7.20	[1] 7.28

[1] Proposed method most favorable in 10 of the 12 cases.

An analysis made of the earning position of 10 major gas and electric utilities in the United States discloses all but one earned substantially less per share of common stock in 1942 than the average earned per share for the base-year period (1936-39). Ten major railroads in the country showed an earning per share of common stock in 1942 many times greater (one company 27 times) than was experienced during the average base-year period. Comparisons made with 10 of the major aircraft, automobile, steel, chemical, metal, and oil concerns likewise show a tremendous increase per share of common stock in 1942 as compared to the average of the base-year periods.

All figures used in this analysis were reduced to a common basis in determining the net earnings per share of common stock, i. e., Federal taxes on income including excess-profits tax were deducted in all cases as provided for in the 1942 Revenue Act.

ATTACHMENT A. AMENDMENTS TO THE PRESENT LAW WHICH WOULD BE REQUIRED TO EFFECT THE PROPOSAL OUTLINED IN THE PRECEDING PAGES

Amend section 711 (a) (2) as follows:

Subparagraph (C) of section 711 (a) (2) is amended to read as follows:

"(C) Income Taxes and Income Subject to Excess-Profits Tax.

"(i) In computing such normal-tax net income, the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter) shall not be allowed;

"(ii) In the case of a public utility, as defined in section 26 (h) (2) (A), computing the excess profits credit under section 714 (b) (2), the deduction for taxes shall be increased by an amount equal to the tax (not including the tax under section 102) under title I or chapter I, as the case may be, of the revenue law applicable to such year."

Amend section 714 as follows:

Insert immediately before the first sentence of section 714 the following: "(a) GENERAL RULE.—"

Insert the following new subsection at the end of section 714 to read as follows:

"(b) PUBLIC UTILITIES.—In the case of a public utility, as defined in section 26 (h) (2) (A), the excess profits credit for any taxable year computed under this section shall be whichever of the following amounts is the greater:

"(1) The excess profits credit as computed under subsection (a), or

"(2) An amount which is equal to the invested capital for any taxable year multiplied by the average percent return on invested capital.

"(c) DEFINITION OF AVERAGE PERCENT RETURN ON INVESTED CAPITAL.—For the purpose of subsection (b) (2) the average percent return on invested capital shall be computed as follows:

"(1) There shall be computed for each of the taxable years in the base period, as defined in section 713 (b), the average invested capital for such year, as determined under section 716, reduced by an amount computed under section 720.

"(2) There shall be computed for each of the taxable years in the base period the excess profits net income, or deficit in excess profits net income, as determined under section 711 (b) with the following additional adjustments:

"(A) The adjustment for dividends received as provided in section 711 (a) (2) (A),

"(B) The adjustment for interest as provided in section 711 (a) (2) (B),

"(C) The adjustment for income taxes as provided in section 711 (a) (2) (C) (ii),

"(D) The adjustment for interest on certain Government obligations as provided in section 711 (a) (2) (G),

"(E) The adjustment for dividends received provided in section 711 (b) (1) (G) shall not be made.

"(3) The amount of the excess profits net income, if any, computed under paragraph (2) for each year in the base period shall be divided by the amount computed under paragraph (1) for each year of the base period.

"(4) The percentages obtained under paragraph (3) shall be aggregated and multiplied by 12 and divided by the number of months in all of such taxable years in the base period.

"(5) If the aggregate of the percentages determined under paragraph (3) for the last half of the base period exceeds the aggregate of the percentages determined under paragraph (3) for the first half of the base period, subparagraph (4) shall not apply, but the following computations shall be made:

"(a) The percentages obtained under paragraph (3) for each of the taxable years in the last half of the base period shall be aggregated.

"(b) The percentages obtained under paragraph (3) for each of the taxable years in the first half of the base period shall be aggregated.

"(c) If the percentage ascertained under subparagraph (a) exceeds the percentage obtained under subparagraph (b) the difference shall be divided by two.

"(d) The percentage obtained under subparagraph (c) shall be added to the percentage obtained under subparagraph (a).

"(e) The percentage obtained under subparagraph (d) shall be divided by the number of months in the last half of the base period and the result multiplied by 12.

"(f) The percentage obtained under subparagraph (e) shall be the average percent return on invested capital if greater than the percentage determined under paragraph (4) but in no case may the amount so determined exceed the highest percentage determined under paragraph (3) for any taxable year in the base period."

Amend section 26 (e) as follows:

"Strike out the period at the end of the last sentence of section 26 (e) and insert the following "or to a public utility, as defined in section 26 (h) (2) (A), computing the excess profits credit under section 714 (b) (2)."

(NOTE—Amendments to present Revenue Act were drafted by Mr. Parker Lindhardt, tax supervisor, General Telephone Corporation.)

ATTACHMENT B

Computations for proposed amendments, excess-profits tax

Item		Base-year period				Taxable year 1942
		1936	1937	1938	1939	
	(FORM 1121)					
a	Invested capital (schedule C, line 36)	$	$	$	$	$
b	Excess-profits net income (schedule B, line 31):					
c	Add one-half interest on funded debt					
d	Less Federal taxes on income					
e	Excess profits net income:					
	Schedule A, line 16, column 2					
	Computed on invested capital method					
f	Ratio excess profits net income divided by invested capital	%	%	%	%	
g	Average return on invested capital [1] equals percent					

[1] Compute average return on invested capital during the base years by taking the arithmetical average of the 4 percentages or applying the growth formula to the percentages as permitted by law for companies using the average earnings method.

	1942 computations	Amount
h	Invested capital, year 1942	
i	Excess-profits net income [2]	
j	Excess-profits credit (h times g)	
k	Adjusted excess profits net income	
l	Excess profits tax	
m	Post-war refund credit	
n	Net excess profits tax	

[2] Amounts of any unusual or nonrecurring tax additions or deductions are to be eliminated.

THE INDEPENDENT TELEPHONE INDUSTRY IN THE UNITED STATES, OCTOBER 1943

Approximately 1 out of every 5 telephones in the United States is owned and operated by an "independent" telephone company. In other words, of the 24,850,000 telephones in the United States at the end of 1942, about 4,837,068 were operated by independently owned companies or by rural or farmer lines and systems. These independent companies thus serve more telephones than there are in all of greater Germany, including Austria and Czechoslovakia, and almost as many as in all Great Britain and France combined. It is estimated that about two-thirds of the area of the United States is served by independent companies.

The development of the telephone industry sprang from the basic patents granted to Alexander Graham Bell in 1876 and 1877. It was natural that the development in the earlier years of the industry was confined chiefly to the larger centers of population where the convenience of the telephone was more highly appreciated and hence of greater value. By the time the basic patents had expired in 1894, there were about 270,000 telephones in service in the United States.

EARLY HISTORY OF THE INDEPENDENT INDUSTRY

With the expiration of these patents, the field was open to all and a large number of independent telephone companies soon sprang up. Such telephone companies were formed not only in small towns which had previously had little or no telephone service—and sometimes two companies were formed in the same town—but in many important towns and even the larger cities companies were also formed to compete with existing Bell companies. Some of these independent companies eventually exceeded their local Bell competitors in number of subscribers. Numerous independent manufacturing companies also arose which not only supplied apparatus to new telephone companies but assisted actively in promoting and financing many of them. By about the end of 1915 there were some 5,300 Bell exchanges and 16,000 independent exchanges; in about 1,000 places Bell and independent exchanges were in competition and in about 600 places independent companies competed with each other. By this time, also, practical long-distance telephony had been developed, the Nation-wide Bell System owning the major part of the longer lines, and for several years there had been insistent demand from independent companies and from the public for more complete interconnection between companies, irrespective of ownership. There were also the obvious complaints arising from the confusion of two or more telephone systems in those communities where that condition existed.

THE TWO GROUPS

Discussion between the Bell System and the independent companies, and pressure from governmental agencies, brought about a general understanding, partly documented, partly practice, which has led to the present status of the telephone industry. Some Bell companies purchased certain competing independent companies, certain other independent companies purchased competing Bell exchanges (the net result of these transactions, however, being a net gain in telephones by the Bell System and a net loss by the independent companies), and certain competing independent companies merged, or sold one to the other. This practice was carried out so completely that today, with one exception nearing solution, there is no competition in the telephone-operating industry. There are today about 6,200 Bell-owned exchanges operated by the 25 associated Bell companies and about 12,000 independent exchanges operated by some 6,350 independent companies.

12,000 EXCHANGES OPERATED BY INDEPENDENTS

The independent companies actually serve almost twice as many communities in the United States as do the Bell companies; but since the Bell companies serve in all of the largest cities in the country, as well as in many of the smaller communities, the number of telephones served by the Bell System is much larger than the number served by the independent companies. The map on pages 4 and 5 shows the approximately 12,000 exchanges operated by independent telephone companies. The Bell owned and operated exchanges are not shown.

INDEPENDENT TELEPHONES CONNECT WITH THE NATIONAL TOLL NETWORK

The independent companies own and operate a large mileage of toll lines, mostly regional in character, and all the independent exchanges and toll lines are interconnected with neighboring companies and with the Bell toll network, which is Nation-wide in extent. Long-distance traffic is freely interchanged between companies of the various ownerships and provisions for routings and divisions of tariffs are covered by agreements between the various operating companies involved.

A large number of the 6,350 independent operating telephone companies are fairly small in size, yet there are approximately 144 such companies having gross incomes in excess of $100,000 per year and about 73 having gross incomes of $50,000 to $100,000 per year.

Well-known cities and towns of the United States served by independent telephone companies

Covina, Calif.	Redlands, Calif.	West Los Angeles, Calif.
Long Beach, Calif.	Redondo Beach, Calif.	Whittier, Calif.
Monrovia, Calif.	San Bernardino, Calif.	Bradenton, Fla.
Ontario, Calif.	Santa Barbara, Calif.	Clearwater, Fla.
Palm Springs, Calif.	Santa Maria, Calif.	Lakeland, Fla.
Pomona, Calif.	Santa Monica, Calif.	St. Petersburg, Fla.

Well-known cities and towns of the United States served by independent telephone companies—Continued

Sarasota, Fla.
Tallahassee, Fla.
Tampa, Fla.
Honolulu, T. H.
Moscow, Idaho.
Bloomington, Ill.
DeKalb, Ill.
Des Plaines, Ill.
Dixon, Ill.
Freeport, Ill.
Galesburg, Ill.
Jacksonville, Ill.
Kewanee, Ill.
Lincoln, Ill.
Macomb, Ill.
Mattoon, Ill.
Monmouth, Ill.
Park Ridge, Ill.
Pekin, Ill.
Streator, Ill.
Connersville, Ind.
Elkhart, Ind.
Fort Wayne, Ind.
Goshen, Ind.
Lafayette, Ind.
LaPorte, Ind.
Logansport, Ind.
Richmond, Ind.
Terre Haute, Ind.
Valparaiso, Ind.
Wabash, Ind.
Newton, Iowa
Fort Dodge, Iowa.
Junction City, Kans.
Ashland, Ky.
Lexington, Ky.
Adrian, Mich.
Ludington, Mich.
Muskegon, Mich.
Owosso, Mich.
Fairmont, Minn.
Mankato, Minn.
New Ulm, Minn.
Cape Girardeau, Mo.
Columbia, Mo.
Jefferson City, Mo.
Beatrice, Nebr.
Hastings, Nebr.
Lincoln, Nebr.
Scottsbluff, Nebr.
Carlsbad, N. Mex.
Fulton, N. Y.
Gloversville, N. Y.
Jamestown, N. Y.
Johnstown, N. Y.
Middletown, N. Y.
Norwich, N. Y.
Rochester, N. Y.
Durham, N. C.
Elizabeth City, N. C.
Fayetteville, N. C.
High Point, N. C.
Pinehurst, N. C.
Rocky Mount, N. C.
Southern Pines, N. C.
Wilson, N. C.
Minot, S. Dak.
Ashland, Ohio.
Ashtabula, Ohio.
Athens, Ohio.
Bellevue, Ohio.
Bellefontaine, Ohio.
Bucyrus, Ohio.
Cambridge, Ohio.
Chillicothe, Ohio.
Delaware, Ohio.
Elyria, Ohio.
Greenville, Ohio.
Lima, Ohio.
Lorain, Ohio.
Mansfield, Ohio.
Marion, Ohio.
Mount Vernon, Ohio.
Newark, Ohio.
New Philadelphia, Ohio.
Norwalk, Ohio.
Portsmouth, Ohio.
Sidney, Ohio.
Troy, Ohio.
Warren, Ohio.
Wooster, Ohio.
Butler, Pa.
Carlisle, Pa.
Chambersburg, Pa.
Erie, Pa.
Franklin, Pa.
Hanover, Pa.
Johnstown, Pa.
Kittanning, Pa.
Meadville, Pa.
Oil City, Pa.
Vandergrift, Pa.
Waynesboro, Pa.
York, Pa.
Westerly, R. I.
Sumter, S. C.
Johnson City, Tenn.
Kingsport, Tenn.
Brownwood, Tex.
Denton, Tex.
Gonzales, Tex.
Greenville, Tex.
San Angelo, Tex.
Sherman, Tex.
Texarkana, Tex.-Ark.
Bristol, Va.-Tenn.
Charlottesville, Va.
Harrisonburg, Va.
Everett, Wash.
Wenatchee, Wash.
Bluefield, W. Va.
La Crosse, Wis.
Wausau, Wis.
Wisconsin Rapids, Wis.

CERTAIN TELEPHONE STATISTICS

The following statistical information will indicate the size of the independent telephone industry as a whole and as compared with the Bell System; the figures are as of the end of the year 1942:

	Total for United States	Bell-owned	Independent
Total telephones	24,850,000	20,012,932	4,837,068
Number of operating companies	6,378	23	[1] 6,350
Number of central offices	19,276	7,204	12,072
Investment in telephone plant	$6,021,653,000	$5,296,653,000	$725,000,000
Gross revenues	$1,649,263,000	$1,469,263,000	$180,000,000
Number of employees	397,107	327,107	70,000

[1] In addition there are more than 60,000 connecting rural lines, mostly owned mutually by groups of farmers.

FINANCIAL SOUNDNESS OF INDUSTRY RECOGNIZED

While there is material difference in corporate size and while financial results vary between companies due to differences in local conditions, between well-managed groups of widely geographically distributed companies there is found

to be a striking similarity in operating results. This fact has become more generally known in recent years, and during that period the securities of independent telephone companies have been more widely recognized for their qualities by an increasing number of investors. Substantial amounts of the senior securities of independent telephone companies are now held by institutions who have the staff and ability to be discriminating in their investment policies and practices.

THE INDEPENDENT MANUFACTURERS

The independent operating companies obtain most of their equipment and supplies from the various independent telephone-manufacturing companies, while the Bell System obtains most of its equipment and supplies through the wholly owned Western Electric Co., which is the manufacturing and purchasing agent for the American Telephone & Telegraph Co. and its associated companies. The independent manufacturing companies as a group represent some $50,000,000 of invested capital and employ more than 10,000 persons. Switchboards and telephones manufactured by the independents are among the finest in the world. Their modern research laboratories are staffed by able engineers and physicists.

INDEPENDENTS RESPONSIBLE FOR THE DIAL TELEPHONE SYSTEM

History shows that independent manufacturing companies have been responsible for some of the noteworthy advances in the telephone art, the dial telephone being the one, perhaps, with which the public is most familiar, although many others could be cited. Likewise, some of the independent telephone-operating companies have initiated practices now standard in the industry and have been the proving ground for developments which have been of value to the entire industry. Dial telephones were first introduced in the United States by independent telephone companies in Chicago, San Francisco, Los Anegeles, Omaha, and other cities during the years 1900 to 1909. Today, approximately 40 percent of the telephones of the independent companies and approximately 60 percent of those of the Bell System are dial-operated.

ACTIVE PART IN THE WAR EFFORT

The war has emphasized the importance of the independent telephone industry, not only to the Nation's over-all communication system, but to its armed forces as well. Independent telephone companies operate in every section of the United States, serving most of the isolated points along the borders and also large areas in the interior of the country where many of the most important war industries and military establishments, such as camps and air fields, are located. The independent manufacturers are at present devoting practically their entire facilities to the manufacture of military equipment for the armed forces.

Senator WALSH. Mr. Alvord.

STATEMENT OF ELLSWORTH C. ALVORD, CHAIRMAN, COMMITTEE ON FEDERAL FINANCE, CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. ALVORD. Mr. Chairman and gentlemen, I am Ellsworth C. Alvord, Munsey Building, Washington, D. C. I appear as chairman of the committee on federal finance of the Chamber of Commerce of the United States.

I would like permission, if I may, to file a prepared statement with you as part of the record following my oral presentation.

Senator WALSH. That may be done.

Mr. ALVORD. I would also like permission, if I may, to file a memorandum prepared by Mr. Roy C. Osgood, who is a member of our committee with respect to the estate and gift taxes.

Senator WALSH. That may be done.

Mr. ALVORD. I realize your time is very limited, and I attempted to prepare my remarks with that in view. Consequently, I merely re-

spectfully call your attention to the testimony of the members of our committee before the Committee on Ways and Means.

Mr. Osgood, on gift and estate taxes.

Professor Fairchild, primarily on inflation.

Mr. Henry Fernald, principally for the purpose of showing the effect of our present tax rate and proposed tax rate upon industrial profit, and myself, from a more general point of view, with respect to the general problems of financing the war and post-war period.

The first point, Mr. Chairman and gentlemen, that we wish to impress upon you is that tax policies and tax rates cannot be considered independently. They are very closely related and intertwined problems and policies, all of which should and must be considered together in order to determine proper fiscal policies.

We have the problems relating to the termination of war contracts. Our committee has appeared before other committees. I refer to that in the written testimony, and I respectfully refer that testimony to you.

There are the problems with respect to the disposition of properties acquired by the Government during the war for war purposes as those properties become surplus properties. And there are the problems and policies with respect to the so-called renegotiation.

I have outlined very briefly for you our position with respect to the termination of war contracts. I can summarize that very briefly. The termination of war contracts, or any war contract, necessarily involves four rather different problems. The war contractor, for example, will have articles completed under the contract but not yet delivered. There is no reason in the world why the full contract price for those articles should not be paid in ordinary course and promptly. The war contractor will have a large accumulation of war materials which he has not yet placed in production. The costs of those raw materials are very readily determinable. The proof is simple. The cost of those raw materials, whether or not they have been allocated to any specific Government contract, can be paid fully and promptly.

Then, we come to the problem of goods in process; the direct labor cost; how direct raw material cost of goods in process are reasonably simple of determination. It is a problem that people are familiar with. It is an ordinary inventory problem. It is different in some industries, of course, but not a new problem. Just direct costs that, as proved, can be paid in full.

Then, we come to the fourth, and it is the fourth group of costs about which I think most of the discussion has taken place. That fourth group consists of costs which we call indirect costs, such as overhead, preliminary engineering expense, and allowable profits. That group involves some diffiulty. It will involve time for the preparation of the claim, will involve disputes. Claims covering that group should be paid promptly in part and the balance given either as a loan to the contractor or payment postponed until after proof of the claim. It is to this class that all the questions with respect to final audits and approval, with respect to negotiation of settlements, that those problems relate.

With respect to the disposition of surplus commodities we recommend the creation of a special agency for the determination of policies, with a statute prescribing such principles and policies and may be necessary to guide them, in order that that agency can continuously

determine proper policies with respect to the tremendous job of disposing of surplus war properties.

All these problems bear very directly upon the problems of financing industry in the post-war period. Gentlemen, you will recall that we have frequently appeared before you and urged as a basic principle for financing the war the simple doctrine of maximum revenues from taxation and then sound policies for borrowing the balance. The determination of maximum taxation is a very practical determination and we have suggested that that determination be made with respect to three rather closely related periods of time. The first was the period of transition from peacetime economy to war economy. As I have frequently said, we failed miserably with respect to the fiscal problems during this period of time. I think the failures during that time are largely responsible for many of our difficult problems today.

The second period of time is the determination of maximum taxation during the period of war economy. The problems during that period of time we think have been handled commendably and excellently.

The third period of time—the period which we feel we are now approaching—we hope we are approaching it very quickly, but no one, of course, knows when this period is coming and therefore we must now give it most serious consideration—that third period of time is the period of transition from a war economy to a peace economy. That is frequently referred to as our post-war period. However, there is no clear-cut line to be drawn between the period of war economy and the period of post-war economy. Many Government contractors are already facing the cut-back and the cancelation termination of war contracts and the problems of converting back to a peacetime economy. It is quite impossible for us to wait until hostilities cease before we begin to prepare for this period of time. One of the most important problems in connection with this post-war reconversion—if you will accept my post-war reconversion phrase as having the meaning that I have given it—is the problem of financing industry. Industry will be confronted with tremendous financial problems. The entire cost of reconversion must be paid somewhere. New plant, equipment, inventories, personnel, management, everything will be in a period of flux or change, with demands being made daily for financing. Unless financing is readily available industry cannot convert to a peacetime economy, and, of course, it is most essential that we get back into the production of civilian goods as promptly as possible if we are to avoid an extended period of unemployment and possible depression. Now, these funds for financing industry are available only in three possible places. First, is the possibility of persuading an individual to part with his money, to place it in the corporation and let the corporation use it. That is the normal method of financing industry, particularly with respect to long-term investment, whether it be in bonds or in equity.

The statistics which we have given to the Committee on Ways and Means, and which I will not repeat here, show the utter impossibility of being able to attract from the individual investor funds for industry under present tax laws. Now we hope that these tax laws will be modified so the individual, after taxes, will see the possibility of a reasonable return upon his investment, an opportunity to get a return

commensurate with the risk that he is taking. Under present tax laws the most profitable corporation cannot hold out to you the slightest hope of a return upon your investment commensurate with the risk that you are taking. If our tax laws are not reduced immediately for the period of post-war financing, then we must go to other sources, because the private source, although available in reasonably limited amounts, will not be available for post-war financing of the extent which industry will require.

A second source is loans from the Government, the financing of post-war industry by the Government. We have heard in the course of the last several weeks many Government officials urging before this committee, of which you gentlemen are members, a system of loans by Government for the meeting of post-war cost and the financing of post-war requirements. It is our position that loans by the Government for industrial use immediately after the war or at any time after the war should be avoided entirely, if possible, but, at any rate, should be limited as greatly as possible. Government finance, as you gentlemen all realize, is the first step to Government domination and control. If industry is to be financed by the Government, then we may expect in this post-war period domination by the Government over the industry which it has financed. If our concept of individual enterprise—which is the true foundation of democracy—is to survive, then we must find a source other than Government loans for the financing of post-war requirements.

There is but one remaining source: That source is the earnings and profits of industry itself, after taxes, undistributed to the stockholders. Now, we hear a great deal about the tremendous reserves of industry, the adequacy, in fact the excess of the reserves of industry for post-war requirements. Those statistics must be viewed from several points of view and analyzed very carefully. I am very confident that if that is done you will find that those reserves are purely paper reserves. They will not be assets available for the financing of post-war industry. If we are to examine the balance sheets of your industrial corporations in the country, we will find tremendous liabilities, for example, for inventories. Now, if the inventory problem—I refer to that in connection with the termination of war contracts—and if our other problems in connection with the termination of war contracts are satisfactorily solved, then quick assets in a much greater extent are available, but inventories, generally speaking, appearing on a balance sheet today at cost or perhaps at cost of market, whichever is less, are not a quick asset. They cannot be used to finance post-war operations.

You will find a general trend in industry from 1940, 1941, 1942, and 1943, a very shocking trend, a dangerous trend.

One normal basis of determining financial responsibility of any corporation is to look at the ratio of its quick assets to its current liabilities. Prior to the war, generally speaking, that ratio was about 3½ of quick assets to 1 of current liabilities. Today, if you make a reasonable approach to the inventory problem and to liabilities for taxes not yet due, which account for a large part of this so-called savings and increase in bank accounts, you will find that that ratio has gone from 3½ to 1 to about 1½ to 1, a very dangerous point to reach.

Senator BAILEY. In that connection, what emphasis do you put on the value of the inventories?

Mr. ALVORD. We have made several computations in reaching the ratio. Most of them have reached about the same result. With respect to some corporations, we have the data; and with respect to the others, we have an estimate of the inventories.

Senator BAILEY. My question related to the cost, the present value or the post-war depreciation which is inevitable.

Mr. ALVORD. That is true, sir.

Senator BAILEY. Which do you take?

Mr. ALVORD. I think the soundest method is the method which we have used in discounting the increases in inventories over 1939. Using your inventory at the 1939 level, they are about normal and probably worth 100 cents on the dollar. I think that is probably not true, but taking them at 100 cents on the dollar, then let us forget the entire increase in the dollar account of your inventories, because on that basis you will probably get a figure fairly close to the level of your inventory values.

Senator GERRY. Do you think your 1939 value is too high an inventory value?

Mr. ALVORD. Well, I do not think so. You just come to the individual corporation, and though a good many corporations may already have had swollen inventories in 1939, I think, generally speaking, 1939 would be a reasonably fair level.

Senator BAILEY. I was looking at the chart furnished by the Department of Justice, that indicate that the profits of the corporations as a whole compare quite favorably with the profits in the immediate past and in the years prior to the year before our entry into the war. Is that your view?

Mr. ALVORD. If we take profits——

Senator BAILEY. That is profits after taxes.

Mr. ALVORD. If we take profits as reported after taxes, we find our estimated 1943 profits are somewhat under 1942, and 1942 was somewhat above 1941.

Senator BAILEY. The line is pretty level, is it not?

Mr. ALVORD. The line is pretty level, yes, sir; but bear in mind that those are all paper profits, they are not real profits.

Senator BAILEY. Your point is those profits are not necessarily in cash but in inventory?

Mr. ALVORD. And in plant facilities.

Senator BAILEY. You will have to discount the inventories in the light of what will happen when there is no further demand for this production.

Mr. ALVORD. That is right.

Senator BAILEY. I want to get at the process whereby you undertook to arrive at what the prospective value of those inventories would be.

Mr. ALVORD. If, in the disposition of our problems under termination of war contracts——

Senator BAILEY (interposing). The Government takes them over at cost?

Mr. ALVORD. The Government takes them over at cost, there is no loss, and that, as I said, would immediately free a tremendous amount of quick assets but not an excessive amount in any degree.

Senator BAILEY. It would avoid a loss in the long run.

Mr. ALVORD. That is true, sir. The costs of this decline in inventory value will be borne in large part, should be borne in large part, by the Government in any event. It will be borne either in declining tax revenue or a direct purchase underwriting of the inventory cost.

Senator BAILEY. The Government is creating one of the largest stock piles on earth. I do not think we want to strip ourselves again.

Mr. ALVORD. I hope not, sir.

Senator BAILEY. I think we will be well off.

After 30 or 40 years we may do something then, but I think we are scared enough now not to do that.

Then, we will dispose of some abroad, will we not?

Mr. ALVORD. Yes. Of course, much property will already be abroad, and presumably I would suppose substantially all property would be disposed of abroad. Other property now in the United States will be devalued property.

Senator BAILEY. That will be disposed of on the basis of gifts or contributions?

Mr. ALVORD. We have suggested that this surplus property which is acquired by the Government should be sold at a value fair to both the Government and buyer, and it should not be given away and should not be dumped on the market.

Senator BAILEY. You have got your problem. Most of the foreign governments certainly cannot pay us what they owe us. They cannot buy from us unless we buy from them, and we do not buy from them; therefore, they say, "Give it to us."

Senator GERRY. Is that not the history of the last war, too, that we practically had to leave the things there because it cost too much to transport them back?

Mr. ALVORD. Yes, sir. I have on other occasions given my analysis of our foreign relations financially. At least, since the last war it does not shape up very well. We have since the last war given, even though sometimes we have been deceiving ourselves, we have been giving a substantial production abroad, with no real return to us.

Senator BAILEY. I am not meaning to say that was not necessary. We were dealing with a busted world, and we will probably deal with a busted world after this war—and be busted ourselves besides.

Mr. ALVORD. I hope neither of those statements is true, but certainly there is a real possibility of that.

Senator BAILEY. I think it is almost inevitable. We have been running right over here at the rate of $56,000,000,000 a year, which is more than a billion every 6 days.

Mr. ALVORD. In any event, the post-war problems, whether they be fiscal, or charitable, or governmental, or private, are going to be tremendous when the process of cleaning up comes after this present war. I personally trust we will do a much better job than we did following the last war.

Senator JOHNSON. With the chances of doing a much worse job.

Mr. ALVORD. Senator, the retrospective appraiser will always pick holes in what was done, but if you place yourself in the position of the people who are making the decisions as of a given time without guessing retrospectively, I think they probably did the best that they could do. We had rather poor results, but nevertheless it was the best that they could do. I do not know that we are going to be better off this time than we were before.

Senator RADCLIFFE. Isn't it better to clean up after the war, to get back to normalcy, than to do a lot of things which are entirely too prospective?

Mr. ALVORD. I did not get back, Senator, until 1919, so I have no personal experience with what happened immediately following the last war, but certainly, based on everything you can see or read, the armistice caught everyone unprepared. I am urging you now, at least, that we cannot afford to risk a repetition of that. We can make plans now and preparations now for the post-war period, regardless of when it comes.

Senator RADCLIFFE. I was not referring to the period of the armistice, but several years after the armistice. The question of liquidation is a matter of years, not a matter of a year.

Mr. ALVORD. I think we had almost immediate liquidation following the armistice, then you recall we had our post-war inflation for a couple of years, and then we bumped into the depression of 1920 and 1921, and then we picked up again.

Senator BAILEY. We ran into a depression beginning September 1920 which lasted until the end of 1921. We began then to make profits and be prosperous wholly by reason of the foreign business policy. If the people had saved the money that they made in the twenties instead of throwing it away in high living and stock-market speculations, we would be all right, would we not?

Mr. ALVORD. I certainly think we would have been much better off.

Senator BAILEY. Should not we undertake to try a period of prosperity for 6 or 7 years from 1941 to the end of the war, whenever it may end?

Mr. ALVORD. I think we should certainly in the first instance have as Government fiscal policies policies which will not prohibit our post-war conversion and expansion, if we are going to maintain anywhere near the balanced budget after this war. Looking at it purely from the fiscal point of view, not from the point of view of the humanitarian or sociologist or philosopher, looking at it purely from a financial point of view of national income—you will pardon my use of that phrase, because it is a very risky phrase to use, with possibilities of unsound statistical interpretation—the national income must be well above the $100,000,000,000 mark, a mark which we never did approach until the present war period.

Senator BAILEY. You do not intend getting that by way of depreciating the currency?

Mr. ALVORD. I certainly do not intend to do that either by a depreciation of the currency or by a renewal of our principle that the more the Government spends the more the people make.

Senator WALSH. Proceed, Mr. Alvord.

Mr. ALVORD. Now, there is a very simple method of letting some of these current earnings and profits be available for financing the post-war period. Financial strength is essential if we are going to finance. Financial strength will attract investment in equity and will permit borrowing. It is absolutely essential to have current financial strength, quick assets. It is our opinion that the only certain way to provide, perhaps inadequately, but nevertheless to provide soundly, for the financial strength of industry, is to permit the accumulation by industry at a time when it has earnings and profits—which it has during

1943—and probably during 1944—to permit industry to use part of those earnings and profits as a savings fund available immediately.

Senator BAILEY. You would not let it go into the Treasury as revenue?

Mr. ALVORD. Yes, sir; I would still let it go into the Treasury.

Senator BAILEY. Reserved for lending or reserved for reinvestment?

Mr. ALVORD. The reserve concept is not quite right, but let us use it now that you have used the term. In other words, let industry build up reserves out of its current earnings and profits invested, say, in nonnegotiable, noninterest-bearing Government securities, those Government securities to become interest bearing and negotiable immediately upon the cessation of hostilities.

Senator BAILEY. If they are negotiable, they are sold on the market, and they will be sold at a loss, because instead of dumping inventories you will be dumping bonds.

Mr. ALVORD. It is, of course, very possible that we shall have a depreciated market in Government securities, but I do not think that will happen during that period.

Senator BAILEY. Non-interest-bearing bonds on the market at anytime will sell at very considerable discounts.

Mr. ALVORD. I think perhaps I spoke too rapidly. I would make them interest-bearing at the time they become negotiable. I think that must be done, sir, and I think we are perfectly right about that. If they are interest bearing, then I think there will not be much depreciation to the extent they are sold on the market. Many of them will not be sold on the market at all, they will merely be used to show a quick asset position, or perhaps hypothecated for loans. If that is done, say, to the extent of 10, 15 or 20 percent of the corporation's current net income, the Treasury gets more cash than it would under the present law, and suffers nothing, while the corporation gets as sound a financial position as we can conceivably give it. We would just remove the prohibitions of the tax laws upon the accumulation or upon this acquisition of a financial position, and then it will be in a position to proceed with its post-war operations as well financed as the Government can let it be, but financed from private sources. At that time then the funds of the private investor, if our other tax rates are properly adjusted, will be available for further financing, and it is only by that process that we can avoid these tremendous loans by the Government which may be discounted perhaps in actual final value by a substantial percentage, and it is only by that sort of a process that we can use private funds for private financing. If, as the result of the experiment, we are able to maintain for example the income of farmers because consumers will have funds to buy the farmers' products, and if we can maintain the income of labor, we stand a fairly good chance of avoiding the terrific depression which might otherwise be upon us. No one knows whether it will be there or not, but it certainly is a very real and serious problem.

Senator RADCLIFFE. Mr. Alvord, I think you said a moment ago that you thought the Government bonds would sell at a depreciated value. How long did the Liberties after the last war stay depreciated, when they were around about 80?

Mr. ALVORD. I think they depreciated, but I think some of the Liberties dropped to around 82.

Senator RADCLIFFE. They were something like that.

Mr. ALVORD. Yes.

Senator RADCLIFFE. What, in your opinion, is going to prevent our obligations going down after this war as they did after the last war? What change in policy would you suggest which would prevent that decrease?

Mr. ALVORD. I have no doubt that the present policies and procedures which are preventing the depreciation of Government securities with considerable success, with very real success, must be continued for a substantial period after the war.

Senator RADCLIFFE. If so, do you think those policies will be reasonably adequate to prevent such depreciation?

Mr. ALVORD. I hope so. It is a tremendous job.

Senator JOHNSON. The Federal Reserve bank has a solution for that. They loan money.

Mr. ALVORD. That is true.

Senator JOHNSON. At par value.

Mr. ALVORD. That is true.

Senator JOHNSON. I do not see how any Federal bond can go below par as long as the Federal Reserve bank will loan money at the par value of the bond.

Mr. ALVORD. Bear in mind that this is rather like pulling yourself up by your bootstraps. You may be able to do it for a while, but not for always.

Senator JOHNSON. It makes currency of the Government bond.

Mr. ALVORD. It has many dangerous possibilities in it.

I suppose it is the only policy which can be carried on now, and certainly the depreciation of Government securities must be prevented after this war by some process or other, and probably this procedure to which you refer, together with other fiscal policies of the Federal Government and the Treasury, will do that job, but certainly one thing must be done. We must get the financing of the Treasury off this day-to-day short-term basis and get our maturities extended well beyond the period of the post-war possible depression, and I would like to make the maturities of the bonds to which I refer fit into a sound Treasury policy with respect to its other securities.

We cannot impress upon you too much the necessity now of determining how post-war conversion costs and financial requirements of industry are to be met. It will be too late if we wait until the armistice, as was done after the last war. Things will move much too fast.

Senator WALSH. Are you coming to concrete suggestions?

Mr. ALVORD. That is my concrete suggestion in that respect, sir, that a deduction be given. I would apply the same principle to individuals, because they are going to need funds after the war just as well as industry. I make the suggestion that a deduction be given subject to a limitation to be determined by the committee, to determine how long this policy is to remain in force. If the computation of that income, say 10 percent of net income, for the amount invested in this special, nonnegotiable, non-interest-bearing Government security, which will be given to the corporation or the individual, with a nice red ribbon tied around it and put in the safety deposit box because it will be no good until some future date, then have the security become both negotiable and interest-bearing, with the interest rate determined in large part by the maturity date, immediately upon the cessation

of hostilities, or immediately, in order to make it practical and realistic, those securities becoming negotiable whenever the war contracts of a particular contractor have been cut back so that his volume, for example, today or tomorrow, is, say, 50 percent of what it was 6 months ago, that will give him a chance to start immediately to convert to the extent that materials and manpower are available.

Senator WALSH. Is this upon renegotiation?

Mr. ALVORD. No.

Senator WALSH. This is in addition to the revenue received on renegotiation by the Government?

Mr. ALVORD. The practical effect of this will be to reduce the effective corporate tax rates today, but to increase the flow of cash into the Treasury. If some such procedure as this can shorten this period of loss after the war and can maintain our so-called national economy at a high level, then the Treasury gains tremendously, because one of our principal bases of difference with the Treasury is that they think of revenues today and they close their eyes to what is going to happen to revenues in the future.

Senator WALSH. They lose immediately but increase in the future?

Mr. ALVORD. They get that cash. They lose in tax revenues and gain in cash, because 100 percent of this will go in instead of the 90 or 80 or the 72 percent tax rate which will go into the Treasury it will be 100 percent in cash, so the cash flow into the Treasury is going to remove the necessity of its borrowing from banks, for example.

Senator BAILEY. On a 10-percent basis how much will be laid aside?

Mr. ALVORD. You are running the corporate net incomes now for normal and excess profits taxes of, perhaps, about $18,000,000,000 or $20,000,000,000—and 10 percent of that deduction would be about $1,800,000,000 or $2,000,000,000.

Senator BAILEY. That is revenue?

Mr. ALVORD. That would be the effect of the reduction.

Senator BAILEY. What is the individual reduction?

Mr. ALVORD. I am not sure, sir.

Senator BAILEY. The total is $43,000,000,000.

Mr. ALVORD. I do not recall exactly but it is in excess of $23,000,000,000.

Senator BAILEY. That would be $23,000,000,000 and $18,000,000,000—that would make $41,000,000,000 as a base for the amount that you can lay aside?

Mr. ALVORD. Yes, sir.

Senator BAILEY. As a reserve to be converted into interest-bearing and negotiable securities upon the ending of the war.

Mr. ALVORD. Yes, sir.

Senator JOHNSON. What are the advantages of your plan over compulsory bond sales? In that instance you do not have to interfere with the tax structure, you can have the tax policy set and have compulsory bond sales.

Mr. ALVORD. I do not know that you can have compulsory sales without reducing your tax rates, and I do not know that you can increase your tax rates without greatly decreasing the proceeds from your voluntary bond sales.

Senator RADCLIFFE. There is some saving in interest; is there not?

Mr. ALVORD. There is no interest paid at all during the war period. There is a substantial saving there. Let me show you how it works. There is a corporation that comes to me and says, "We have a net income in 1943 that we estimate at $1,000,000"; 10 percent of that is $100,000. If we take the $100,000 and buy the bond, which the Government will immediately give us, we get a deduction. That is the picture. Anyone who looks at that picture will ask at least one question: "How certain are you that your net income will be a million?" and also invariably they will say, "Our net income might be $1,500,000 if certain deductions which we claim are disallowed or certain transactions which we think are not taxable become taxable," and they will buy probably $150,000 instead of $100,000 as a matter of insurance, and the Government gets that entire $150,000 for use without cost to the Government, during the period of the war.

Now, let us see what happens. Its final tax liability is determined to be, say, $1,000,000. It bought $150,000 of these bonds; it would get a deduction only for $100,000, and the Treasury has had the additional $50,000 without cost.

Let me suggest another possibility. This corporation gets into the post-war period and runs into a period of operating losses, which under the present law, will be carried back against its 1943 income, for example. Suppose those losses are enough to wipe out its entire 1943 income—and that is not an improbability—then the corporation has set aside about $150,000 from which it gets absolutely no tax benefit because its tax liability is zero. Just as in my first case, the Treasury has had the money for the period of the war without cost. We think the corporation, under those circumstances, will be in a position to shorten its period of operating losses and get much more quickly into a period of operating income, of high employment, of civilian production, so that the Government then will have incomes to tax, that it will not lose as the result of the operating loss, and the national economy at that time will be in a much sounder position.

Senator WALSH. Therefore, your proposition is that you improve the post-war period and prevent economic collapse. You would temporarily reduce the income from taxes and increase the Federal debt.

Mr. ALVORD. That is true, sir. That is very true, sir. In other words, we think that although these present tax rates are bearable for the period of the war, they are excessive when we take the post-war period into consideration.

Senator WALSH. That, of course, would be unthinkable.

Mr. ALVORD. That is true, sir.

There are other things which I have outlined in my written statement which I think should be put before you. The most important of these is a provision permititng the amortization of the cost of facilities purchased after the war in the process of converting back to a peacetime production. Instead of saying, "We will give you the normal rate of depreciation," the Government and individual will be much better off if we say, "Write that off over a period of 5 years and forget about depreciation after that."

This plan that I have discussed I think will completely satisfy the demands for so-called post-war reserves, because this is really a saving for post-war purposes, and the causes of the demand for post-war

reserves will be met by this sort of a system, except in one or two situations. Deferred maintenance, for example, stands on its own footing. It is a special sort of thing. There should be allowed now a deduction against 1943 income and current income, a reasonable allowance for deferred maintenance, and that provision will be just as administrable as your present provision giving the allowance for reasonable wear and tear. That is, you will be standing some of the cost of the war-incurred depreciation out of present-time current income. With shortage of material and the lack of manpower, maintenance of practically every facility in the United States has been deferred. Expenditures which would be made to keep them maintained in good operating condition cannot be made, although your income is still coming in from the use of those facilities. If you postpone maintenance until after the war it means you are transferring present costs, which should be charged against present income—you are transferring those costs over into a future year to which they have no relation and in which there may be no income.

The remaining suggestions that I make with respect to the general tax problems I think I will omit in my present presentation. I would like, however, to discuss three or four provisions of the present bill. Perhaps, first, I had better take up this section 115 that we hear so much talk about. That is the section which says if you have done anything after the Second Revenue Act of 1940 became law which may have had as one of its objectives a saving in tax, the Commissioner can reverse the entire thing.

Senator WALSH. The witnesses whose names are on the calendar will be excused until 2 o'clock.

You may proceed, Mr. Alvord.

Mr. ALVORD. Now, I have no patience with taxpayers who use provisions of the present law for tax-avoidance purposes, and I am not attempting to condone their activities, but let me point out a few things.

First, these loopholes that are referred to quite generally have been known from the time the first excess-profits tax began in its first draft appearance. Many of those loopholes I have pointed out, frequently, in testimony before the Ways and Means Committee and in testimony before this committee.

For example, I have criticized, and I still criticize, the doctrine of using the tax basis for assets in the computation of invested capital rather than the cost of those assets.

Now, you are getting into a tremendously big field. If that field is to be solved sensibly two things should be done: The proposal should not be made retroactive; I think that is exceedingly unfair. This tremendous power given is not anything but the retroactive levying of additional taxes where no one supposed they existed.

If under the present law these devices are illegal, let that fight go on and let it be determined whether they are illegal. If they are illegal then the person responsible for that probably knew that and took a chance on it. If they are not illegal, they should be subjected to additional tax just because somebody thinks that one of the purposes was a tax benefit.

Unfortunately, but nevertheless truthfully, I would suppose that there has not been a single business transaction since October 8, 1940,

without very serious consideration being given to tax consequences. That always happens with high tax rates. You could not run a business otherwise.

So, first, I certainly would not make the provision retroactive. Second, I think that provision should spell out these various devices which are considered to be tax-avoidance devices, but not grant a general power to haul in everything that the Commissioner might want to haul in. Spell it out in detail. Your experts know what they are talking about; they have got all the stuff, and they have had it for a long time. They can spell this thing out and say specifically that transaction A of type A will not be allowed in the future.

Now, here is what you are running up against, for example: We have the liquidation of a subsidiary. Now, back in 1936 Congress adopted the policy of encouraging the simplification of corporate structures and said, "You can liquidate a subsidiary without gain or loss." Well, every one of those liquidations necessarily had a tax benefit behind it—always had. There is always a tax benefit that results, and usually that is the primary cause, it may be the sole cause of the liquidation, and yet Congress said: "Gentlemen, you can liquidate your subsidiaries because we want to simplify corporate structures, and we think in the long run we will get more revenue."

Now, is liquidation under section 112 (b) (6) going to be considered one of the tax-avoidance devices because it was done for the purpose of reducing taxes?

I think that would be giving tremendous power to the Commissioner of Internal Revenue—a policy to reverse completely the policies of the Congress in conection with transactions of this type.

Senator BAILEY. I read here section 115, at the bottom of page 32 of the bill:

> If any person or persons acquire on or after October 8, 1940, directly or indirectly in, or control of, a corporation, or property, and the Commissioner finds that one of the principal purposes for which such acquisition was made or availed of is the avoidance of Federal income or excess-profits tax by securing the benefit of a deduction, credit, or other allowance, then such deduction, credit, or other allowance shall not be allowed.

What is wrong with that in principle?

Here I am; I am liable for tax, and I go and acquire a property or a corporation for the purpose of getting a reduction; I am reducing my liability on my other income. Is not that what this has in mind?

Mr. ALVORD. That is what it says.

Senator BAILEY. Is not that the intent?

Mr. ALVORD. That is one of the principal purposes.

Senator BAILEY. Yes.

Mr. ALVORD. Let us take the simple case I am just talking about. Suppose corporation X owns 100 percent of the stock of subsidiary Y· the Congress has said to corporation X, "You can liquidate the subsidiary any time you want to without gain or loss." On the liquidation of that subsidiary the assets go over to the parent. Its income from then on will be realized by the parent. The parent's invested capital and its earnings credit in both cases are necessarily increased. There cannot help but be a reduction in tax liability. That was one of the primary purposes. Are we going to condemn it now retroactively? I do not think so.

Senator BAILEY. You just object to the retroactive feature?

Mr. ALVORD. On this specific thing I object to both, because I do not think that is one of the so-called tax loopholes which have been availed of. There are two factors. One is where you buy the shell of the corporation which, for some reason or other, has had a series of operating losses or has a high credit for excess-profits-tax purposes. That situation can be readily spelled out. You have no other purpose in acquiring that thing except to get the credit or the carry-over loss, and you may miss on the carry-over loss if you are not careful.

Senator BAILEY. I think your objection is to the language that defines one of the principal purposes. Will you be satisfied if it said the Commissioner would have to find the fact that the principal purpose was to avoid tax liability?

Mr. ALVORD. If you do that, Senator, I am quite sure the section means nothing, because it would be utterly impossible to say the tax benefit was the sole purpose, or the primary purpose, so I do not suggest you do that. It is much better if you do nothing. I think the thing to do is to spell out the various types of transactions which you gentlemen think are within the class of tax-avoidance loopholes, spell them out and say, "From now on they are bad as to the past, even though we condemn them for the future." As to the past we say nothing, and we let the courts decide whether they were bad loopholes, bad tax-avoidance devices and, therefore, the allowance of a deduction is denied. There is a pretty good body of law on that point.

Senator WALSH. Your objection, therefore, is to the retroactive feature?

Mr. ALVORD. That is the first objection.

Senator WALSH. And the second objection is to the principle itself, even if it was not retroactive.

Mr. ALVORD. The generality of the language. I just give you as an example this liquidation of a subsidiary under declared policy has been in the law since 1936.

Senator BAILEY. Could you draw specifications so as to delimit this generality into the detail that you have in mind?

Mr. ALVORD. If there were available to me all the knowledge that the boys in the Treasury have, certainly I could do it. I could take a pretty good wallop at it with their knowledge.

Senator BAILEY. I believe you said we would have to refer this to the Treasury and ask them to do it, because you certainly haven't enough knowledge to do it.

Mr. ALVORD. I haven't the slightest idea how many of these things there are. I think I know most of them. Incidentally, I have never advised nor permitted my clients to use any of them, so I have no personal interest in this thing at all.

Senator BAILEY. You know the members of the committee have none.

Mr. ALVORD. You have only what the experts bring to you. The practical way is to spell this out just as you do with penalties, just as you do with deductions, spell out what types of transactions are bad. I think that can be done.

Senator BAILEY. Do you agree if a man acquires the property of a corporation for the sole purpose of avoiding a tax liability he should not be permitted thereby to avoid the taxes?

Mr. ALVORD. Certainly, sir. I do not think he could get by with it under present law. If you once get those facts I think the benefit would be denied to him. It has been done in many other cases. Many of them have gone to the Supreme Court. Again, you will practically never have a case in which you have proved on the record that the sole purpose was a tax benefit. I do not think you will have that case. The only way you can get a case like that is where counsel for the taxpayer stipulated it, and I cannot believe he would.

Senator BAILEY. You have the difficulty that the Commissioner does not find the fact, it is the revenue agent that finds the fact, and the Commissioner approves or disapproves it.

Mr. ALVORD. He probably approves it blind.

Senator BAILEY. Your opinion is that there are so many revenue agents distributed over the country there is no telling what they may do.

Mr. ALVORD. A general power such as that, you know, will necessarily create thousands of cases that you generally never expect to hit.

Senator BAILEY. That is what I say. You can anticipate that.

Mr. ALVORD. That is true, sir. The next point I would like to discuss very briefly is our objection to the 95 percent rate. Now, you gentlemen have heard me on that before, and I will do no more than generally refer to my prior testimony.

If there were such a thing as an accurate determination of excess profits—and there is not—if there were, and if all costs were allowable deductions, and if proper provisions were made for current costs extending into the post-war period, costs of reconversion which are really sound charges against current income, if these provisions existed—and they do not—and if you then solve your termination of war contracts and your disposition of Government surplus property satisfactorily and properly, then I would say why not put on a 100 percent rate? But don't deceive yourself. You are deceiving no one else. There is no incentive left when you take 25 percent. As a matter of fact, you gentlemen realized 90 percent was too high, that is why you wrote the 80 percent ceiling in it.

Senator JOHNSON. But suppose you had that reserve you spoke of?

Mr. ALVORD. If you allow these deductions for reserves along with these other items I mentioned——

Senator JOHNSON (interposing). We do that in the 95 percent.

Mr. ALVORD. Oh, no, sir. I think what you have in mind is this post-war refund of 10 percent of the excess-profits tax, which is quite another matter?

Senator JOHNSON. That is what you are talking about, is the excess-profits tax now.

Mr. ALVORD. I am now talking about the excess-profits tax—the reserve idea was being discussed.

Senator JOHNSON. There is a 10 percent reserve in this 95 percent tax.

Mr. ALVORD. That is true, but it is quite inadequate; it is a little bit unworkable under the law as it stands, and further, the bonds under that provision do not become available to the taxpayer whenever he has a cut-back in his war contracts. But if we can get these various things I have suggested so that you really have a sound excess-profits-tax law, so you are not taxing normal profits at 100 percent, which you are doing under the present law in case after case after case, then I

would say why not go 100 percent and let your post-war refund, as England does, amount to 20 percent? That additional 5 is not worth quibbling about, and it certainly would have no practical effect. Your 95 percent rate under the law as it stands now is, in your opinion, without possible justification.

Now, another thing that must be borne in mind in connection in determining the effect of that 95 percent rate is the proposed reduction in the invested capital credit. The average earnings base remains without change, but to your heavy goods industries, to the industries which you gentlemen are very familiar with—and there are only a few of them—that this would would hit, the present law says: "We will allow you 8.7, 6.5." The proposed House bill says, "We will give you 8 percent on your first $5,000,000 6 percent on the next $5,000,000, 5 percent on the next $190,000,000 and 4 percent on everything over $200,000,000." Now, there are only very few corporations which will be affected by the 4 percent rate, but if you will apply the effect of your tax rates to the corporations in these various brackets, you will find that your yield after taxes is measurably low, and as yet none of the profits have been distributed to the stockholder. For example, in your larger corporation your yield, if it has that income, your yield after taxes will be about 4 percent under the present law, but under this provision you cut it down to about 2½ percent.

Senator JOHNSON. I am more worried about the liquidation of the outstanding debt than I am that the stockholder makes a quarter of a percent more.

Mr. ALVORD. Nor does it make it adequate to pay the interest on the present debt or future debt.

Senator JOHNSON. That seems to be to be a very deplorable situation.

Senator BAILEY. To your stockholder it is very important that he have a return on his investment, not for his sake alone, but wholly because sooner or later he is going to have to depend on equity capital and he will not get any equity capital and he will not have any employment except by the Government.

Mr. ALVORD. That is very true, sir.

Senator BAILEY. Unless he has a return on the common stock.

Mr. ALVORD. That is very true, sir, and that is where substantially all your private financing must be raised.

Senator BAILEY. Don't you think that is fundamental in what we call free enterprise?

Mr. ALVORD. Yes, sir; that is very fundamental.

Senator BAILEY. There is no equity financing now?

Mr. ALVORD. None to speak of.

Senator BAILEY. There is none. I have got the record. It is minus.

Mr. ALVORD. That is probably true. When I say "none" there are some refunding operations, and that sort of stuff.

Senator BAILEY. There is no new financing.

Mr. ALVORD. Certainly among the larger corporations, there may be some private equity financing, based largely on a hope that some day the tax laws will permit a return.

This is what you are doing, Senator, you are saying by statute, "Gentlemen, we prohibit you from getting any increased income, whether that increased income is the result of normal growth, whether it is the result of real ingenuity, whether it is the result of decrease

in cost." Certainly increased volumes and decreasing costs are the two principal objectives we have been striving for ever since we have entered this period of war economy. And you are saying to these corporations, "Gentlemen, we want you to increase your volumes, we want you to decrease your costs, but you do not get a cent for it."

Senator WALSH. Would you let the law remain as it is, or would you have a flat percentage credit to all corporations?

Mr. ALVORD. That is a rather big question, Senator, but I think I can answer it. I would say practically, for present purposes, I would leave the law exactly as it is in those two respects. I do not mean to say the law as it is is satisfactory, it has lots of troubles in it. The Congress in the period of 3 years has done the best possible job it could do with it, but gentlemen, a true excess-profits tax is impossible to work. You cannot write one, and the Treasury cannot administer one.

That brings me to another point.

For those two reasons the excess-profits tax should specifically be made to terminate, specifically to be repealed at the end of the year in which hostilities cease, so that from then on we will know that you will rely on industrial profits in the hands of corporations solely for a normal tax. Your excess-profits taxes cannot continue in permanent operation and cannot continue beyond the cessation of hostilities.

Senator WALSH. We would like to adjourn in 5 or 7 minutes, if you can finish in that time.

Mr. ALVORD. I will try, Senator.

Senator BAILEY. Let me ask you one question. The taxes have increased up to 45 percent.

Mr. ALVORD. Much more than that.

Senator BAILEY. The profits have remained fairly stable. That means the purchaser is paying the bill, and the Government is the purchaser insofar as all these war profits are concerned.

Mr. ALVORD. That is true, sir.

Senator BAILEY. So, the Government is paying the taxes.

Mr. ALVORD. That is true, sir.

Senator BAILEY. Would you ask the Government to reduce the taxes or pay less?

Mr. ALVORD. I think not only from that point of view, I think it would pay the Government to reduce the taxes and get more revenues.

Senator BAILEY. It would cost us less. That may be theoretical, but it looks plausible on the face of it.

Mr. ALVORD. Many people shudder at the idea, but practically that is the result. The consumer must pay or the man goes out of business.

Senator BAILEY. Exactly.

Mr. ALVORD. There isn't any doubt about it.

If the United States Government is the purchaser, the sole purchaser, then certainly it must pay for the entire operation.

Senator BAILEY. If the capital is exhausted the company goes into bankruptcy and people cease to be employed.

Mr. ALVORD. That is true, sir. It also ceases to produce an income.

Senator BAILEY. In this case the Government is the tax collector, the tax spender and the consumer.

Mr. ALVORD. That is very true, sir.

Mr. BAILEY. I would like to see you figure out something on that.

Mr. ALVORD. The best present suggestion I have got is this savings device that I have discussed with you.

Let me come to renegotiation question. I will hurry through "renegotiation," because I have discussed it at length before the Ways and Means Committee in its earlier hearings, I think in September, and I would like to file as a part of the record at this time my statement before the Ways and Means Committee.

Senator WALSH. It may go into the record.

Mr. ALVORD. Renegotiation involves two entirely separate things. I want it clearly understood now I am talking at the present time solely about the problem of recapturing profits once they have been earned and once they are in the pockets of the citizens. I am not discussing repricing, forward pricing, future pricing. The recapture of profits once they are in your pocket can be done, in my opinion, in only one way, that is by taxation. Now, quite apart from renegotiation, we think the present tax laws do that job. We think you did a splendid job in writing the present tax laws. If they do not do it wholly satisfactorily you can supplement them. It is perfectly simple to do. But do not be misled by the position of the supporters of renegotiation. They say, "Oh, no; this is not taxes at all. We are merely pursuing a procurement policy. All we are doing is fixing prices retroactively."

Senator BAILEY. I would like to ask you another question.

Mr. ALVORD. You may, sir.

Senator BAILEY. In our haste in making war contracts we could not be provident, we could not contract at arm's length as you would ordinarily do. That matter was in the hands of the Army and Navy. They were in a tremendous hurry, and they did make some very improvident contracts. The principle there was a different one. We should renegotiate with the view of getting the contract on a sound basis, should we not?

Mr. ALVORD. That policy, as far as future pricing is concerned, is perfectly sound. Let us agree that upon what we have found, that is the prices are too high. You can take those away from us by taxation, and your tax laws will do it. As to the future, let us get the cost down, let us cut the prices down by agreement upon prices for future deliveries. It is a perfectly sound policy. But don't be misled when they tell you it is the procurement policy that they are pursuing when they reach into your pocket and take as many dollars as they may wish to take out of your pocket and say, "Senator, you are a swell fellow; it is fine, but we have got your money." The Government can reach into any citizen's pocket in only one way, it can exercise but one power, and that is the power of taxation. If you want to delegate that power to someone else, if you are afraid to exercise it yourselves, then delegate it in the only way I know of in which you may validly delegate power, and that way is the prescribing of sufficiently detailed principles or standards, so when you go to someone else to find out whether the particular officer has acted within his power, that fellow will have some way of determining it.

Now, the recapture of excessive profits, once they are in your pocket cannot be administered through renegotiation under that type of statute.

Senator JOHNSON. You say they cannot, but they do just the same.

Mr. ALVORD. Ah! But how are they doing it? The best intentioned, the ablest men in the country are on that job, they are doing it under a provision under which they can determine that you have excess profits, and, Senator Bailey, there are not two citizens that will do exactly the same thing under exactly the same circumstances. They tell you they cannot be governed by principles and standards, they have got to take each one separately and individually and decide that you, Senator Johnson, owe the Government $1,000 and Senator Bailey does not.

Senator BAILEY. That is an arbitrary power.

Mr. ALVORD. That is arbitrary to the highest degree.

You have never given such power to anyone before, and yet if your renegotiation is going to work I agree that the officials have got to have that type of power. If you cannot control their actions by standards and principles, it is utterly impossible for them to administer it.

Senator BAILEY. Can you write out some standards?

Mr. ALVORD. The House attempted to. I can supplement the House provisions.

Senator BAILEY. Do you like the House provisions?

Mr. ALVORD. Well the standards are much too general to do much good. They are just taking out of the joint statement of the various secretaries principles that are supposed to have been applied in the past. I think there are other standards much more specific. For example, I think there are no excessive profits, I think you gentlemen will agree there are no excessive profits, if I, after estimated taxes under the present law, have left less than your own definition of normal profits. That is what your excess-profits tax credit is, that is your definition of normal profits, and if I have left no more than normal profits I cannot have excess profits either under the tax statute or under the renegotiation statute.

Senator BAILEY. Your point is that we not only limit the excessive profits, but we have a law here that really limits normal profits.

Mr. ALVORD. That is very true, sir.

Senator BAILEY. Or rather reduces the normal profits.

Mr. ALVORD. Cuts the normal profits down.

Senator WALSH. Would you repeal the law?

Mr. ALVORD. Practically, Senator, I would do this, and I think I can sum up here very quickly: I would say this law shall not continue in force after January 1, 1944. I would say it shall be enforced prior to April 28, 1942.

Senator WALSH. Would you deny the Army and Navy the right to recompute a contract which was not subject to competition and which involved, at the time it was made, no knowledge of cost of material and other things? Would you deny them their right to renew it and make another contract?

Mr. ALVORD. Not at all, sir. I do not think it was negligence and carelessness on the part of the procurement officers. I think they did a better job than many other people did.

Senator JOHNSON. There was uncertainty as to the prices of materials at that time.

Mr. ALVORD. Senator, why not correct that uncertainty as to the future? Do your repricing as to the future. As to the past your tax laws are designed to take care of the profits, and they will do it.

Senator WALSH. I think there is a distinction between contracts made on a competitive basis and those that have been made hastily and quickly, without any effort to estimate, or that really anyone knew what the cost was going to be.

Mr. ALVORD. With that I agree. I am being a little bit practical in what I am saying to you. I think your procurement officers are now in a position to determine prices and costs and to agree upon reasonable prices, and therefore I would terminate this law as of the end of this year.

Senator WALSH. And go back to the competitive basis?

Mr. ALVORD. Go back to the competitive bidding, go back to the negotiated prices. I think your negotiated contracts will still be necessary to a great extent, but your procurement officers have knowledge now, and your contractor has knowledge. They know what they are going to make for all practical purposes. There will be some contracts in which the prices are too high, and in the cases where the prices are too high the tax laws will come along and take it away from them. That is the way the thing should function.

Senator BAILEY. Suppose you have a contract between the Government and another party to build all the ammunition that is to be manufactured, the price will be so much but the profit will be exceeding a certain sum, and insofar as it did exceed that sum or percentage, it should be recoverable by the Government; is there anything wrong with that?

Mr. ALVORD. And it is recoverable under the present tax law?

Senator BAILEY. It is recoverable under the present law.

Mr. ALVORD. A contract voluntarily entered into of that nature is not unusual in the business world. It is a perfectly good contract and should be enforced.

Senator WALSH. We used that method, Senator, as you know, in the matter of building ships and airplanes, but the Administration asked us to repeal it when it was interfering with the war effort.

Senator BAILEY. There may have been some reason when we tried to build so many ships, when we did not know how many we could build, but we know now.

Senator WALSH. That is right.

Senator BAILEY. We can approximate the costs. There is a great more certainty now than there was a year ago. I went into that with Admiral Land. He was planning ahead for 12,000,000 tons last year, and they were producing 20,000,000 tons of shipping. I sympathize with him. He is attempting to put the ships in the water, regardless of cost.

Mr. ALVORD. Ships were more important than costs, Senator.

Senator BAILEY. Exactly. The whole point now is we have reached a stage where we are a little bit more well informed.

Is that your point?

Mr. ALVORD. Yes. We certainly have reached a point where we do not need the dangers in a democratic nation of controlling future prices.

Senator JOHNSON. Yes; but the cost-plus method has some very bad features, too.

Mr. ALVORD. Senator, don't let anyone deceive you. What your renegotiation statute is doing, in effect, is forcing everybody into the cost-plus basis. I am very serious about that.

Now, my second suggestion to you is that you get rid of the thing as of January 1, 1944, on. For profits realized during 1943, I would say to the contractor, "Here, if you want to pay an additional 5 percent in excess profits upon your negotiated profits, you do not have to be renegotiated." That means if he is paying a 90 percent excess-profits tax rate, he would pay 95 percent on his negotiated profits from war contracts, and certainly that remaining 5 percent in anyone's opinion must necessarily be reasonable, and if he were subject to the 80 percent ceiling, with the safeguard which you gentlemen wrote in last year because you thought your rates were too high, let him pay 85 percent upon his negotiated profits. Then you have got your established tax procedure, you have established tax policies for reclaiming these excess profits once they have gotten into the contractor's pocket, and let the repricing go ahead.

In connection with the repricing I merely wish to point out in the bill you are extending the power of the secretaries tremendously with respect to future prices. The bill gives the power to determine prices for the future and to compel deliveries under that determination. He can fix the prices at anything he wants, and you would be compelled to deliver your accounts to the Government at that price.

Senator WALSH. Is it compulsory?

Mr. ALVORD. It is compulsory, yes, sir.

Senator WALSH. The language is compulsory?

Mr. ALVORD. Yes, sir. The present law, as I read it, does not give quite that amount of power. Repricing is based upon an agreement, I think. It is a little bit difficult to tie the War Powers Acts and renegotiation statute in together to make sure you reach a conclusion, but I think the decision with respect to future prices under the present law must be a voluntary agreement.

Senator WALSH. I think that is true.

Mr. ALVORD. If you do not agree, then they retroactively renegotiate you out of your excess profits. I think that is the way it is supposed to work. This gives compulsory power, under which you must deliver at the price determined.

The pending bill must be considered quite seriously from the point of view of this repricing power, because I think repricing a contract under the bill and repricing under the law, although precisely the same process might be used, might be conceived a different process without different results.

Judicial review, Mr. Chairman and gentlemen, is the most constructive amendment made by the House bill to renegotiation. I have discussed it in my brief, and I will not discus sit now beyond telling you that I think the the provisions in the House bill can be improved, but from the point of view of the Government and the contractor, quite considerably.

Thank you very much.

Senator WALSH. Your presentation is always interesting and helpful.

Thank you.
Mr. ALVORD. Thank you, sir.
(The matter submitted by Mr. Alvord is as follows:)

BRIEF OF ELLSWORTH C. ALVORD

(Presented to the Committee on Finance of the United States Senate, at Hearings on the Revenue bill of 1943, December 3, 1943)

Mr. Chairman, gentlemen, I am Ellsworth C. Alvord, an attorney, of Washington, D. C. I appear as chairman of the committee on Federal finance of the Chamber of Commerce of the United States.

INTRODUCTION

The position of the committee on Federal finance of the United States Chamber of Commerce, in support of the chamber's policies, has been presented in detail to the Committee on Ways and Means of the House of Representatives, by members of our committee:

(1) Mr. Roy C. Osgood discussed the estate and gift tax proposals of the Treasury and recommended several amendments to the present law. I am filing with your committee an additional memorandum prepared by Mr. Osgood;

(2) Prof. Fred. R. Fairchild discussed principally the much-mooted question of inflation;

(3) Mr. Henry B. Fernald discussed the burdens upon both individuals and corporations under the existing income-tax laws; and

(4) I discussed the more general problems of financing the Government during the war and the post-war period and also filed a memorandum with respect to several necessary amendments to the so-called technical administrative provisions of the present law.

Our testimony and the record of the hearings before the Committee on Ways and Means are available to your committee and, consequently, will not be repeated. We trust that our testimony and memoranda will be helpful to your committee in its consideration of the bill now pending before you.

SUMMARY OF OUR POSITION

For the convenience of your committee we summarize our position:

(1) Revenue proposals and policies cannot be segregated from current problems and policies under the renegotiation law, or involved in the termination of war contracts, or in the disposition of surplus properties and facilities acquired for war purposes.

(2) The Treasury needs maximum revenues, consistent with the admitted objectives to be attained, not only this year, but for years to come.

(3) There is no tax system which will prevent inflation, but sound fiscal policies and taxes which will produce such maximum revenues and create confidence will give maximum aid in the fight against inflation.

(4) Viewed solely from the point of view of the war period, revenues under the present laws might be increased, but taxes during the war period must not produce minimum revenues during the post-war period.

(5) The present law imposes maximum tax burdens upon the incomes of individuals and corporations, which may be bearable during the war period, but which, viewed from the point of view of the post-war period, are unquestionably excessive.

(6) The costs of reconversion from a war economy must not be financed by Government loans.

(7) The pattern for the post-war period is being shaped and molded by current policies.

(8) The Congress and your committee are deciding today whether democracy shall survive this war, or whether government dictatorship, in the form of socialism or communism, will be substituted.

OUR OBJECTIVES

We emphasize the following objectives:

(1) Maximum war production until the cessation of hostilities.

(2) Maximum civilian production during the period of the war and throughout the post-war period.

(3) Maximum consumer purchasing power throughout the post-war period.
(4) Maximum employment and pay rolls for those now employed and who wish employment upon the cessation of hostilities, including those returning from the war.
(5) Victory must preserve our country, our homes, our opportunities, our freedoms, and our form of government.

Only through the attainment of these objectives can adequate incomes for farmers be maintained; can our people be employed at adequate salaries and wages; can industry survive. Only through the attainment of these objectives can the American system of individual initiative and free enterprise—the true foundation of our democracy—stand a chance to survive.

DISPOSITION OF SURPLUS PROPERTIES

In any discussion of Federal taxation at this time, the problem of the disposition of Government-owned surplus property—land, buildings, equipment, raw materials, and supplies acquired for war purposes or upon the termination of war contracts—is important. If properly handled, large sums will be placed in the Federal Treasury. If, on the other hand, such property is dumped upon the market in an effort to obtain the greatest financial return to the Government at the earliest possible moment, irreparable damage will be done.

There should be centralization of responsibility and authority respecting the disposition of such surplus property. An independent surplus property commission should be created by legislation, and principles and policies to guide the conduct of the activities of the commission should be enacted.

When they become no longer needed for war production, Government-owned war plants should be sold at prices that are fair to the Government and to the buyers. Such plants should not be operated by the Government after the war. Surplus supplies should be sold through the normal channels of distribution.

Only by the organization of a responsible, independent agency and the establishment of proper principles and procedures can we succeed in avoiding an upheaval which would have disastrous effects upon employment and economic stability, with serious repercussions on the yield of Federal taxes.

TERMINATION OF WAR CONTRACTS

Industry faces tremendous problems upon the termination of war contracts:
(1) Its war facilities must be disposed of without loss.
(2) Its inventories must be disposed of without loss.
(3) Its bills receivable must be paid promptly in order that it can meet its bills payable.

Our recommendations have been presented in detail to the House Military Affairs Committee on October 25, 1943, and to the Senate Subcommittee on Post-War Planning on November 4, 1943. Briefly we recommend the prompt enactment of legislation with the following important features:

(1) Mandatory partial payments to prime and subcontractors, subject to preliminary review, but not to detailed audit. This payment should cover (*a*) the contract price of completed articles, (*b*) direct material costs (including raw materials), and (*c*) direct labor costs. Claims covering these classes can be prepared and proved promptly. They can be paid immediately and in full. In addition, a partial payment can be made promptly of the balance of the claim (consisting of indirect costs and profit—items which will be more difficult of proof and which may involve disputes), subject to essential safeguards to prevent overpayment.
(2) Loans, or guaranties of loans, for amounts in excess of the partial payment.
(3) Approval of the principle of negotiated settlements conducted by the service departments, which shall be final and conclusive except for fraud.
(4) The establishment of a central policy board to prescribe uniform policies and procedures with respect to termination.
(5) Specification, in the statute or uniform regulations, of the bases of allowable costs and profits, as guides to the proper determination of advance payments and final settlements.
(6) Development of a standard termination clause for use by all war agencies.
(7) Clear separation of termination procedure and renegotiation liabilities.
(8) Development of specific Government policies and procedures governing the immediate removal of Government-owned property in order to facilitate civilian production.

(9) Creation of a reviewing agency, independent of the service departments, for the settlement of disputed questions of law or fact.
(10) Development of procedure permitting companies holding large numbers of terminated contracts and subcontracts to settle all of them in a single claim rather than through individual prime contracts.
(11) Provisions similar to the Dent Act of 1919 legalizing settlements under defective or informal contracts.
(12) Recognition of dismissal wages and the amortization of emergency facilities as proper termination costs.
(13) Treatment as canceled material of inventory stocks produced or procured in advance of specific war contracts at the insistence of Government departments.

POST-WAR METHOD OF FINANCING

Industry faces tremendous financial requirements for the immediate post-war period. Most of its needs will be found among the following:
(1) New facilities must be acquired, through reconversion of war facilities, restoration and modernization of existing facilities, purchase, and construction.
(2) New inventories must be acquired and carried, at least until the proceeds from the sale of finished products are received.
(3) New enterprises must be established, new products discovered, old markets regained, and new markets developed.
(4) New management and new labor must be trained and fused.
(5) Research, engineering, and scientific services must be reestablished.
(6) Severance or dismissal wages, particularly for those engaged in war production, must be paid.
(7) A period of operating losses, ranging from a few weeks to many months, during the period of transition or reconversion from a war economy to a peace economy, must be financed.
No one can predict all the needs for funds or the amounts of funds required. But no one doubts that adequate funds must somehow, some time, be forthcoming. And everyone knows that there are only three available sources: (1) Funds in the hands of private investors; (2) earnings and profits in the hands of industry; and (3) the Government. The issue presented is: Will industry be compelled to resort to financing by the Government?
If individual initiative and free enterprise are to be preserved, the financial requirements of industry for the post-war period must be obtained from private sources, and must not be obtained from the Government.

PRIVATE FINANCING

Private financing rests upon the financial strength of industry. Industry will require both risk capital and credit. In other words, the financial strength of industry must be sufficient to attract risk capital and credit. But risk capital and credit can be attracted only if a financially strong industry can offer a return commensurate with the risks involved. A financially strong industry means an industry capable of producing profits after taxes. A return commensurate with the risk involved means a return after taxes to the investor.

AVAILABILITY OF PRIVATE FUNDS

One would be unrealistic indeed to believe that even the most profitable enterprise could today attract funds in the hands of the public by offering a return after taxes commensurate with the risks involved. Our present tax laws are prohibitive. Mr. Fernald developed this point in his testimony before the Committee on Ways and Means. (See pp. 641–651.) The conclusion is inescapable.
Furthermore, one would be unrealistic indeed if he viewed the immediate post-war period and concluded that the private investor, under the then probable rates of taxes, would receive a yield commensurate with the risk he is taking.
It is quite true that the private investor has not lost all hope of a reasonable return at some time in the future. He finds, for example, some prospect in the

possibility of a reasonably stable system for taxing capital gains, which will offset somewhat his utter inability to retain after taxes out of current distributions an amount commensurate with the risks he takes. It is also true that private funds are being invested as "hedges" against inflation. Otherwise, we must recognize that at least during the immediate post-war period taxes will probably not be reduced to the point at which the private investor will receive after taxes an attractive yield. In this event, risk capital and credit in adequate amounts cannot be obtained from funds in the hands of private investors.

Consequently, if we are to avoid financing by the Government, we are compelled to conclude that the only source available for meeting a substantial portion of the financial needs of industry for the post-war period must come from the accumulated current earnings and profits of industry itself.

AVAILABILITY OF CORPORATE PROFITS

As we have already stated, the Revenue Act of 1942, from the point of view of the post-war financial requirements of industry, imposes excessive burdens. Earnings and profits after taxes are unquestionably both inadequate and unavailable. The statistics and estimates furnished by the Treasury are not reliable indices. Current earnings and profits, to the extent not taken by taxes, are in large part frozen in plant, facilities, equipment, and inventories. In fact, the balance sheets of too large a portion of industry reveal insufficient working capital; a dangerously low ratio of current assets to current liabilities; tremendously unprecedented inventories; a paradoxical financing of current production, not through assets, but through current (though not yet due) liabilities to the Government for taxes and to creditors for purchases; and inadequate assets to finance post-war pay rolls and probable post-war losses.

NET INCOME RETAINED BY CORPORATIONS

Treasury testimony before the Ways and Means Committee has laid much stress on an estimated $11,000,000,000 which the Treasury estimates corporations will have retained as accumulated earnings (net income after taxes in excess of dividends paid) as indicating that corporations as a whole should have ample accumulated funds to meet the post-war situation.

The basis of this estimate appears in a table on page 103 of the hearings before the Committee on Ways and Means, October 4, 1943, which shows the figures from 1936 to 1941, inclusive, as "actual" and 1942 to 1944, inclusive, as "estimated."

For the 6 years for which the actual results are there shown—i. e., from 1936 to 1941, inclusive—the result is to show that the minus figures for the years 1936-38, inclusive, exceeded the plus figures for the years 1939 to 1941 by $238,000,000, that is, for those 6 years there was a net impairment, rather than an accumulation, of surplus.

Following the situation back to the year 1930, compiling figures from the Treasury Report for Statistics of Income for 1939, the attached table has been prepared. This shows that the net result for the 15 years 1930 to 1941, actual, and 1942 to 1944, inclusive, estimated, is a net impairment of $14,181,000,000. In otherwords, accepting at their face the Treasury estimates of large accumulations of retained earnings for the years 1942, 1943, and 1944, the net result for all corporations would be that taxes and dividends paid had exceeded income for the entire 15 years by $14,181,000,000, as follows:

	Millions
Net income (excluding dividends received)	$100,434
Income and excess-profits taxes	57,225
Net income (excluding dividends received) after taxes	43,239
Net dividends paid	57,420
Net impairment, 15 years	14,181

Corporations, all returns—Net income retained after taxes and after net dividends paid, 1930 to 1944

[In millions of dollars]

Taxable year	Net income (excluding dividends received)	Income and excess-profits taxes	Net income (excluding dividends received) after taxes	Net dividends paid	Net income retained (impairment indicated by minus sign)	
					By years	Cumulative
1930 [1]	2,078	713	1,366	5,613	−4,247	−4,247
1931 [1]	−2,746	399	−3,145	4,182	−7,327	−11,574
1932 [1]	−5,089	286	−5,375	2,626	−8,001	−19,575
1933 [1]	−1,956	423	−2,379	2,101	−4,490	−24,065
1934 [1]	753	596	157	2,642	−2,485	−26,540
1935 [1]	2,409	735	1,674	2,927	−1,253	−27,793
1936 [2]	5,094	1,191	3,903	4,703	−800	−28,593
1937 [2]	5,143	1,276	3,872	4,832	−960	−27,553
1938 [2]	2,340	850	1,490	3,222	−1,742	−31,295
1939 [2]	5,272	1,232	4,040	3,941	199	−31,096
1940 [2]	7,204	2,549	4,655	4,058	597	−30,509
1941 [2]	14,107	7,166	6,941	4,463	2,478	−28,031
1942, estimated [2]	19,850	11,750	8,100	4,100	4,000	−24,031
1943, estimated [2]	22,000	13,450	8,550	4,000	4,550	−19,481
1944, estimated [2]	24,000	14,600	9,400	4,100	5,300	−14,181
Total, 15 years	100,464	57,225	43,239	57,420	−14,181	

[1] Results for 1930–35 compiled from "Statistics of Income for 1939, pt. 2," pp. 15, 48, 49–49. Similar compilations for 3 years 1936–39 agree with results for these years shown by (2).

[2] Results for 1936–44 as stated in table, p. 103, "Revenue revision of 1943. Hearings before the Committee on Ways and Means," Oct. 4, 1943; of which 1936–41 are stated as "actual" and 1942–44 as "estimated."

NEEDS OF THE TREASURY

On the other hand, the Treasury needs all the cash it can get from private sources. One would be most unrealistic if he believed that there were any immediate possibility of reducing present taxes to the point where earnings and profits could be retained in adequate amounts and become available for post-war purposes. On the contrary, the flow of cash into the Treasury from private sources should, if possible, be increased.

We believe that there need be no irreconcilable conflict between the needs of the Treasury and the needs of industry.

POST-WAR RESERVES

Funds for financing post-war requirements can be accumulated, axiomatically, only during a period when industry is making profits. That period, we know, is the current calendar year. Perhaps that period may include the calendar year 1944. Beyond that, predictions are impossible. Even 1944 seems uncertain.

Two plans have been proposed. Each involves a very simple, workable method:

(1) Every corporate taxpayer (and the plan could readily be conformed and made applicable to individuals) should be permitted to purchase nonnegotiable and non-interest-bearing Government bonds, which would become immediately negotiable and interest-bearing upon the cessation of hostilities (or upon the termination of its war contracts, or their "cut-back" to, say, 50 percent). The rate of interest would, of course, be governed primarily by the maturity date.

(2) The taxpayer would be allowed a deduction in the computation of taxable net income for the amount of the bonds purchased by it during the taxable year (or within 75 days after the close of its taxable year).

(3) Under the first plan, the savings of the corporation, invested in the special security, would become available to the corporation without further taxation. Thus every corporation would be treated alike. Under the second plan, the savings of the corporation would be invested in a Government security maturing in 18 months, and the proceeds as received by the corporation would be considered as taxable income subject to the corporate normal tax. Thus, the corporation with little or no income in the immediate post-war period would receive the full benefit of its savings, while the corporation which earned a greater income during the immediate post-war period would receive a correspondingly lesser benefit.

(4) Obviously, a reasonable limitation must be imposed upon the allowable deduction. If the plan first proposed is adopted, it is suggested that the deduc-

tion should not exceed 10 percent of the corporation's net income. If the second plan, the suggested limitation of 20 percent of net income seems reasonable.

The objectives of both plans are the same: To place industry in as strong a position financially for the post-war period as is possible—that is, to give industry an opportunity, now denied it by the tax laws, to accumulate current earnings and profits to assist it in financing its post-war requirements.

We believe that the first plan is preferable. It treats all industry without discrimination; the needs of any particular corporation will not necessarily be measured by its experiences during the immediate post-war period; it does not involve a "gamble" on the amount of corporate normal tax during the post-war period and therefore upon the amount of savings to be available for post-war purposes; and the maturity dates of the bonds can be adjusted to other Treasury financing.

APPLICABILITY TO THE INDIVIDUAL

Industry is not in a peculiar position. Individuals are facing the same need for financial strength to carry them over the immediate post-war period. They too, can save for the post-war period only when they have current incomes. Farmers will need funds for replenishing their herds, for rebuilding their fences, for repairing their buildings, for the purchase of new machinery and equipment. Employees must have funds to carry them over until production is resumed.

We recommend that the plan proposed for industry be conformed to the plan of individual taxation adopted by the Congress.

AMORTIZATION OF WAR FACILITIES

By Executive order dated October 5, 1943, the provisions of the present law relating to the allowable deductions for amortization of the cost of war facilities have been effectually terminated. A startling new principle has been announced: The cost of all war facilities shall hereafter be paid for with Government funds. We urge the Committee on Finance to review the policy thus announced and determine whether that policy conforms to its policies.

Under the present law, the cost of war facilities may be spread over a period of 5 years or over a period of the emergency, whichever is the lesser. Upon termination of the emergency, the taxpayer has the option to recompute the allowance. For example, if the appropriate secretary determines that the facility has ceased to be necessary in the interest of national defense, then the cost of the emergency may be spread over the shortened amortization period. It is recommended that the taxpayer similarly be given the power to terminate the amortization period, at any time after December 31, 1943, and to spread the cost of its facility over the preceding period, except that the amortization period should not be less than 3 years.

AMORTIZATION OF PEACE FACILITIES

The acquisition of new plant facilities and equipment for the post-war period may be facilitated substantially, without ultimate cost to the Treasury. It is recommended that the taxpayer be given the option, in lieu of depreciation, to spread the cost thereof over a 5-year period.

DEFERRED MAINTENANCE

The problem of deferred maintenance is in a class by itself. Deferred maintenance means that expenditures to maintain property, which would be deductible when made, are necessarily postponed (and the deduction therefore postponed) by reason of lack of time, lack of materials, or lack of manpower. But maintenance expenditures thus deferred are determinable within the current taxable year, are proper charges against the income of the current year and there is no necessity for postponing the deduction. It is recommended that a reasonable deduction be allowed for maintenance expenditures thus deferred.

ACCELERATED DEPRECIATION

Existing rules and regulations of the Treasury with respect to accelerated depreciation, although they purport to allow additional depreciation because of the extended use and lack of care of the facilities during the war period, in effect deny the allowance of all but normal depreciation. Depreciation based upon the normal life of the facilities, is inadequate to cover the actual depre-

ciation of facilities in abnormal use during the war period. It is recommended that an adequate provision for accelerated depreciation be included in the pending revenue bill.

GOVERNMENT OWNED OR OPERATED ENTERPRISES

Corporations which are owned or operated by the Government and engaged in private business in competition with private enterprise should be subjected to the same taxes as private enterprise. In addition, immunity from taxation should not be used as an inducement to communities or public corporations to purchase privately operated enterprises.

NEW ENTERPRISES

As we have previously stated an opportunity must be afforded for new enterprises. Our present tax laws are prohibitive. Likewise, existing enterprises which necessarily suffer losses during their formative period, or which have suffered losses primarily because of the demands of the war, must not have their future profits subjected to existing tax rates.

The problem is important and far reaching. A permanent solution should be provided in the first revenue bill following cessation of hostilities. A temporary solution should be provided now by the extension of the net loss carry-forward provisions from 2 to 3 years.

REPEAL OF THE EXCESS-PROFITS TAX

It is urgently recommended that the pending bill include a provision specifically terminating the taxation of "excess profits" at the end of the calendar year within which present hostilities cease.

DOUBLE TAXATION OF INDUSTRIAL PROFITS

We have frequently discussed the excessive burdens upon corporate profits resulting from their multiple taxation under present law. Industrial profits are taxed in the hands of the corporation which earns them; they are again taxed, in part, in the hands of the corporate stockholder; and they are again subjected to taxation in the hands of individual stockholders when distributed in the form of dividends. The undistributed profits tax was an ill-designed device to meet this problem. The British system is probably incapable of application to our industrial enterprises. The Committee on Finance and the Congress are urged to give the subject the serious consideration which it demands.

ADMINISTRATIVE BURDENS

We believe that few people appreciate the tremendous administrative burdens imposed by the present law upon the Bureau of Internal Revenue. Its job cannot be measured solely by the unprecedented number of income-tax returns required and filed under existing law. Of greater importance are the tremendously difficult, complicated, and technical provisions of the present law, the questions of policy and law presented, and the sums of money involved.

We believe that drastic and immediate action is necessary. Every encouragement for the employment and training of new personnel must be given. Every encouragement must be given present personnel to remain with the Treasury. As a partial solution, we suggest that the Commissioner of Internal Revenue be authorized to create 100 positions and to fill them with persons, each of whom will be qualified to receive, and who may be paid, $9,000 a year.

ADDITIONAL REVENUES

As we have stated, neither corporations nor individuals can bear a greater burden of taxation upon their incomes. If substantial additional revenues are to be obtained, they must be sought from new sources. For this purpose, for the purpose of relieving millions of taxpayers from the necessity of filing income or Victory tax returns, and for the purpose of reducing administrative burdens under the present laws, we commend for your consideration the enactment of a retail sales tax.

A RETAIL SALES TAX

After considering the various forms of sales, transactions, and turn-over taxes, we have come to the conclusion that a tax imposed upon retail sales—that is, a tax upon sales for consumption or use—is the most practical at the present time.

Discriminations and administrative difficulties can be avoided, however, only if—

(1) There are no exemptions;
(2) The tax is imposed at a uniform rate;
(3) No other Federal taxes are imposed upon retail sales;
(4) The tax is imposed upon aggregate purchases;
(5) The tax is imposed upon the purchaser; and
(6) Fractional cents are disregarded.

The yield of a retail sales tax meeting the above conditions will, of course, depend upon its rate. A 10 percent tax would probably yield during the calendar year 1944 in excess of $6,000,000,000. A 5 percent tax, probably about $3,500,000,000.

Its gross yield, however, must be offset. For if a retail sales tax is adopted, it is our belief that, in lieu of exemptions and to prevent the imposition of too great a burden upon low income groups the existing personal exemptions for individual income-tax purposes must be increased somewhat; and the first surtax bracket should be established somewhere above the first $1 of taxable income. If these things are done, then the Victory tax may be integrated with the normal tax, without the loss of taxpayers and without the loss of revenues.

Contrary to the expressed position of the Treasury, it is our belief that a sales tax meeting the conditions we have above outlined:

(1) Is capable of reasonably simple and effective administration;
(2) Is desirably deflationary;
(3) Will collect substantial revenues, without imposing unbearable burdens, from those receiving four-fifths of the national income;
(4) When viewed merely as a part of our tax system, will not impose burdens which discriminate in favor of high-income groups and against low-income groups;
(5) Will render unnecessary the tremendous increases in certain excise taxes advocated by the Treasury; and
(6) Will aid in stamping out black markets.

If, in addition to the imposition of a tax upon retail sales for consumption or use, the Congress determines that it is desirable to impose additional excise taxes upon luxuries, for example, these additional taxes may be imposed upon the manufacturer. Thus, in effect, the advantages of a gradual sales tax are obtained, but with none of its difficulties and disadvantages.

THE PENDING BILL

We commend the members of the Committee on Ways and Means for their sound action in rejecting the revenue proposals advanced by the Treasury. Their reports upon the bill are worthy of study.

We come now to a discussion of some of the provisions of the bill now pending before you.

INCREASE IN EXCESS-PROFITS RATE TO 95 PERCENT

The proposed increase in the rate of the excess-profits tax rate to 95 percent is without justification. If excess profits could be determined with reasonable accuracy, if all real costs were allowed as deductions, if appropriate provisions were made for post-war costs of reconversion, and if all the problems arising from the termination of war contracts are solved satisfactorily and promptly, then perhaps the present rate of 90 percent could be increased for a limited period of time. Under these conditions, we would suggest a rate of 100 percent, with 20 percent to be included in the post-war refund—there is nothing but academic theory to support the retention by the corporation of 5 percent of its excess profits. A practical and realistic approach is essential in the determination of tax rates. Permission of a corporation to retain 5 percent of its excess profits, computed under the present law, deceives no one. A 95 percent rate is confiscatory. Frequently, in fact, usually, it would result in an effective rate greatly in excess of 100 percent. It would be a prohibition upon increased earnings, whether resulting from decreased costs or increased volume.

It is pointed out that the proposed increase applies to corporations engaged solely in civilian production, as well as to corporations engaged in war production. It will have an unfortunate, adverse effect upon both.

REDUCTION OF INVESTED CAPITAL CREDIT

The reduction in the invested capital credit is unsound in principle, unfair in its application, and unjustified by actual conditions. It reduces to the danger point an already inadequate return on the capital invested in a business. Under present law, after the 40 percent normal and surtax, the net return on a invested capital base ranges from 4.8 percent on the first $5,000,000 of capital down to 3 percent on capital over $200,000,000. The House bill would reduce the 3 percent figure to less than 2½ percent (2.4 percent). It is obvious that such a rate of return will not even equal the interest obligation on borrowed money, let alone permit dividend payments.

Assume a corporation with capital slightly more than $200,000,000 earns, before Federal income and excess profits taxes, a 10 percent return, say, about $20,000,000. Under the reduced invested capital credit proposed, it would have a return, after taxes, of about 3¼ percent on its capital, but the rate of return upon the profits over its base credit would be only about 0.22 of 1 percent. Obviously, there would be no profit inducement to the corporation to increase its earnings over its base credit.

The only arguments in support of the House proposal are found on page 23 of the committee report: (*a*) The Canadian law does not allow an increase in invested capital for earnings accumulated after January 1, 1939; and (*b*) a corporation will not distribute dividends if accumulated earnings are included in its invested capital. These arguments are wholly irrelevant to the issue. If sound, they might support a special treatment for accumulated earnings—such as their segregation and inclusion in invested capital at whatever rate the Congress determines is appropriate. However, the issue presented by the provision in the pending bill is whether the invested capital credit should be reduced. We are strongly of the opinion that the reduction is not justified and is inadvisable.

SECTION 115, ACQUISITIONS TO AVOID INCOME OR EXCESS-PROFITS TAX

In an effort to reach certain cases of flagrant tax avoidance, section 115 of the House bill provides that—

"If any person or persons acquire, on or after October 8, 1940, directly or indirectly, an interest in, or control of, a corporation, or property, and the Commissioner finds that one of the principal purposes for which such acquisition was made or availed of is the avoidance of Federal income or excess profits tax by securing the benefit of a deduction, credit, or other allowance, then such deduction, credit, or other allowance shall not be allowed."

The Commissioner is further granted the authority to allow a portion of such items if he determines that such allowance will not result in tax avoidance. The provision is made retroactive to taxable years beginning after December 31, 1939.

While there can be no objection to the general purpose of this provision, assuming such purpose to be to prevent artificial tax schemes having no motive other than tax avoidance, the breadth of the provision included in the House bill is certain to raise doubts with respect to almost every transaction. For example, the acquisition through a section 112 (b) (6) liquidation of all the assets of an existing subsidiary may technically fall within the provision because it may be in part motivated by the tax saving of running the previously bifurcated enterprise as a single entity. Yet it is clear that there is nothing reprehensive about the desire of a taxpayer so to reorganize its business structure. In fact, the Congress long ago specifically adopted the policy of encouraging the simplification of corporate structures and the acquisition of properties. The tax laws contain specific means for accomplishing this purpose and the right to employ them has never been questioned on the ground that tax would be saved. Many other instances could be cited of legitimate transactions which may be brought into question because of the absence of any clear-cut standards in the proposed provision. Although, in the administration of the section, these cases may not be penalized, no cause for concern should be permitted to exist.

A more careful attempt should be made to define the precise types of cases intended to be reached, which are presumed to be largely cases of the purchase of corporate shells merely in order to obtain the benefits of a high invested capital

credit or net operating losses, where normal business practice would not involve such a course. At least, some indication should be given that the section is not intended to overrule or cut across all other provisions of the tax laws, many, if not all, of which were adopted with full knowledge of the tax consequences involved and, in fact, with the very idea of creating such consequences.

Furthermore, to question a transaction merely because one of the principal motives is a tax motive makes the field of possible investigation illimitable. All corporate simplifications since 1936 have been at least in part influenced by tax considerations. In fact, tax consequences are now almost always taken into account by businessmen in determining a course of action. Consideration of tax consequences, therefore, cannot be made a major test.

Apart from these general considerations, however, there is little justification for making the new provision retroactive. This feature of the bill is explained on the ground that the devices dealt with by the new provision are palpable tax-dodging schemes, the legality of which is questionable under existing law, and that approval, even by implication, of any previous tax-dodging scheme should be avoided. However, it would be simple enough to declare specifically that the new provision should not be deemed to imply any approval of such schemes or to affect the decision of their legality under existing law. It is fairer to compel both parties to rely upon the then existing law for past years, particularly since it is reasonably certain that the type of tax-avoidance scheme which the Government is amply justified in upsetting is as vulnerable under existing law as under the proposed enactment, than to attempt to bolster the Bureau's position by a provision which may well be construed to cover a far broader and more questionable field. Furthermore, the staff of the Treasury and the joint committee, as well as the committees of Congress, have repeatedly been advised of many of the schemes and urged to correct them. Retroactivity is not justified upon the ground of lack of knowledge.

POST-WAR REFUND OF EXCESS-PROFITS TAXES

Under the present law (sec. 250 of the Revenue Act of 1942) the post-war bonds are of no real value until the cessation of hostilities. The provisions of the present law were enacted in recognition of the fact that the excess-profits-tax rates were too high and for the purpose of making at least partial provision for reconversion costs. However, current experience upon the termination of war contracts establishes that many contractors will require financial assistance prior to the date of cessation of hostilities. We recommend that the bonds should become negotiable as soon as the war volume of a contractor has decreased beyond a stated ratio—for example, whenever his current war production is less than 50 percent of his war production at a stated prior date, say, 6 months earlier.

DENIAL OF DEDUCTION FOR FEDERAL EXCISE TAXES

Section 110 of the pending bill denies a deduction for Federal import duties and Federal excise and stamp taxes, under section 23 (c) (1), but without preventing their deduction as an ordinary and necessary business expense, under section 23 (a). It is pointed out that section 23 is applicable both to individuals and to corporations. We assume that the section does not affect corporation deductions—for example, the capital-stock tax and the transportation tax. Any doubt with respect to their deductibility should be removed.

INCREASE IN SOCIAL-SECURITY TAX

The House bill is silent with regard to the increase to 2 percent (from the present 1 percent) in the tax upon both employers and employees for Federal old-age and survivors insurance. This increase, unless suspended, is shortly to become effective.

Since the first suspension of an increase in the tax, the burdens upon employees have increased, and they, as well as employers, have been faced by withholding methods of considerable complexity. Any approaching need for strengthening the reserve of the insurance fund can be more accurately appraised when the problems of war financing are less acute and proposals for broadening the Social Security System can be carefully weighed.

We recommend that during the war, or least for the next year, there be no increase in the social-security taxes.

RENEGOTIATION

The position and recommendations of our committee upon the recapture of so-called "excessive profits" by renegotiation were presented in detail to the Committee on Ways and Means of the House of Representatives on September 16 of this year. In order to avoid repetition, it is requested that my statement be incorporated at this point in my testimony before your committee.

We believe that everyone admits that high excess-profits tax rates and recapture through so-called renegotiation cannot both remain, and that the recapture provisions of the present law are "dangerous and undemocratic." We urge their repeal. If our tax laws are inadequate, they should be amended and supplemented.

However, the House bill is based upon the policy of continuing the present law, with amendments designed to make it more workable and equitable and to provide judicial review of renegotiation decisions.

Our comments upon the House bill follow:

NONRETROACTIVITY

The House bill does not attempt to prevent the retroactive application of the original law and its various supplements. Their retroactive application is unconstitutional, and practically there is no necessity for retroactive application. The Government should not compel its contractors to resort to litigation.

ADDITIONAL TAXES

Contractors should be given the option to pay an additional excess-profits tax (making the applicable rate 95 percent, or, if the "ceiling" applies, then 85 percent) upon their renegotiable profits, in lieu of renegotiation. Certainly there can be no excessive profits retained by the contractor under these suggested rates. The option should be made applicable to 1943.

If the 95-percent rate proposed by the House bill is adopted, and if the "ceiling" is increased to 85 percent as suggested by the Treasury, for 1944, then, of course, there is no necessity for recapture through so-called renegotiation of any 1944 profits. However, as we have previously stated, there is no justification for increased excess-profits tax rates applicable to profits upon nonwar activities. Nonwar activities. Nor is there any justification for increased rates upon war profits or war contracts, except as a practical expedient to remove all conceivable necessity for renegotiation.

EXEMPTION OF STANDARD COMMERCIAL ARTICLES

If it is the intention of the Congress to exempt all contracts and subcontracts for the sale of "standard commercial articles," as this term is ordinarily understood, then the definition in the House bill should be revised.

The House bill requires, among other things, that a standard commercial article be not "specially made to specifications furnished by a department or by another contractor or subcontractor." It has been the custom for many years for the manufacturer of a standard commercial article to prepare for his convenience, and for the convenience of the Government, specifications for this article, which specifications are then adopted by the Government, and the Government, when ordering this particular article, or in asking for bids on this particular article, does so by specification. If this would be considered a specification furnished by a department, then the contract for sale of many standard commercial articles ordered and purchased in this way would remain subject to renegotiation.

It is suggested that the following is a more accurate and practical definition:

"The term 'standard commercial article' means an article—

"(A) which is of a general type or design manufactured and sold in civilian, industrial, and commercial use,

"(B) which is manufactured and sold as a competitive product, and

"(C) for which a maximum price has been established and is in effect under the Emergency Price Control Act of 1942 as amended or under the Act of October 2, 1942, entitled 'An Act to Amend the Emergency Price Control Act of 1942 to Aid in preventing Inflation and other Purposes'."

The House bill merely authorizes the Board, in its discretion, to exempt standard commercial articles. We recommend that a specific statutory exemption be provided.

STANDARDS TO BE APPLIED

The House bill prescribes a few very general standards to be taken into consideration in determining excessive profits. However, the standards of the House bill are probably too general to serve any useful purpose. Certainly they should be supplemented by the standards which we suggested to the Committee on Ways and Means. And certainly the costs, prices, and profits of competitors are important factors.

ALLOWABLE DEDUCTIONS

All deductions allowable for tax purposes should be allowable for renegotiation purposes—not merely those allocable to war profits.

The net income of the contractor for tax purposes should first be determined. Its net income should then be apportioned between nonrenegotiable and renegotiable business. The simplest principle is to allocate upon the basis of gross receipts.

STATE INCOME TAXES

The House bill proposes an unfortunate change with respect to the deduction of State income taxes. The entire amount of State income taxes should be allowed as a credit against excessive profits determined by renegotiation, in the same manner as the credit is given for Federal income taxes.

FORWARD REPRICING

Forward repricing—that is, a repricing under an existing contract of goods to be delivered in the future—should be a matter of agreement between the Government and the contractor. The House bill gives to the Government the apparent right to fix the price and to compel deliveries at that price. This is a most undesirable and unnecessary extension of the present law. In addition, the provision of the present law providing the procedure for repricing and judicial review should be reviewed, to make certain that all repricing is subject to the provisions of the bill applicable to the determination of excessive profits.

THE CENTRAL BOARD

An appeal to a central board will be ineffective and futile if the Board adopts the policy of affirming the decision of the lower board. This seems to be the policy presently in effect.

THE TAX COURT OF THE UNITED STATES

The review of renegotiations determinations will unquestionably impose a severe burden upon the Tax Court of the United States. It is recommended that the court be consulted, in order that burdens will not be imposed upon it which will interfere with its continued efficient disposition of tax cases.

JUDICIAL REVIEW

Perhaps the most constructive amendment of the present law proposed by the pending bill will be found in the provisions relating to judicial review. Generally speaking, the review of administrative actions may be classified into two types: (1) A review de novo of the administrative action—such as the review by the Tax Court proposed in the pending bill; or (2) a control of administrative action, under which the reviewing court determines whether the administrative action is in accordance with law. It is our opinion that a de novo review of renegotiations decisions is unnecessary. We recommend a "control" review, in the nature of a proceeding for an injunction or a declaratory judgment. Jurisdiction of proceedings of this nature may be conferred upon the district courts of the United States (with concurrent jurisdiction, maybe, given to the Tax Court). Jurisdiction to review renegotiation decisions de novo cannot be conferred upon a constitutional court created under article III of the constitution.

In no event, should power be given to determine excessive profits greater than than determined by the Board, or to fix prices less than those fixed in the order.

POWER TO WITHHOLD PAYMENTS

The House bill provides that a renegotiation decision or order (such as a direction to withhold payments to the contractor or an order fixing forward prices) shall not be suspended upon the filing of a petition for review. This provision reverts to the archaic procedure enforced many years ago in the collection of income taxes. Present-day practices, adequate to protect both the Government and the contractor, should be adopted. The renegotiation decision or order should not became effective until it becomes final.

SECTION 3806

Where "excessive profits" are refunded to the Government as a result of renegotiation, the amount refunded should be excluded from the contractor's gross income, as if it had never been received. Only by the application of this policy can interminable disputes over tax liabilities be avoided.

When such refunds are agreed to before the Federal tax return is filed, the Treasury Department permits exclusion of the profits from income on the basis of an administrative ruling (I. T. 3611). After the return is filed, and a tax liability has been assessed with respect to the excessive profits refunded, section 3806 of the Internal Revenue Code becomes applicable. This section is designed to accomplish the same result as I. T. 3611 by directing the exclusion of the "excessive profits eliminated" by renegotiation from gross income. A tax is computed after excluding such excessive profits. This is compared with the tax shown on the return. The difference is the "tax credit." The service departments are required to reduce the "excessive profits eliminated" by the amount of the tax credit applicable thereto.

The section is unquestionably sound in principle. It is phrased in very complicated, technical, and ambiguous language. With the aid of cooperative administrative interpretation it has functioned with reasonable satisfaction. Major difficulties with respect to settlements by partnerships and individuals were overcome by I. T. 3619.

Section 3806 was based on the language of section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended by the Revenue Act of 1942. Extensive changes are made by the pending bill in the definition of terms, which must be carefully correlated with section 3806.

For example:

(1) Section 3806 refers, in paragraphs (a) (1) and (b) (1), to "the amount of excessive profits eliminated." The amendment to paragraph (c) (2) of section 403 (p. 112 of the bill) provides that in determining the amount of excessive profits to be eliminated, credit shall be allowed under section 3806. The direction in the bill creates an obvious inconsistency.

(2) The bill also provides (p. 104) that excessive profits are to be determined without deduction for State income taxes, but in determining the amount of excessive profits to be eliminated "proper adjustment" shall be made on account of the State taxes excluded. This provision is confusing and its effect upon the tax credit computation is not clear. In computing taxable net income the full amount of State taxes paid (and not refundable) would be a deduction, regardless of how it is treated in renegotiation proceedings.

(3) The specification of the cases of repayment or offset to be taken into account under section 3806 does not correspond to the specifications of methods (A) to (D) on page 111, lines 12-23, of the bill. There should be correlation.

TECHNICAL PROVISIONS OF FEDERAL TAX LAWS—AMENDMENTS URGED

(Supplement to statement of Ellsworth C. Alvord presented to the Committee on Finance of the United States Senate at Hearings on H. R. 3687, December 3, 1943)

I. THE EXCESS-PROFITS TAX

(1) *Availability of unused excess-profits credit of predecessor corporation to successor corporation in railroad reorganizations.*—Section 142 of the Revenue Act of 1942 provides for a carry-over of the invested capital credit in the case of railroad reorganizations under section 77m of the Bankruptcy Act, whether the old corporation continues in existence or whether a new corporation is created. Through oversight in drafting, however, the section inadvertently fails to provide that an unused credit of the predecessor corporation may be carried over to and

used by the successor corporation. Consequently, the present law results in discrimination in favor of those railroad corporations which continue on as old corporations after the reorganization and against new corporations resulting from bankruptcy proceedings. This situation should be corrected by providing that such a new corporation should be considered the same taxpayer as the old corporation which it succeeds, for the purposes of the unused excess-profits credit adjustment.

(2) *Elimination of base period deduction under section 23 (p) for past service payments.*—Under section 23 (p) of the applicable revenue act, payments of past service liability for pension trust purposes were not allowed as a deduction in full for the year of payment, but were required to be spread over a period of 10 years. In many instances the last year of such 10-year period was 1939. It is clear that such deductions are nonrecurring and, in computing the average earnings credit for use in excess-profits tax taxable years in which such deductions are no longer present, they should be eliminated in the computation of average base period net income. Section 711 (b) (1) should therefore be amended to provide for such an adjustment.

(3) *Elimination of 95 percent limitation in income credit.*—The limitation of the income credit to 95 percent of base period average earnings should be removed. It is the result of a 1940 compromise having nothing to do with merit and represents a direct extension of the excess-profits tax rate to normal profits.

(4) *Extension of Section 718 (c) (5) to reorganizations generally.*—Under the invested capital credit a deficit in the taxpayer's earnings and profits does not impair its invested capital. Section 718 (c) (5) preserves such a taxpayer's invested capital, unimpaired, for its successor in a so-called identity reorganization. The same result should obtain in respect of reorganizations generally in order to produce a consistent operation of the use of tax basis in lieu of cost in computing invested capital. Section 718 (c) (5) should, therefore, be broadened.

(5) *Adoption of proper basis in inadmissible asset adjustment.*—Section 720 and the applicable regulations provide that, for the purpose of the inadmissible asset adjustment, both admissible and inadmissible assets shall be taken at their adjusted basis for determining loss. This is correct insofar as it requires a loss basis to be used, since this is the basis upon which paid-in capital and accumulated earnings and profits are computed for purposes of section 718. It fails, however, to take into account that the adjustments to such basis, which are prescribed by section 113, are not those which are proper in computing earnings and profits for invested capital purposes. To be consistent with the invested capital computations, the adjustments which should be employed are those proper under section 115 (1) for determining earnings and profits. A similar difficulty was discovered and remedied in section 718 (a) (2) by the Revenue Act of 1942, but through inadvertence the corresponding change was not made in section 720. Section 720 (b) should therefore be amended to provide that the adjusted basis shall be the unadjusted basis for determining loss with those adjustments which are proper under section 115 (1) for determining earnings and profits.

(6) *Extension of section 722 to changes in character of business occurring after base period.*—Section 722 should be revised to make definite and certain that changes in the character of the taxpayer's business occurring after the end of the base period can constitute grounds for relief in the case of a taxpayer in existence prior to January 1, 1940. Recognition of such changes as eligibility factors does not afford the taxpayer an opportunity to obtain a constructive income based on income realizable from war production or war activity. The maximum amount of constructive income possible in any event is automatically limited to the amount of income that the change would have produced if the result of such change had been in effect during the base period. The amount of income thus produced in the base period is measured by base period business conditions and economic circumstances. It is believed that a proper construction of section 722 (b) (5) permits consideration of such post-base period changes since their consideration is consistent with the principles and limitations of the section. Tacit recognition of the principle involved is found in secton 722 (c) which grants constructive income relief to corporations coming into existence after December 31, 1939. In order to avoid any possibility of ambiguity, however, the statute should be amended to make the rule explicit.

(7) *Preservation of exemption of section 727 corporations despite consolidated return.*—The 1942 act abolished the excess-profits tax exemption of a corporation otherwise exempt from excess-profits tax if it is included in a consolidated return. There is no justification for denying the exemption solely by reason of

the consolidation. The rule works a particular hardship in the case of a corporation exempt from excess-profits tax under section 727 (g) because it derives 95 percent or more of its income from sources outside the United States. Preservation of the exemption need not upset the consolidation, for the corporation may still be included in the consolidated return but its income and credits can be eliminated in the computation of the tax from which it is exempt. This is the type of treatment accorded Western Hemisphere Trade Corporations by virtue of their exemption from surtax. The same approach should be adopted in the case of corporations exempt from excess-profits tax under section 727.

(8) *Limitation of section 742 (f) (1) adjustment to cases of actual credit duplication.*—Although supplement A, as revised by the Revenue Act of 1942, is a very great improvement over the original provisions, there is one defect in section 742 which should be remedied. This defect is in the rule provided in section 742 (f) (1) for the purpose of avoiding duplications in base period net income.

Section 742 (f) (1) provides in general that where the component corporation's stock was acquired since December 31, 1935, for a consideration other than the issuance of the acquiring corporation's stock, the component's base period experience prior to the date of acquisition of its stock shall be excluded from the acquiring corporation's base period net income "in such amounts and in such manner as shall be determined in accordance with regulations prescribed by the Commissioner with the approval of the Secretary." The theory of this limitation is that the assets used to acquire the component's stock will themselves have produced a base-period experience for the acquiring corporation for the period prior to their use for the purchase of the component's stock and to permit the inclusion of the component's base period net income for the same period will result in duplication.

It is believed that this adjustment is basically wrong in theory. The surviving enterprise reflects in whole or in part the component's business, not the continued use of the assets employed to acquire the predecessor's stock. Therefore, the correct method for guarding against duplication would be to eliminate the base-period experience of the acquiring corporation attributable to such assets prior to their disposition.

Assuming, however, that the existing policy is to remain, it is believed that the Bureau regulations have gone far beyond the intent of the statute, by requiring an automatic elimination of a component's experience regardless of whether any possibility of duplication exists. It is obvious that there are many transactions where the stock of a component has been acquired other than in a stock-for-stock transaction where there is no chance of a duplication. For example, the component's stock may have been acquired with stock of another domestic corporation, the dividends from which would have been excluded from base-period income. Or stock may have been issued for cash which was immediately thereafter used to acquire the component's stock. In none of these cases should an adjustment be made. It is believed that section 742 (f) (1) gives the Commissioner sufficient discretion not to require an adjustment in such cases, but the regulations do not adopt this approach. Section 742 (f) (1) should therefore be amended so as to provide specifically that taxpayers have the right to avoid a reduction in credit by proving that under the facts of their particular cases inclusion of the component's base-period experience will not result in duplication.

(9) *Revision of section 761.*—Section 761 as added by the 1942 act prescribes with one exception the same adjustment in the parent's invested capital upon a tax-free liquidation of a subsidiary as section 718 (a) (5) and (b) (4) of the prior law, where the stock of the subsidiary is held by the parent with a carry-over basis. This exception is that reductions in the parent's invested capital as a result of the liquidation are not limited to its accumulated earnings and profits. The reinstatement of this limitation is necessary in order to produce a fair reflection of invested capital at least in those cases where the subsidiary was originally created by the parent corporation and deficits have occurred in the operations of the subsidiary prior to liquidation. The limitation has the effect of producing the same result as if the subsidiary's operations had been carried on by the parent and is obviously proper.

II. GENERAL AMENDMENTS AFFECTING CORPORATIONS

(1) *Correction of section 131 (b) relating to the foreign-tax credit.*—Under the provisions of section 131 of the Internal Revenue Code taxpayer is allowed a credit against the amount of his United States tax for foreign taxes paid or

accrued. One of the basic principles of the foreign-tax credit, however, is that it shall not exceed the effective rate of United States tax on the foreign income. The limitations designed to achieve this result are contained in section 131 (b).

Prior to the 1942 amendments, section 131 (b) provided that the foreign-tax credit should not exceed the same proportion of the United States tax against which it was to be taken as the taxpayer's foreign net income was of its total net income. The existence of the excess-profits tax caused no difficulty, since it was a deduction in computing net income. Thus, while it served to reduce the denominator of the limiting fraction, it also served to reduce the numerator (foreign net income) if the income from foreign sources was subject to such tax.

Beginning with 1942 the deduction of the excess-profits tax in computing net income was eliminated and in lieu thereof a credit for income subject to excess-profits tax was substituted. Instead of merely conforming section 131 (b) to the new treatment of the excess-profits tax by substituting the credit for income subject to excess-profits tax for the old deduction of the tax itself, the 1942 act changed the section 131 (b) ratio by stating both the numerator and the denominator in terms of total income rather than that portion of each class which is subject to normal and surtax. This produces an erroneous result in cases where the foreign income is not subject to excess-profits tax, since it is equivalent to attributing a portion of the credit for income subject to excess-profits tax to the taxpayer's foreign income—a false assumption. The correct rule is to use as the numerator the normal tax net income from foreign sources (that is, the foreign income reduced by its share of the credit for income subject to excess-profits tax only in those cases where this class of income is subject to excess-profits tax) and as the denominator the taxpayer's total normal tax net income, without adjustment. These factors are directly related to the tax against which the credit is being taken and will produce an appropriate result in all cases.

(2) *Correlative adjustment of income and excess-profits-tax liabilities.*—The interdependence of the income tax and the excess-profits tax makes it essential that they be audited concurrently. It is understood that the Bureau of Internal Revenue, as a matter of administrative policy, intends to follow this practice. Statutory safeguards should be provided, however, to insure that the correlative adjustment in one tax occasioned by adjustments in the other tax will not be barred because of the running of the statute of limitations or otherwise. A typical case in which this situation might arise is where the Commissioner challenges a taxpayer's computation of its excess-profits credit. If the Commissioner succeeds in reducing the excess-profits credit, the taxpayer's adjusted excess-profits net income and therefore the credit under section 26 (e) for income subject to excess-profits tax will be increased, thereby reducing the normal and surtax. If, however, this adjustment is not finally determined until after the statute of limitations on refunds for normal and surtax has expired, the taxpayer may be subjected to an additional excess-profits tax without a corresponding reduction in income tax. While it is believed that the Bureau will make every effort to avoid situations of this kind, it is clearly desirable that all risk be eliminated by statute.

Another aspect of this type of correlative adjustment which should be given immediate consideration is the question of computing interest on deficiencies and overpayments. It is obviously unfair to charge interest on the deficiency side of what amounts to a single adjustment from the due date of the return, but to allow interest on the correlative overpayment only from the date of the last payment. The proper method for making the determination in such cases is to arrive at a net figure, deficiency or overpayment, as the case may be, and compute interest on such amount from the applicable date.

(3) *Extension of railroad provisions to other bankruptcy reorganizations.*—The promised extension of the railroad provisions to other bankruptcy reorganizations should be effected as soon as possible. Many pending insolvency reorganizations are being held up because of the delay in clarifying the tax consequences. It is to the Government's interest as well as that of the taxpayer that these proceedings should be brought to a conclusion and the reorganized businesses should be permitted to proceed with their normal operations without fear of unanticipated tax burdens. Legislation extending the railroad provisions to other bankruptcy reorganizations should also incorporate the suggestions made earlier in this memorandum relative to the unused excess-profits credit.

(4) *Exclusion of refunds of real property taxes from gross income.*—In the case of refunds of State and local real property taxes, discrimination exists under present law between cases where the prior deduction year is closed and those where it is still open when the recovery is made. In the former case the refund

must be included in income when received and is taxed at the rates then prevailing. In the latter, an adjustment is made in the prior deduction and a deficiency is assessed. For example, the X Corporation pays $10,000 in real property taxes in 1939, claiming the deduction therefor on its income-tax return. In 1944, $4,000 of this tax is refunded as excessive. Assume the Federal tax rate applicable to such corporation in 1939 was 19 percent, and in 1944 it is 40 percent. If the corporation is required to include the $4,000 recovery in income for 1944, it will pay a tax of $1,600, although its tax saving in 1939 because of the $4,000 deduction was only $760. Because of the almost compulsory nature of the original payment, this treatment for income-tax purposes is clearly inequitable.

Section 157 of the Revenue Act of 1942 recognized this difficulty in the case of unconstitutional Federal taxes previously deducted and provided that in such cases recoveries should be excluded from gross income for the year of the refund if taxpayer agrees to an adjustment of the prior deduction year. Real property taxes are on the same footing from the point of view of the hardship which would be involved in requiring refunds to be included in taxable income for the year of recovery. It is believed that failure to include this type of taxes in the 1942 provision was the result of inadvertence and this oversight should be remedied as soon as possible.

(5) *Application of tax benefit rule to depreciation.*—The Supreme Court has recently held that excessive depreciation not beneficially allowed, i. e., not used to offset taxable income in earlier years, must, nevertheless, under existing law be applied to reduce the basis of depreciable property. (*Virginian Hotel Corporation of Lynchburg* v. *Helvering*, 63 S. Ct. 1260 (1943). It is unnecessary to demonstrate the unsoundness of this rule as a matter of policy, however it may be justified as a matter of statutory interpretation. Accordingly, the Code should be amended to eliminate any adjustment under such circumstances. Furthermore, it is submitted that in view of the high corporate tax rates consideration should be given to a more general revision of the rules applicable to depreciation in order that the taxpayer may have a more reasonable opportunity of realizing a return of its capital without being subjected to income tax thereon.

(6) *Acceleration of refunds resulting from carry-back provisions and change in amortization period.*—Two provisions have been enacted by Congress which will be of great benefit to taxpayers in the difficult reconversion period to be expected at the conclusion of the war. One of these is the right to shorten the period of amortization of emergency facilities and the other is the carry-back of unused excess-profits credit and net operating losses. Unfortunately, however, both are dependent on the comparatively slow process of obtaining refunds from the Treasury Department. In the meantime the taxpayer's cash position is not helped and it is possible that refunds will come too late in many cases to avoid financial disaster. Serious consideration should be given in accelerating the taxpayer's refund rights.

(7) *Application of 6-month holding period to involuntary conversions occurring after December 31, 1941.*—The benefits of the involuntary conversion provisions of section 117 (j) added by the 1942 act have been extended retroactively to taxable years beginning after December 31, 1939, for excess-profits tax purposes, but the required holding period for years beginning prior to January 1, 1942, is 18 months rather than the 6 months specified for 1942 and subsequent years. This works hardship upon a taxpayer with a fiscal year ending in 1942, particularly where the involuntary conversion occurred in 1942. This is especially true in the case of fiscal years ending after June 30, 1942, since a portion of the tax for that year is required to be computed at the rates specified in the 1942 act. The minimum relief which should be extended to such taxpayers is that they would be permitted to avail themselves of the 6-month holding period in connection with the 1942 act computation. It is believed, however, that sound policy required that the 6-month holding period should be available for both the 1941 act and the 1942 act computations in those cases where the involuntary conversion occurred after December 31, 1941, since the dangers of experiencing an involuntary conversion as the result of war conditions (with a resulting loss of an opportunity to age the property) were equally prevalent during such period for both fiscal and calendar year taxpayers.

(8) *Extension of benefits of section 117 (j) to all types of property.*—The treatment accorded to involuntary conversions by section 117 (j) should not be limited to capital assets and depreciable property, but should be extended to all types of property, including inventories.

(9) *Elimination of penalty tax for filing consolidated returns.*—Section 141 (b) of the Internal Revenue Code provides that if consolidated returns are filed the surtax rate shall be increased by 2 percentage points. The justification for consolidated returns is that only by treating the affiliated group as a taxable entity can the appropriate result be reached. In view of the fact that it is admitted that this is the only correct way of determining the tax there is no excuse for a 2-percent penalty rate and it should be eliminated.

(10) *Elimination of intercorporate dividend tax.*—The intercorporate dividend tax should be eliminated. Even if the tax has possessed some degree of utility in bringing about desirable simplifications of corporate structure, it is no longer needed for that purpose. Such simplification has already taken place in large measure and will no doubt continue to do so, where it is desirable, as the result of other measures such as the Holding Company Act, and the tax-free liquidation of subsidiaries made possible by section 112 (b) (6) of the Code. It is high time that this tax, unimportant as a revenue producer and a deterrent to investment in new enterprise, should be eliminated from our tax structure.

(11) *Retroactive amendment of undistributed-profits tax of 1936.*—Under the undistributed-profits tax imposed by the Revenue Act of 1936, taxpayers which were prevented by contract restrictions from distributing all or part of their income as dividends were given relief. Section 26 (c) (1), dealing with this matter, provided that such contracts must have been executed by the corporation prior to May 1, 1936. It was never intended that the phrase "by the corporation" should be so narrowly construed as to deny the credit because the contract was executed by a predecessor corporation which was subsequently merged with, consolidated into, or liquidated into the taxpayer. In such cases the taxpayer, or successor corporation, is, in the eyes of the tax law, a continuation of the pre-existing business enterprise.

The law is being interpreted, however, to deny the credit in such cases. This results in substantial injustices, which should be cured by a retroactive amendment making clear that a contract will be deemed to be executed by the corporation if it was executed by a predecessor corporation the property of which has been acquired by the taxpayer as the result of a merger, consolidation, section 112 (b) (6) liquidation, or as the result of a series of such transactions.

(12) *Limitation of dividend treatment of capital distributions by personal holding company.*—The Revenue Act of 1942 provided that any distribution by a personal holding company except in complete or partial liquidation was to be treated as a taxable dividend in the hands of its shareholders. The purpose of this provision was to enable a personal holding company to obtain a dividends paid credit and thereby avoid the personal holding company surtax even though it has no earnings and profits. The 1942 amendment goes beyond the needs of the case, however, and unjustifiably restricts the right of shareholders of a personal holding company to be treated like the shareholders of other corporations. The provision in question should be amended so as to treat the capital distribution of a personal holding company as dividends only to the extent necessary to give it a dividends paid credit sufficient to offset its subchapter A net income.

(13) *Repeal of capital stock tax and declared value excess profits tax.*—The capital stock tax and its companion tax, the so-called declared value excess profits tax, should be repealed. The combined operation of these two taxes merely penalizes the inability of a corporate taxpayer accurately to foresee the trend and amount of its future earnings. The Treasury has itself on several occasions recommended their abolition and it is obvious that the complications involved in these taxes far outweigh their values as revenue producers.

III. MISCELLANEOUS AMENDMENTS INCLUDING CHANGES AFFECTING INDIVIDUALS

(1) *Repeal or amendment of windfall provision of Current Tax Payment Act of 1943.*—The windfall provision of the 1943 act should be repealed unless it can be appropriately amended to limit its application to true windfall situations resulting from abnormal war conditions.

As the provision is now drafted, it applies to many situations where no windfall is in fact involved. A conspicuous example of such a case is where the taxpayer has become a beneficiary of a trust at or after the close of the last base year upon the death of the preceding life beneficiary. Even though the trust income in the taxable year does not exceed the trust income in any of the base years, the entire trust income in the taxable year, except for the $20,000 credit, may be subject to

the windfall tax solely by reason of the fact that during the base years it was received by the preceding life beneficiary. Obviously, if the income is substantial the $20,000 exclusion is not capable of preventing gross hardship.

The variety of circumstances in which the windfall provisions can cause unjustifiable hardship and the impossibility of anticipating all of such cases raise the question of whether the provision should not be repealed in its entirety. If retained and if a general relief clause cannot be devised, then at least specific hardship cases such as that referred to above should be taken care of as they arise. Certainly the exclusion of such a case from the impact of the provision is consistent with the specific exclusion of the case where partnership income in the taxable year is represented by corporate income in the base years.

(2) *Clarification of non-trade or non-business expense provision.*—It is believed that the 1942 amendment allowing a deduction for ordinary and necessary expenses paid or incurred for the production of income, or for the management, conservation, or maintenance of property held for the production of income, has been given too narrow a construction by the Treasury Department's Regulations. Among the deductions which are declared to be unallowable are expenses incurred in the preparation of income-tax returns, in defending against income-tax deficiencies, and in the recovery of refunds. This is clearly erroneous since the commonest burden of all attaching to the receipt of income is the expense of preparing income-tax returns and determining the true tax liability arriving from the receipt of such income. The statute should be amended to eliminate any occasion for such a narrow construction as has been adopted by the regulations.

(3) *Reduction in rate of interest on deficiencies and refunds.*—The rate of interest charged on deficiencies and allowed on refunds should be reduced from 6 to 4 percent. The rate now in effect was established at a time when the general level of interest rates on borrowed money, including Government borrowing, was materially in excess of present levels. A considerably lower rate is clearly required under existing conditions unless the interest on deficiencies and refunds is to be in the nature of a penalty. The reduction, however, should be effective only after a specified future date—January 1, 1944, for example.

(4) *Regulation.*—We wish to renew our recommendations made to this committee in 1941 (pages 670 and 671 of the Hearings on H. R. 5417) that the doctrine of the congressional adoption or ratification of interpretative regulations by subsequent reenactment of the statute should be abrogated or sharply limited by legislation and that legislative regulations should be promulgated only after public hearings held upon due notice.

STATEMENT OF ELLSWORTH C. ALVORD

(Presented to the Committee on Ways and Means of the United States House of Representatives, at hearings on renegotiation of war contracts, September 16, 1943)

Mr. Chairman, gentlemen, I am Ellsworth C. Alvord, of Washington, D. C. I appear as chairman of the committee on Federal finance of the Chamber of Commerce of the United States.

INTRODUCTION

Inasmuch as the present hearings are directed primarily to renegotiation, our present discussion and recommendations will be similarly restricted. However, the position we take is not based solely upon the problems of renegotiation. Many other problems must be given mature consideration, such as (*a*) policies and procedure upon the termination of war contracts; (*b*) the disposition of Government-owned property and facilities acquired or financed for war purposes; (*c*) present and future fiscal and tax policies; and (*d*) the financial strength of industry upon the cessation of hostilities, and its ability to obtain adequate risk capital and credit for peacetime operations. The solution of these problems will fix the place of private enterprise—the foundation of our democracy—in the post-war period. If private enterprise is the objective, the solution becomes simplified and more certain.

MR. MAURICE KARKER

I am confident that I can express on behalf of industry the keenest regret upon the resignation of Mr. Maurice Karker as Chairman of the War Department

Price Adjustment Board which become effective yesterday, September 15. We trust that his health has not been seriously impaired by the unselfish, patient, and constant devotion of his time and strength for more than 14 months to the problems and policies of renegotiation.

We ask the privilege of joining in the statement of the Committee on Appropriations of the House of Representatives in its report on the Military Establishment appropriation bill for the fiscal year 1944 (Rept. No. 568, 78th Cong., p. 13):

"The War Department and the Government are exceptionally fortunate in having a man of Mr. Karker's experience and ability and conception of the spirit of the renegotiation statutes in charge of the Army's renegotiation work. He is an outstanding example of men of high caliber who are making available their time and talents to the Government."

THE PREVENTION OF EXCESSIVE WAR PROFITS

Industry insists, and was among the first to insist, that there must be no excessive profits during the present war; that the word "profiteer" be erased completely from America's current vocabulary. The outstanding accomplishments of American management and labor in war production for our armed forces will not be blurred or blotted. There is neither justification nor necessity for excessive war profits.

Can the earning of excessive war profits be prevented in all cases by pricing? It is our opinion that the answer must be "No." If not, then how can excessive war profits be recovered or recaptured after they have been earned? Is so-called renegotiation the only, or the best, or the preferable procedure for reaching into the pockets of the American citizen to remove a portion of the profits he has already realized? The answer again must be "No."

NEGOTIATION OF PRICES

Negotiation of prices and timely readjustments of prices are procurement functions. Sound procurement policies will, of course, do much to restrict the future realization of excessive profits. If prices were right, there would be no excessive profits. But during war the first duty of procurement officers is to meet the demands of the military. Production and deliveries are of first importance. Time is more important than price. Lives, victory, peace are involved. Better a thousand bombers now, regardless of price, than 10 next month at a reasonable price painstakingly computed prior to awarding the contract.

As war production moves into gear and as military demands become more stabilized, then there is time for better cost estimates and closer pricing. And procurement officers and industry become more experienced. But under the exigencies of war the military and industry are always seeking new products, always striving for improvements. Time is always more important than price.

Even if there were adequate time, there are innumerable factors which make estimated costs prove too high. The efficiency, ingenuity, and resourcefulness of management and labor and their tireless insistence upon simplified production methods; changes in design; substitution of cheaper materials; decreased costs, or better delivery, of raw materials; increased volume (which frequently, but not always, results in lesser costs); increases in allowable tolerances; extension of delivery dates; better facilities; quicker shifts-over to new tools and dies; more experienced management; more efficient labor; better performance by subcontractors; allowances for contingencies which do not occur—these and many other factors, constantly recurring unforeseeable, unpredictable—contribute to decreased costs. (Other factors, of course, frequently create increases in cost.) So long as American ingenuity remains, however, even though procurement officers and management cooperate and exercise their greatest skill, some excessive profits will be realized. In brief, the control of excessive prices cannot rest solely upon sound procurement policies. Accordingly, the second problem is presented: How can excessive profits be recaptured, once they have been earned?

Much confusion exists by reason of a failure to distinguish between the two distinct policies involved: (1) Negotiation and readjustment of prices; and (2) the recovery or recapture of excessive profits after they have been earned. To remove all misunderstanding and confusion, we state, by way of repetition, our position specifically: We are recommending no change with respect to (1). Nor do we propose to disturb the privilege of voluntary refunds by contractors who

prefer to make lump-sum payments rather than specific price adjustments. Our recommendations are confined to (2)—that is, the recapture of excessive profits once they have been earned.

THE POSITION OF THE ADVOCATES OF RECAPTURE BY RENEGOTIATION

The advocates of recapture by so-called renegotiation of excessive profits already in the pockets of the contractor concede that their approved policies and procedure require—

(1) The delegation by the Congress to executive officials of unlimited legislative power, including the power to ignore laws duly enacted by the Congress—and the Congress must prescribe no standards to guide them, or by which the propriety of their actions can be judged;

(2) The power to redelegate to subordinates of their own choosing all or any of the unlimited legislative powers received from the Congress—and the statute must impose no limitations upon the power to redelegate and no standards for the exercise of the legislative powers so delegated;

(3) That the legislative rules so prescribed by them may be altered, amended, supplemented, or repealed at the will of an ever-changing personnel—and the citizen can be afforded no protection;

(4) The exercise by an executive official, or by a subordinate of his own choosing, of judicial power to apply to specific cases the legislative rules so prescribed by them, whether or not those rules have been published and whether or not they have been or will be applied to others—and the exercise of that judicial power must be uncontrolled and uncontrollable, and none of the accepted principles invariably prescribed for the exercise of judicial power must be applicable. That is, there need be no requirement of due notice; no reasonable opportunity to be heard; no record of the proceedings; no findings of fact based upon an established record; and no formal decision;

(5) That there must be no effective appeal to superior executive officers from the judicial decisions of the subordinates—and any attempt to appeal must be discouraged;

(6) That there must be no review by or appeal to the courts from their judicial decisions, even of the constitutionality of the statute;

(7) That under the above circumstances they may choose those who have earned excessive profits and those who have not, their determinations being governed solely by the particular rules they may wish to apply in the particular case—and their determination must be final;

(8) That under the above circumstances, they may determine how much of the profits in the pocket of each person so selected are in their opinion excessive—and they cannot apply the same principles to his neighbor or his competitor;

(9) That under the above circumstances, they may reach into the pockets of any American citizen who has contributed to war production and take out as much or as little as in their opinion is excessive—and then silence his objections by "persuasion," misstatements of fact, threats, or duress;

(10) That they must have the power to bankrupt every or any war contractor or subcontractor—and the exercise of that power must likewise be uncontrolled and uncontrollable;

(11) That if power is granted to act for the benefit of a contractor (i. e., power to renegotiate "upward"), that power must be most carefully circumscribed, limited, and guarded—but these "safety" provisions must not be applicable to the power to act to the detriment of a contractor;

(12) That there can be no finality, for every change in the statute must be applied retroactively—and closing agreements assuring finality are ineffective.

(13) That fundamental principles of American democracy and constitutional government, and legislative precedents, must be disregarded and discarded—and we must accept a government by men and not by law;

(14) That every war contract entered into by the Government of the United States of America must be but a scrap of paper.

If the law is dangerous and un-American, as they concede it to be, is there no less dangerous and more American method available?

Before attempting a discussion of this question, let us review specifically and carefully how the powers conferred have been exercised.

DISCRIMINATIONS UNDER PRESENT LAW AND POLICIES

It is impossible to enumerate all the discriminations resulting from the present law, the general principles promulgated thereunder, and their administration. The advocates of recapture through so-called renegotiation confess that discriminations are necessary and vital to the procedure they approve. They concede that discriminations are inherent in the system they approve. They admit that they have no suggestions to prevent or correct or mitigate them. The following are some of the more glaring illustrations:

(1) Against war contractors, and in favor of non-war enterprises;

(2) Against cases which are renegotiated, and in favor of cases which will not be "caught";

(3) Against the financially weak, and in favor of the financially strong;

(4) Against those in need of working capital and in favor of those having adequate working capital;

(5) Against those to whom the post-war credit of the present law is vital and in favor of those who are more fortunate;

(6) Against those whose profits have been invested in new plant, facilities, or equipment and in favor of those whose profits are in cash or liquid assets;

(7) Against the slow turn-over industries and in favor of the quick turn-over industries;

(8) Against those who were not paid prior to April 28, 1942, and in favor of those who were paid;

(9) Against those whose 1941 profits are reflected on a fiscal year basis and in favor of those whose 1941 profits are reflected on a calendar year basis;

(10) Against those who are operating under one contract (or extensions thereof) and in favor of those who have taken separate contracts;

(11) Against those who operate within the United States and in favor of those who operate outside the United States;

(12) Against those who have contracts covered by the Military Appropriation Act, 1944 (i. e., contracts with the Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation, and Rubber Reserve Company) and in favor of those who have no such contracts;

(13) Against those who are subcontractors of contractors who are exempt from renegotiation by administrative action and in favor of those who are subcontractors of contractors who are exempt from renegotiation by the statute (although we understand that this rule has perhaps been reversed);

(14) Against those whose contracts involve personal property and in favor of those whose contracts involve real property;

(15) Against those who have engaged in war production and who have had foreign war losses and in favor of those who have remained out of war production and who have had foreign war losses;

(16) Against those to whom the "carry-back" provisions of the revenue laws would apply and in favor of those to whom the "carry-forward" provisions apply (that is, against those who have a year of loss following a year of profit and in favor of those who have a year of loss preceding a year of profit);

(17) Against those who realize losses on nonrenegotiable business and in favor of those who realize losses on renegotiable business;

(18) Against certain industries and in favor of other industries;

(19) Against contractors in the same industry and in favor of contractors in the same industry;

(20) Against competitor A and in favor of competitor B;

(21) Against citizen A and in favor of citizen B;

(22) Against those whose aggregate war volume exceeds $100,000 annually and in favor of those whose aggregate war volume does not;

(23) Against those whose aggregate war volume exceeds $500,000 annually and in favor of those whose aggregate war volume does not—if an unconditional exemption is adopted;

(24) Against those who will not "break up" their contracts or curtail their volume so as to be within the statutory exemption and in favor of those who will "break up" their contracts or slow up their volume so as to be within the statutory exemption.

DURESS

Without attempting to determine whether the element of legal duress was present, the following statements by members of Price Adjustment sections in the field have been made, in order to induce an acceptance of the section's decision:

(1) You will be reported to the Congress.
(2) Your case will be widely publicized.
(3) You will receive no new contracts.
(4) Your existing contract commitments will be "cut back."
(5) Your existing contracts will be terminated.
(6) We will be compelled to make an extensive audit in your case.
(7) You have received the best treatment of anyone in your industry.
(8) Your allowable rate of profit for next year will be considerably reduced.
(9) You may appeal to Washington, but Washington invariably sustains us.
(10) You may appeal to Washington, but you will get worse treatment.
(11) Funds now due you will be withheld.

We know, on the other hand, that Price Adjustment officials in Washington have done and are doing their utmost to prevent the use by officials in the field of improper methods of "persuading." In defense of the officials in the field, we are confident that in most cases they do not intend to use improper methods. It is improbable that frequently they do not realize that many citizens constantly fear reprisals on the part of their Government and, consequently, do not appreciate the effect of their statements upon the contractor.

THE ONLY ISSUE

There is but one issue before your committee and the Congress, as we have said: Is there a less dangerous and more American method by which excessive profits already realized can be recovered or recaptured?

JUSTIFICATION OF RECAPTURE THROUGH SO-CALLED RENEGOTIATION

The advocates of recapture through so-called renegotiation assert in justification of the present law:

(1) It is well administered.
(2) It is an essential aid to procurement—whereas it seriously interferes with procurement.
(3) It compels reductions in costs—whereas it actually contributes to increased costs.
(4) It will protect industry from criticism and condemnation—whereas experience to date proves emphasis upon, and the publication of, fantastic and misleading statements about the war profits of industry.
(5) It has been responsible for billions in refunds and in known price reductions—whereas substantially all the refunds would have been paid into the Treasury under the present tax laws; and, to the extent that the unreduced prices would have resulted in excessive profits, substantially the entire amount thereof would have been paid into the Treasury under the present tax laws.
(6) Recapture of excessive profits through so-called renegotiation is a procurement function—whereas it is peculiarly and solely a function of taxation, which is the only method (regardless of the name attached to the process) recognized in a democracy by which the hand of government reaches into the pocketbooks of its citizens.
(7) Essential flexibility can be gained only through renegotiation—whereas whatever flexibility results from recapture through so-called renegotiation is lost by the immediate imposition of taxes. This argument is valid only if our tax laws are repealed insofar as they would otherwise apply to cases subject to renegotiation.
(8) They approve of the enactment by the Congress of appropriate amendments providing for adequate judicial review—whereas their fundamental position denies all possibility of an adequate judicial review.
(9) Tax laws cannot recapture excessive profits—whereas our present tax laws probably already impose unjustifiable burdens in most cases.

Let us discuss further each of the above assertions in support of the present law.

ADMINISTRATION OF RECAPTURE BY RENEGOTIATION

The administrators of recapture through so-called renegotiation require no defense. Were it not for their ability and integrity, the administration of the

recapture provisions of the present law would have broken down long ago. But the task and burdens imposed upon them are impossible.

On the other hand, there has been and will continue to be an ever-changing personnel in charge of the administration of the law. Will the present officials agree to remain until the last case has been completed? How many of them will remain after the cessation of hostilities? The ability of their successors cannot be assumed.

The administration of the law is not under attack. Nor are the past or present officials who have been responsible for its administration. Our position is directed solely to the underlying principles and consequences involved in an attempt to recapture excessive profits through so-called renegotiation.

We merely add that the high caliber of the administration does not justify the delegation of powers which, in the hands of others, would be tyrannical.

EFFECT UPON PROCUREMENT

It is our judgment that the recapture provisions of the present law have a seriously adverse effect upon war production. It is, of course, impossible for any nongovernmental organization to ascertain all the relevant facts. However, important and perhaps determinative facts are unquestionably in the possession of the executive departments. It is respectfully suggested that your committee ask for the presentation to you of all memoranda submitted to them relating to the effect of recapture upon procurement, as well as all memoranda reflecting oral reports upon this point by procurement officers. If thereafter there is any doubt about the soundness of our judgment, we suggest that your committee call leading procurement officers to testify, without restraint from their superior officers.

REDUCTIONS IN COSTS

Much credit is claimed for reductions in costs—an objective desired and sought by everyone—as a result of recapture through so-called renegotiation. It is inferred that reductions in costs would not have resulted except for the recapture provisions. On the contrary, reductions in costs actually effectuated are attributable to the factors we have heretofore discussed. The actual decreases have resulted in spite of recapture. Many others would have resulted but for recapture.

PROTECTION OF INDUSTRY

It is our firm conviction that renegotiation affords industry no protection from public criticism or condemnation. Industry's accomplishments in production, both for war and essential civilian needs, are too well known. Its leadership in urging the prevention of excessive profits and its insistence upon unprecedentedly high excess-profits tax rates are too well known. The publication of fantastic figures and misstatements of fact—for most of which the recapture provisions are responsible—is, of course, unfortunate and regrettable. But the overwhelming majority of the public is quite familiar with the true facts; and the true facts will some day be known to the remaining small minority who may be interested in them.

SAVINGS CLAIMED FOR RECAPTURE

The actual statistics showing cash refunds and price reductions to the Government are reported in the hearings. It is not necessary to repeat them.

There seems to be, however, some misunderstanding with respect to the amounts which would be paid into the Treasury under our present tax laws, if recapture did not exist and if the known price reductions had not been made. It is, of course, not our desire to minimize the effect of the price reductions upon the costs of the war, upon the fiscal requirements of the Treasury and upon our economy—and probably the most important effect must be attributed to price reductions which are not known, cannot be ascertained, and cannot be measured. Quite to the contrary. Unquestionably, the actual aggregate price reductions are many, many times the amount of the known price reductions—certainly if a future effect of past and present and future price reductions is taken into consideration.

The point we wish to make is that, for all practical purposes, at least 80 percent, and in many cases 90 percent, of the amounts refunded would have been

paid into the Treasury under the present tax laws; and to the extent that former prices (that is, prices prior to the known and unknown reductions) resulted in excessive profits to the recipient, a corresponding 80 or 90 percent would have been paid into the Treasury under the present tax laws. And these percentages give no effect whatsoever to the amount of taxes which are paid or would have been paid by the individual stockholders upon the corporate profits distributed to them. A computation based upon a so-called effective rate is incorrect. It is also improper to attempt to reduce the rates by an estimated amount of the post-war credit accruing to every payer of excess-profits taxes. Any effort to adjust the amount by reason of the existing post-war credit provisions merely raises the following questions: (1) Are the existing post-war credit provisions too liberal; and (2) what is the *present* value of the bonds, to be delivered to the excess-profits tax payer at some indefinite time in the future and in some indeterminable amount, which may prove to be zero?

RECAPTURE AS A PROCUREMENT FUNCTION

If we were to select the one ground upon which the advocates of recapture through so-called renegotiation place their greatest defense of the system, we would state their position as follows: Recapture through so-called renegotiation is not a method of raising revenue; it is not the exercise of the power to tax; it is the exercise of a function of procurement.

We see nothing to be gained by an attempt to "label" the process. Names are frequently misleading. A simple description of the function will suffice.

Under recapture through so-called renegotiation, the hand of Government reaches into the pockets of certain of its citizens and extracts funds for its own use.

This function has been known as long as there have been governments. It was a function exercised freely and gleefully by monarchs. Revolutions and wars have taken that power from executives and placed it in the hands of elected representatives. Every executive has viewed that power with an ambitious and selfish eye. Every executive has attempted to take that power away from the elected representatives. Even other committees of the House of Representatives seek at times to usurp the jurisdiction of the Committee on Ways and Means. And the Senate has been known to trespass on the exclusive power of the House of Representatives to originate tax legislation. Without fear of contradiction, we assert that this is the first occasion upon which the Congress of the United States has been led into a surrender to executive officials of its power to tax.

Regardless of the name by which recapture through renegotiation is called, it remains the power to tax.

FLEXIBILITY THROUGH RENEGOTIATION

By flexibility, the defenders of recapture through so-called renegotiation mean the recapture from each individual contractor or subcontractor of the amount which they or their subordinates determine are excessive. Flexibility is gained by the lack of rules or principles of general application; by the fact that they are not bound to give the same weight to the same factors in similar cases; by the application to each case of their own uncontrolled and uncontrollable judgment and discretion.

Assuming that recapture through so-called renegotiation produces the flexibility claimed and sought by its advocates, it is the precise result which in our opinion must be avoided. The exercise of legislative power means the promulgation of rules of general application. Competitor A must receive the same treatment as competitor B, in substantially similar circumstances. Citizen A received the same treatment as citizen B. The separation of legislative power from executive power was insisted upon in order to avoid discriminations. The permission and the privilege to discriminate are foreign to our concepts of justice and democracy. They condemn, they cannot justify, recapture through so-called renegotiation.

JUDICIAL REVIEW

The advocates of recapture through so-called renegotiation now concede that the Congress should adopt specific provisions assuring adequate judicial review of and control over their decisions. If our recommendations are adopted, then

the necessity for such provisions probably disappears. Accordingly, our discussion of judicial review is postponed to our consideration of the problems and policies involved if our recommendations are not adopted and the device of recapture through so-called renegotiation is retained.

ADEQUACY OF OUR TAX LAWS

Industry took the lead in urging the enactment of unprecedentedly high excess-profits tax rates. The Revenue Act of 1942 (which became law on October 21, 1942—6 months after the enactment of the renegotiation statute) imposes rates of 40 percent upon corporate normal profits, and 90 percent upon corporate excess profits, subject to an 80-percent ceiling upon the aggregate tax. In addition, it again taxes the same profits, when distributed to stockholders, at rates ranging from 22 percent up to 91 percent. For example, the rate of 22 percent applies to the first dollar of net income; an effective rate of 50 percent applies to net incomes of approximately $14,000; and the maximum rate of 91 percent is reached in the case of net incomes exceeding $200,000.

If only the corporate rates are considered, we are confident that they successfully recapture for the Government all excessive profits in at least 90 percent of the cases. In fact, there was much more concern in the Congress over the severity of the 1942 act than over its liberality.

If the effect of both corporate and individual taxes under the Revenue Act of 1942 is considered, and assuming current distributions approximating, say, 50 percent of the corporate profits remaining after corporate taxes, the number of possible cases of excessive profits melt into both theoretical and practical insignificance.

RESTATEMENT OF ISSUES

Let us assume that, considering only the existing taxes upon corporate profits under the Revenue Act of 1942, our estimate is substantially correct: That the existing tax upon corporate profits under the Revenue Act of 1942 will successfully recapture for the Government all the excessive profits realized by corporations (whether or not engaged in war production) in at least 90 percent of the cases.

The real issue now confronting your committee and the Congress can be narrowed:

Can the dangerous and un-American process of recapture through so-called renegotiation, and its application to all war contractors and subcontractors be justified, in order to reach 10 percent of the cases? Our answer is "No."

Restating the issue:

Is it possible to prescribe a less dangerous and a more American procedure to reach the 10 percent? Our answer is "Yes."

Again restating the issue:

Assuming that our present tax laws are adequate to recapture for the Government all excessive profits in at least 90 percent of the cases, is it possible to perfect them so that they will prove adequate in the remaining 10 percent of the cases? Our answer is "Yes."

SUMMARY OF OUR POSITION

(1) The recapture of excessive profits through so-called renegotiation cannot be justified.

(2) The delegation of unlimited and uncontrollable powers essential to an administration of recapture through so-called renegotiation is dangerous and un-American.

(3) The power of taxation is the only acceptable power granted to the Congress by which profits in the possession of a citizen can be taken for the use of his Government.

(4) If the Congress determines that our existing tax laws are inadequate to prevent in every case the retention of excessive profits, then the tax laws should be amended.

(5) If appropriate amendments to existing tax laws are adopted, they should become effective as of April 28, 1942; and every war contractor or subcontractor should have the option to pay the additional taxes thus imposed upon his 1942 profits or to remain subject to renegotiation.

(6) It is not coincidence that among the defenders of recapture through so-called renegotiation will be found those who opposed the alternative bases adopted by the Congress for measuring normal profits.

PROCUREMENT POLICIES OF GREAT BRITAIN

In testimony before your committee, it has been stated that in Great Britain war contractors are allowed a return of only 7½ percent upon their investment and all profits in excess thereof were recaptured. We are reasonably confident that this testimony is based upon a misunderstanding. There is no renegotiation statute or procedure in Great Britain and there is no effort made to recapture excessive profits through so-called renegotiation. The policy referred to is solely a procurement policy. That is, procurement officers, in the letting of certain types of contracts, attempt to agree upon prices which will give the contractor no more than an estimated yield of 7½ percent upon his investment. Our information is that, nevertheless, Great Britain relies upon its tax laws for the recovery or recapture of excessive profits.

NECESSARY AMENDMENTS IF RECAPTURE THROUGH RENEGOTIATION REMAINS

Let us now discuss necessary amendments which, in our opinion, should be adopted if recapture through so-called renegotiation remains in the law.

RETROACTIVITY

The act of April 28, 1942, should not be applied retroactively to profits accruing prior to January 1, 1942. Its retroactive application admittedly is unfair, creates unnecessary and avoidable discriminations, and is unquestionably unconstitutional.

Nor should extensions of the act be given retroactive effect.

STANDARDS

Appropriate standards must be adopted by the Congress to guide and control the executive officials in the exercise of the legislative powers delegated to them. If the principles consistently pronounced and applied by Justices Holmes and Brandeis, for example, are applied, the statute, in the absence of adequate standards, is unquestionably unconstitutional. We merely point out in passing that if appropriate standards can be prescribed for recapture through renegotiation, similar standards can be adopted as part of our tax laws. Whereupon recapture through renegotiation becomes unnecessary.

A few standards are suggested:

(1) The definitions of "normal profits" adopted by the Congress in the revenue laws should be applicable.

(2) Renegotiation should be confined to the elimination of excessive profits resulting from specified causes, such as (*a*) increased quantities, (*b*) allowances for contingencies which do not occur, and (*c*) changes in specifications which result in decreased costs.

(3) There should be no recapture through renegotiation if after Federal taxes (as shown on the income and excess-profits tax return) there is left to the war contractor less than its excess-profits tax credit (as shown on the return).

(4) In no event should renegotiation reduce profits to a point less than the excess-profits tax credit (as shown on the return).

(5) Any refund paid or payable pursuant to a renegotiation agreement must be subject to further adjustment in the event that the carry-back provisions of the revenue laws are applied.

(6) Profits subject to renegotiation should first be reduced by (*a*) a reasonable allowance for probable losses on the termination of war contracts or as a result of cut-backs; (*b*) a reasonable allowance for probable losses resulting from idleness during the process of reconversion; and (*c*) the readjustment of the deduction for amortization. (A discussion of reserves for possible post-war contingencies will be postponed to the hearings on proposed tax legislation.)

(7) There should be no recapture through renegotiation if the contract provides for refunds or adjustments in prices if actual costs are less than estimated costs.

(8) The statute or the legislative rules promulgated thereunder should specifically provide that the contractor must be afforded an adequate opportunity to be heard, after due notice.

PUBLICATION OF LEGISLATIVE RULES

All rules and principles should be published, and no unpublished rule or principle should be applied.

JUDICIAL REVIEW

An adequate opportunity for judicial review of the decisions of renegotiation officials can be afforded only if the statute provides that the decision of the renegotiation officials must be based solely upon facts in the record, must contain a detailed statement of the facts relied upon to support their decision, must set forth each of the principles applied and the effect of each, and must be furnished to the contractor. (Confidential facts not within the knowledge of the contractor, of course, must not be disclosed. But the Government's files should contain a detailed statement of such confidential facts, and they should be furnished the contractor as the reasons for their confidential character disappear.) We point out that this is precisely what the advocates of recapture through renegotiation assert cannot be done.

In addition, the provisions of the present law which define "excessive profits" to mean "any amount of a contract or a subcontract price which is found as a result of renegotiation to represent excessive profits" must be repealed.

Although it should not be the exclusive judicial agency to review the decisions of renegotiation officials, it is suggested that serious consideration be given to conferring appropriate jurisdiction upon The Tax Court of the United States.

Finally, in order to afford adequate protection against improper methods of persuasion, the opportunity for judicial review should be afforded whether or not a bilateral agreement is entered into.

INTEGRATION WITH EXISTING TAX LAWS

Section 3806 of the code was inserted by the 1942 act to insure that amounts determined by renegotiation to be excessive profits for any year would be eliminated in determining taxable income for that year, and that the amount refundable to the Government with respect to such excessive profits should be reduced by any amount of taxes which has been paid or would be payable with respect to the excessive profits eliminated. The section was hurriedly drafted and does not properly cover various situations which arise. The Bureau, by I. T. 3811 (1943-12 I. R. B. 7), has endeavored to set forth sound interpretations. But the section should be redrafted and expanded.

RENEGOTIATION UPWARD

It is only fair that specific power be given to increase prices if power to decrease prices is to remain. Reliance should not be placed solely upon the limited powers found in the First War Powers Act, 1941 (which can be exercised only "to facilitate the prosecution of the war"). We are not unmindful, however, of the problems involved.

It is interesting to note the insistence, by the advocates of recapture through so-called renegotiation, upon statutory limitations in the event of a grant of power to increase prices, and their insistence upon no limitation upon the exercise of power to decrease prices.

CONCLUSION

We can find no justification for the recapture of excessive profits through so-called renegotiation.

Citizens' funds should be taken by the Government only through taxation.

Our present tax laws are adequate, or they can be made adequate, to recapture for the Government all excessive profits realized by corporate war contractors. Even if this were not the case, there would be no justification for recapture through so-called renegotiation.

The recapture provisions of the present law are indeed dangerous and un-American.

(The following statement was submitted for the record:)

STATEMENT OF ROY C. OSGOOD, PRESENTED TO THE COMMITTEE ON FINANCE OF THE UNITED STATES SENATE AT HEARINGS ON THE REVENUE BILL OF 1943, H. R. 3687, DECEMBER 8, 1943

To the Committee on Finance of the United States Senate:

Roy C. Osgood, vice president of the First National Bank of Chicago, and in charge of its trust department, which administers estates, presents this statement

as a member of the committee on Federal finance, Chamber of Commerce of the United States.

The statement deals primarily with the estate and gift tax aspects of the present law and proposals which have been made with respect to them. Permission is requested to have this statement appear in the record of hearings.

TREASURY PROPOSALS UNSOUND

The Committee on Ways and Means and the House of Representatives is to be congratulated on its rejection of the Treasury proposals to decrease the present estate-tax exemption and to increase the present high estate- and gift-tax rates. The Treasury appeared before your committee and asked that the proposals rejected by the House bill be enacted into law. In making this request it said that the estate-tax rates had not kept pace with the increase of the income-tax rates. It requested a heavy increase in a capital levy based upon the same temporary and artificial increase in the national annual income that is the basis for the request for an increased income-tax levy. The Treasury request is unsound and should not be granted for the following, among other, reasons:

1. Estimated yield less than 1 percent of total.

The proposed estate- and gift-tax revisions are estimated to yield approximately $400,000,000 in addition to the estimated present yield of $560,000,000. This is a total of $960,000,000 and would represent an increase in yield from this source of 72 percent though it will be noted that the increase itself accounts for less than 1 percent of total estimated revenue of 48 to 49 billion dollars.

This increase is produced by raising rates and lowering exemptions. The general estate-tax exemption of $60,000 is reduced to $40,000. The present minimum estate-tax rate of 3 percent on the first $5,000 is raised to 5 percent. The present maximum of 77 percent on the excess over $10,000,000 is changed to 80 percent on the excess over $10,000,000. These increases produce relatively more heavy burdens in the intermediate brackets.

The rejection of these proposals by the House should stand. If anything, the existing rates should be lowered. The $400,000,000 proposed to be raised by a capital levy of this kind had far better be covered by an equivalent saving in expenditures.

2. Proposals exceed British and Canadian death tax.

A comparison of the British and Canadian death-tax impact with the United States situation discloses that existing United States death taxes nearly approximate those of Great Britain and Canada. On the other hand, the Treasury proposals far exceed either the British or Canadian tax. These facts are well illustrated by the accompanying table.

Comparative death taxes

[Based on equal division between wife and 2 children]

Amount of estate (before exemption)	British (estate and legacy) [1]	Canadian [2] (Dominion plus Ontario death duty)	Present United States (Federal plus Illinois inheritance tax)	Proposed United States (Federal plus Illinois inheritance tax)
$100,000	$13,400	$13,077	$5,504	$12,903
$250,000	55,500	45,531	48,194	72,850
$500,000	150,000	121,156	126,500	201,850
$1,000,000	352,000	328,971	303,500	540,850
$5,000,000	2,670,000	2,585,568	2,430,400	3,731,350
$10,000,000	6,640,000	5,510,170	6,042,400	7,731,350

[1] These figures are obtained from the table submitted by the Treasury Department to the Committee on Ways and Means on Mar. 5, 1942. They combine the estate and the legacy tax therein mentioned.

[2] The Canadian amounts do not take into consideration the exchange rate but are expressed in terms of the Canadian dollar. If the Canadian dollar is valued at 90 cents the amount of the Canadian tax would be proportionately lower.

In the comparison with Canadian taxes it should be noted that the only fair comparison takes into consideration Dominion plus Provincial taxes and Federal plus State taxes. For the Canadian illustration the Province of Ontario was selected because of its importance in the Dominion. For the illustration in this country, Illinois was selected as being representative, Illinois death taxes being neither high nor low. The Canadian and United States illustrations are based upon a wife and two children as beneficiaries. This is the normal situation and produces a much smaller tax than if a wife only were the beneficiary. Of course, if the beneficiaries were more distinctly related or strangers the tax would be even higher. It should be noted that in 1942 Congress refused to accept a proposal to increase the estate tax rates which was less drastic than the current proposal.

The table speaks for itself. However, attention is directed to the fact that the Treasury proposals raise the death tax impacts in this country far beyond those imposed by either Britain or Canada. On an estate of $5,000,000 the proposed tax is over $1,000,000 greater than in Britain or Canada.

The situation of a nonrelative inheriting an estate of $3,000,000 from a resident of the State of Oregon might also be mentioned in order to give an illustration from a State other than Illinois. In this situation the total Federal and Oregon death tax would amount to $3,060,715, or $60,715 more than the total estate. This is not taxation; it is something else.

3. Disruptive effect on present and post-war production.

The proposed increase in rates of a capital levy, though producing less than 1 percent of the estimated revenues will have a wholly disproportionate effect on our economy. In these times tax rates must be regarded from the point of view of their effect upon the Nation's present and future productive capacity. High estate tax rates are capable of producing a variety of results harmful not only to the persons called upon to bear the tax but also to the industry of the Nation.

Few estates include large amounts of liquid assets. Therefore, it becomes necessary to sell a considerable portion of the estate assets at death. Such sales have a dislocating effect at a time when every effort is being made to preserve stability. This is especially true when the estate consists primarily of a productive business. A heavy tax may compel the sale of sufficient capital stock to cause loss of control and impairment of both the incentive and valuable management policies that enable the business to produce those things which are now vital to existence. In some cases the sale of the stock is impossible and actual liquidation of the business is necessary resulting in a complete loss of productive capacity. In other cases the liquidation is temporarily avoided by borrowing sufficient cash to pay the heavy tax but this necessitates the making of engagements so heavy as to impair the credit of the concern.

All of the foregoing effects, whether forced sale of the business, forced change of control, or strain upon credit, are made doubly serious because of their appearance at the very time when the enterprise is least able to stand the strain on account of the loss of personal management resulting from the death of the former head.

In the case of small business establishments, practically the only market available in the case of such forced sale or liquidation is that furnished by larger companies in the same line of business which are interested in acquiring the smaller concern. The result is a natural tendency for the larger enterprises to become larger and for small business to disappear. A large enterprise does not have the same problem since its ownership is easily diffused throughout the population. High estate taxes thus have the result of encouraging the concentration of business activity in the hands of a few large companies and decreasing individual enterprise.

The present estate tax rates are high enough to produce these results even in normal times. During the war period, when many businesses are being closed through necessary war regulations or converted to military purposes, to add the proposed increases to such high rates is only to magnify the disruptive effects of an unreasonable tax.

4. The proposal violates all sound principles of death taxation.

The Treasury proposal violates all sound principles of death taxation for the following reasons:

(a) *It magnifies the Federal record of instability.*—Five changes in estate-tax rates have been made in the last 11 years. This proposal would make six recent changes. With this unstable record, equality among individual taxpayers is impossible since it makes the amount of contribution of the different citizens depend entirely upon the fortuitous circumstances of death. For example:

If A had a $200,000 estate and died in 1926 it would have paid $1,500 in Federal death tax. If B died owning the same sized estate in 1933, it would have paid $9,500 in tax. If C had left the same sized estate early in 1935, the tax would have been $12,800; D leaving a like estate in 1937 would have paid $19,800; E, leaving such an estate after the Revenue Act of 1940, would have paid $21,600; F, leaving the same sized estate under the act of 1941, would pay $38,7000; G, leaving the same estate under the proposed rates would pay $51,150. The proposed increase alone is about equal to the Federal tax on such an estate a few years ago. The proposed increased tax would be 3.300 percent of the total tax in 1925. Certainly these seven persons faced unstable rates, a deterrent to effort and accumulation. If these seven persons each had owned a $200,000 interest in the same business the disruptive effect of an unstable estate tax, wholly apart from other taxes, must be evident.

(b) *Treasury proposes to fit estate and gift tax into an elastic tax system.*—In appearing before your committee the Treasury said it was investigating the possibility of "integrating the estate and gift taxes and correlating them with the income tax." As previously noted the proposed increase in yield from the estate tax is 72 percent. This is an even greater percentage of increased yield than that proposed under the individual income tax (about 35 percent). Obviously there is an attempt to consider both the estate tax and the income tax as adjustable to revenue needs. This is unsound. The income tax occurs at a regular interval, once a year. The rates of such tax may naturally be determined by consideration of the tax base and the amount of revenue to be raised. Rates will normally be subject to frequent change in harmony with changed and unforeseen conditions. In such cases there is no long-range inequality among taxpayers produced by such changes in rates.

On the other hand, the estate tax occurs only once so far as the taxpayer is concerned and the time of its impact is unpredictable even from the standpoint of the Government. There is no direct relation between the needs of the Government and the estate-tax rates for the reason that there is no predictable tax base. Citizens die without regard to the needs of the Government and deaths are not subject to the control of the tax collector. Obviously, therefore, the estate tax by its very nature is not adaptable for use as a flexible base to accomplish elasticity in the tax system. Neither is the gift tax, which serves to police the estate tax. Other forms of revenue must be utilized to meet the expanding and contracting needs of the Government. The estate tax and the gift tax should be kept stable.

(c) *The proposal continues to violate principles of moderation.*—Excessively high estate-tax rates disrupt the family's economic position, stimulate evasion and produce harmful effects upon enterprise. The proposed increase in rates further aggravates the existing difficulties. When estate-tax rates become unreasonable every dollar of property included in the gross estate becomes important. Minor defects in the law are magnified and injustices become real. Under moderate tax rates these injustices become unimportant and fewer problems require legislative solution.

(d) *The proposal aggravates depletion of the tax base.*—In appearing before your committee, the Treasury said about estate and gift taxes, "Small as their relative contribution to the total has been in the past, it has fallen during the war." This result is partly due to a depletion of the estate-tax base and partly due to an unsound attempted comparison with a rapidly expanding income tax.

We should be just as concerned with future tax capacity as with present revenues. The estate tax is essentially a capital tax, and if capital is dissipated through excessive high estate-tax rates, the tax base, that is, the capital which produces income subject to taation, may be lost in future generations. While it is important to have our present tax plans designed so that the present generation will pay for as much of the war expenditures as possible, future generations will have their burden in paying for those portions of such expenditures as are financed by Government borrowings. Estate taxes force the second generation to pay

twice: First, through loss of income on the capital levy involved in the estate tax and second, in that generation's proportionate share of current taxes imposed at some future date to pay the borrowings.

If through excessively high income taxes the building of wealth through productive enterprise is prevented and if through excessively high death taxes such wealth as has already been accumulated is removed from productive enterprise, there will come a time when comparatively little wealth will remain in productive enterprise. The result will be a constant lessening of tax revenues from all sources which have productive wealth as their base. We cannot maintain a fruit crop by cutting down fruit trees. Nor should we destroy the stability of an estate-tax structure by trying to keep it relative to an expanded income tax based upon temporary war requirements.

5. Proposals adversely affect State revenues.

In 26 States the Federal estate tax is a deduction before computing the State death tax. Thus in these States as the Federal tax is increased the State tax is decreased. For example:

An Illinois estate of $1,060,000 (before exemption) now bears a minimum Federal estate tax of $289,140 leaving $770,860 subject to inheritance tax in Illinois. On the assumption that the estate goes to one child the Illinois tax would be $71,120. Under the proposed rates the same estate would bear a minimum Federal estate tax of $549,890 leaving only $510,110 subject to Illinois inheritance tax. The Illinois tax on this amount would be $35,011 which is $36,109 less than the Illinois tax with the present Federal estate-tax rates. A 50 percent decrease in the Illinois State revenue from this estate.

There are 24 other States which are similarly affected, namely: Arkansas, California, Connecticut, Idaho, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Missouri, Montana, Nebraska, New Hampshire, North Dakota, Ohio, South Carolina, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming. To these should be added the District of Columbia.

In each of these States the State death tax revenues will be decreased as a direct result of the proposed increase in the Federal estate tax.

In addition, all State death-tax revenues will suffer indirectly by a reduction of the corpus of estates through the imposition of heavy Federal death taxes. This is because in succeeding generations the estates will be greatly reduced in size. Further, future State taxation of incomes derived from estates will yield less revenue to the States due to depletion of the invested capital base from which such income is derived.

6. Estate tax increase by exemption changes.

The plan of lowering estate-tax exemptions at a time of proposed rate increase is indefensible from a rational viewpoint. The present exemption of $60,000 should be raised, not lowered.

From the standpoint of the decedent and his dependents, the rates of tax must not be so high as to make impossible or discouragingly difficult reasonable provisions for the family and dependents. This principle indicates liberal exemptions from the standpoint of the common welfare. The amount of the exemption should be the sum, the income from which would provide a support for dependents sufficient to prevent them from becoming a charge upon the public. There generally would be common agreement that there should be exempted from tax an amount of capital sufficient at least to provide an annual income for the support of a widow and two children. Probably there would also be agreement upon a larger exemption in the case of more children.

Under the Treasury income-tax proposals the present exemption of $1,200 for the head of a family and $350 are each dependent are reduced to $1,100 and $300, respectively. This is a minimum normal family exemption of $1,700, though, of course, if one of the children is of an age to receive the individual exemption of $500, the total exemption might be $1,900. Thus, roughly speaking, the income-tax exemption for the average family will run between $1,700 and $1,900, irrespective of dependents of more remote relationship. Before the present estate-tax exemptions were reduced, a fair average income on capital was 5 percent. Then the estate-tax exemption, plus the gift-tax exemption, would have have proved adequate. In the past few years, however, the average income yield from suitable investments has dropped to 3 percent, so that to produce income now about equal to the normal income-tax exemption there would be required an investment of about $60,000. Even this leaves no margin for investment costs, losses, income fluctuations, and other forms of taxation, to say noth-

ing of an existing increase in living costs. A reasonable margin of safety would raise the capital requirement to about $100,000.

Even this is the minimum, and does not consider the economic status to which the family have been accustomed. It is a well-established principle of State probate law that a widow's exemption and a child's exemption for at least a year for the purpose of debt priority should be sufficient to afford them support and maintenance in the manner of life to which they have been accustomed. The payment of these allowances takes precedence under most State laws over the debts of the decedent or other distributions out of his estate. Much the same principle should be applied and has been applied in determining the priority of the exemptions for widows and children in death-tax statutes. Certainly a $100,000 Federal estate-tax exemption is about the minimum that ought to be granted under a sound theory of exemptions. From the standpoint of the beneficiaries, the matter of exemption is a consideration of first importance.

A liberal exemption makes the effect of the first rate or the first few rates both progressive and distinctly moderate as applied to the first brackets above the exemptions.

7. Effect of increase of rate and decreases of exemptions upon small business.

In addition to the effect upon family funds, any increase in estate-tax rates and decrease in exemptions should be considered now in their effect upon the small business establishments of the country. By small business establishments I mean the one-man-owned business and small group-owned manufacturing, wholesaling, retailing, and service business concerns classified as small, compared with large, by Department of Commerce standards. These will take in manufacturing plants with 100 employees or less, wholesale establishments with less than $200,000 annual net sales volume, retail stores, service establishments, hotels, and construction enterprises having annual receipts of less than $50,000. It is interesting to note that out of about 3,000,000 establishments, large and small, around 92 percent are classified by the Department of Commerce as small. This small business, however, has nearly 45 percent of the business personnel of the country and produces over one-third of the total value of the output. Many of these small establishments are necessary war casualties. Some of them have been closed by loss of manpower. Many have been closed by inability to convert to war work. Others have been closed by shifts of population caused by war production. Many are the victims of various orders, rules, and regulations necessitated by our war economy.

For example, the Department of Commerce estimates that at the end of this year there may be a net reduction of 300,000 retail concerns for 1942 and 1943. Last year Mr. Walter F. Crowder, of the Department of Commerce, in testifying before the Senate Special Committee to Study the Problems of American Small Business said, "Available data, inadequate though they are, indicate that the business birth rate for the last of 1943 will be down about 50 percent from the rate characteristic of recent years. It further seems likely that the over-all death rate may increase by as much as 33 percent."

The average birth rate of business (that is, the number of new enterprises established) from 1920 to 1937 was 217 per 1,000 business establishments listed and the average death rate (that is, concerns going out of business) for the same period was 209 concerns per 1,000 listed. In other words, we had an average annual increase of business establishments during this period of 8 per 1,000 concerns listed. A representative year is 1927, in which year there were 2,172,000 concerns listed. During that year 483,000 new business enterprises were established and during the same year 456,000 business enterprises were discontinued for a net gain of 27,000, or 13½ per 1,000 concerns listed.

If we apply the Department of Commerce's prediction and decrease the average birth rate by 50 percent, the result will be about 109 new business establishments per 1,000 listed. If we further increase the death rate by 33 percent, as suggested by the Department of Commerce, the death rate will increase to about 279 concerns per 1,000. This will be a net decrease of 170 concerns per 1,000 listed as against an average increase of 8 per 1,000 during the period 1920–37.

Small business concerns will naturally make up the great bulk of business deaths. For example, in 1940, 98.4 percent of all business failures had liabilities of less than $100,000. Many of the small business concerns which have survived are carrying on a hand-to-mouth existence. Those that have been closed and await a possible reopening after the war have had their fixed property frozen and

its value reduced. This is true, not only of small businesses but of agricultural organizations, particularly those dairy farms that have been obliged to sell their stock for lack of manpower. Many of these concerns will, upon the death of the owner, find a substantial portion of their property taken on account of the present low estate-tax exemption and the high rates of tax.

8. Estate-tax rates should not accelerate the death rate of small business.

The war is only one factor in the problems of small business. Mr. Charles C. Fichtner, of the United States Department of Commerce, testified before the Senate Small Business Committee as follows:

"Many concerns—now 'big business'—have had a modest beginning. The pioneers plowed profits back into business, thereby enlarging the base of equity capital and, through successful operations, have proved to outside risk capital the potentialities of their business. Today profits of small concerns, after payment of taxes, are not large enough to plow back such profits into the business. Taxation on the present and prospective scales prevents small enterprises from building up a strong equity capital position, either through the creation of adequate reserves or through the establishment of earned surpluses. Lacking these reserves and a sound equity position, these small businesses will be extremely vulnerable to failure on recessions in business activity. Neither can they attract outside private capital to strengthen their financial position."

The Department of Commerce then suggested that the Government might give consideration to certain tax incentives for small businesses. One of the greatest possible tax incentives to small business would be the lowering or repeal of the Federal estate tax. With this tax eliminated, a substantial factor contributing to the death rate of small business would be eliminated.

A typical example is the situation of a small manufacturing concern having a value of $250,000. It was entirely owned by "A," who had built it up from a basement hobby and had no other estate. "A" had one son whom he had trained in the business and expected that at his death his son would continue the business. On "A's" death recently his son discovered that it would be necessary to raise $52,382 in Federal and State death taxes. The value of $250,000 was in the business. It consisted of plant equipment and inventory. But the estate tax had to be paid in cash. Even the small amount of cash held by the company was not available, since income taxes on any dividends paid left little remaining. This small manufacturing concern went out of business in the usual way. It sold out to its larger competitor and goes down in the statistics as another small business casualty resulting from estate taxes.

Following this page is inserted a table which is illustrative of the position of the small business where multiple deaths are involved.

Let it be assumed that A owned a family business not in corporate form, built by family effort which had grown to $250,000 in 1926. The computations presented (example A in the table) provide a comparison of the relative capital exhaustion of his estate computed on the basis of the various Federal income and estate tax rates in effect between 1926 and the present time as compared with (example B in the table) the capital exhaustion of the same estate had the present Federal income and estate tax rates been in effect during the entire period. The computations also compare the amount of net income available during the period for the support and maintenance of dependents and for plowing back in the business.

The computations are based on the assumption that A died in 1926 leaving an estate of $250,000 to his widow, who upon the death of A became the head of the family. The widow died in 1932 leaving her share of the estate plus accumulation to her son who was married. The son died on December 31, 1943. It is also assumed that the family living expenses were entirely derived from the business and would not exceed the sum of $6,000 per annum or the net income after the payment of income taxes whichever is the smaller. No consideration is given to changes in cost of living.

It is further assumed that the estate would provide an average yield of 4 percent between 1926 and the present time but it should be noted that with conservative management it might be difficult under present conditions, and during the visible future, to obtain a gross income of 4 percent if the business were in corporate form and corporate income taxes were also considered. Illinois inheritance taxes have been included and the maximum credit for them has been taken in computing the Federal estate taxes.

Comparison of capital depletion and income reduction

EXAMPLE A. UNDER REVENUE ACTS APPLICABLE 1926 THROUGH 1943

	Year	Capital	4% Income	Expense	Tax Income except E-Estate II-Illinois Inheritance	Net addition to capital
Original estate	1926	$250,000.00	$10,000.00		$135.00	
Decedent died 1926, entire estate to widow who becomes head of family	1926	250,000.00 10,364.00			E 600.00 II 9,764.00	
	1927	239,808.00 3,461.71	9,584.24	$6,000.00	122.53	$3,461.71
	1928	243,067.71 3,596.03	9,722.71	6,000.00	126.68	3,596.03
	1929	246,663.74 3,799.22	9,866.55	6,000.00	67.33	3,799.22
	1930	250,462.96 3,882.96	10,018.52	6,000.00	135.56	3,882.96
	1931	254,345.92 4,033.62	10,173.84	6,000.00	140.22	4,033.62
Widow died 1932, entire estate to son who is head of family	1932	258,379.54 3,721.67	10,335.18	6,000.00	513.51 II 10,449.81 E 13,658.56	3,721.67
		262,101.21 23,108.37				
	1933	238,992.84 3,119.33	9,559.71	6,000.00	440.38	3,119.33
	1934	242,112.17 3,269.89	9,684.49	6,000.00	414.60	3,269.89
	1935	245,382.06 3,388.91	9,815.28	6,000.00	426.37	3,388.91
	1936	248,770.97 3,512.27	9,950.84	6,000.00	438.57	3,512.27
	1937	252,283.25 3,640.11	10,091.33	6,000.00	451.22	3,640.11
	1938	255,923.35 3,772.60	10,236.93	6,000.00	464.33	3,772.60
	1939	259,695.95 3,909.93	10,387.84	6,000.00	477.91	3,909.93
	1940	263,605.88 3,914.92	10,544.24	6,000.00	629.32	3,914.92
	1941	266,520.80 3,162.63	10,660.83	6,000.00	1,498.20	3,162.63
	1942	269,683.43 2,325.64	10,787.34	6,000.00	2,461.70	2,325.64
	1943	272,009.07 2,387.05	10,880.36	6,000.00	2,493.31	2,387.05
Son died Dec. 31, 1943		274,396.12 63,472.91			II 11,439.61 E 52,033.30	
					11,301.74 II 31,683.42 E 65,291.85	
Totals at end of period		210,923.31	172,300.23	102,000.00	108,227.02	55,898.49

Comparison of capital depletion and income reduction—Continued

EXAMPLE B. ASSUMING PRESENT REVENUE ACT IN FORCE 1926 THROUGH 1943

	Year	Capital	4% Income	Expense	Tax income except E-Estate II-Illinois inheritance	Net addition to capital
Original estate		$250,000.00	$10,000.00		$2,071.28	
Decedent died 1926, entire estate to widow who becomes head of family	1926	250,000.00 62,382.00			E 45,300.00 II 7,082.00	
	1927	197,618.00 152.89	7,904.72	$6,000.00	1,751.83	$152.89
	1928	197,770.89 156.98	7,910.84	6,000.00	1,753.86	156.98
	1929	197,927.87 161.18	7,917.11	6,000.00	1,755.93	161.18
	1930	198,089.05 165.51	7,923.56	6,000.00	1,758.05	165.51
	1931	198,254.56 169.94	7,930.18	6,000.00	1,760.24	169.94
Widow died 1932, entire estate to son who is head of family	1932	198,424.50 174.50	7,936.98	6,000.00	1,762.48 E 31,102.13 II 4,899.88	174.50
		193,599.00 36,002.00				
	1933	162,597.00 0	6,503.88	5,207.70	1,296.18	None
	1934	162,597.00 0	6,503.88	5,207.70	1,296.18	None
	1935	162,597.00 0	6,503.88	5,207.70	1,296.18	None
	1936	162,597.00 0	6,503.88	5,207.70	1,296.18	None
	1937	162,597.00 0	6,503.88	5,207.70	1,296.18	None
	1938	162,597.00 0	6,503.88	5,207.70	1,296.18	None
	1939	162,597.00 0	6,503.88	5,207.70	1,296.18	None
	1940	162,597.00 0	6,503.88	5,207.70	1,296.18	None
	1941	162,597.00 0	6,503.88	5,207.70	1,296.18	None
	1942	162,597.00 0	6,503.88	5,207.70	1,296.18	None
	1943	162,597.00 0	6,503.88	5,207.70	1,296.18	None
Son died Dec. 31, 1943		162,597.00 24,746.83			E 20,877.55 II 3,868.78	
					24,800.37 II 15,850.66 E 97,279.67	
Totals at end of period		137,850.67	119,066.07	93,284.70	137,930.70	961.00

No allowance has been made for the normal losses inherent in the investment of capital assets nor has consideration been given to the loss usually attendant upon the liquidation of the decedent's interest in a small family business when

the whole estate is represented by his interest in such a business. Such liquidation frequently impairs the producing and earning capacity of the business, thereby further reducing the capital and income available for future taxation.

Specifically the comparison is reflected in the following figures:

Original estate, $250,000

CAPITAL EXHAUSTION

	Example A—Under Federal income and estate tax rates in effect 1926 to 1943, inclusive	Example B—Assuming present Federal income tax and Federal estate tax rates in effect 1926 to 1943, inclusive
Original estate	$250,000.00	$250,000.00
Net estate remaining	210,923.21	137,850.67
Capital exhaustion	39,076.79	112,149.33
Shrinkage (percent)	[1] 15.63	44.86
Total Federal estate taxes paid	$65,291.56	$97,279.67
Percentage of original estate (percent)	26.40	38.90

INCOME REDUCTION

Annual net income of original $250,000 estate, after income taxes	$9,865.00	$7,926.72
Average annual net income after income taxes, for support of dependents, 1927-43	$9,662.15	$5,545.04
Shrinkage (percent)	2.81	30.06
Annual net income, after income taxes, for son's dependents after his death in 1943	$6,743.84	$3,841.06
Shrinkage (percent)	31.64	51.55

[1] 8.46 percent of this capital exhaustion incurred under present Federal estate tax rates upon death of son in 1943.

The computations in example B illustrate the future of a man who had built a family business to $250,000 in 1943, as compared with A who had reached that point in 1926. This man's future for 17 years, at the present income and estate tax rates, looks discouraging. On the assumption that $5,000 of invested capital will employ one person, his capital would have shrunk from $250,000 to $137,000 and the number of his employees from 50 to 27. The family annual income, on account of the decreasing $6,503; the income for family expenses, after taxes, from $6,000 to $5,207; and the Treasury's annual taxes from $1,751 originally to $1,296. In only 6 years of the 17 would any income have gone back to capital for needed business or family reserves against loss, illness or physical incapacity.

Consider the case of a man who has to start at scratch in 1943 and leave his family an estate of $250,000 at the end of 20 years, assuming a continuation of the 1943 rates of Federal and New York State income and estate taxes for 20 years. To die leaving an estate of $250,0000 from savings at the end of that time he would need to: accumulate $320,000; have annual earnings before income taxes of $190,000; pay income taxes of $153,000 annually; live on $21,000 annually; and save $16,000 annually. The case speaks for itself.

Recently there has been a growing appreciation of the plight of small business and a recognition that some consideration must be given to the preservation of that portion of our economy which constitutes so important a part of the commercial life of our Nation. Today there are many forces actively and effectively reducing the quantity of risk capital available to provide the spark of life to new business ventures or for transfusion into the veins of small businesses. It would seem to be the part of wisdom to eliminate the demands of the Federal estate tax thereby removing its contribution to progressive business anemia and to that extent alleviate the almost insurmountable difficulties which beset small business in its struggle to survive.

9. Death tax field should be returned to States.

In addition to the economic problems caused by the Federal estate tax there are reasons of good statesmanship for its repeal. Federal estate taxes are not

technically a levy on the estate, but are excises imposed upon the transfer of the property and are measured by the size of the estate. However, rights of transfer of property at death are determined wholly by State laws and the Federal Government has no right to control them. State death duties are based on the right to control death transfers and are a tax upon such a right. Federal death duties are purely excise taxes, just as liquor and tobacco taxes are excises.

The effect of the Federal estate tax is a matter of considerable concern. The position of the States was expressed by the Honorable Herbert H. Lehman, then governor of the State of New York, in a letter to the chairman of your committee in connection with the Revenue Act of 1938. Mr. Lehman wrote:

"The independent sovereignty of the States is threatened by Federal taxing policy. This country was organized on the theory and has prospered under a system of independent 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 been 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."

Traditionally, the death tax field has been reserved to the States as distinguished from the Federal Government. In the past, Federal death taxes were imposed purely as a temporary measure. Early in its legislative history, the Federal Government resorted to this method of raising revenue under pressure of emergencies caused by war; the law was repealed in 1802. A second Federal statute was in force from 1862 to 1870, again an emergency period. A similar statute was in effect from 1898 to 1902, a third emergency period. The present Federal estate tax law originated with the enactment of the statute of September 8, 1916, and was an emergency measure based upon the expenditures that were likely to follow American participation in the First World War. At the conclusion of the war, efforts were made to abandon the tax because of its emergency character and under the Revenue Act of 1926 the Federal estate tax as such became more or less nominal because of the 80-percent credit granted for the payment of State death taxes. In 1932—another emergency period—the additional estate tax was enacted, and in years following the amount of the tax increased beyond all original concepts.

The trend toward the centralization of power in Washington at the expense of State and local governments has gone too far. We have reached the point where, in order to preserve something more than a semblance of our form of government, it is necessary to reverse that trend. By the progressively greater demands of the Federal Government in the estate tax field the proper balance between the Federal Government and the various States, which have a concurrent and an equal right to assess this form of tax, has been disrupted. This balance should be restored by returning the estate tax field to the States.

10. Exemption of Insurance.

It is admitted that the complete repeal of the estate tax may be inexpedient during the period of the present war. Consequently, its repeal as of the end of the calendar year in which hostilities cease may be desirable action to consider at the present time. There is, however, an immediate step which can be taken which will be of material assistance in alleviating the devastating effects of the estate tax. This step is the immediate exemption of all insurance on the life of the decedent which is not payable to the estate. Only a few States attempt to levy a death tax on such insurance.

Such a fortuitous tax as a death tax, which is bound to be an incursion into capital and cannot be paid out of income, should not be taxed out of the field of protection. Pending such time as the estate tax is repealed, some means should be provided whereby the shock of the tax on noncash assets may be lessened. Insurance is the ideal method but under the present law its use is impossible because the insurance itself increases the amount of the tax.

For example, the Federal estate tax (before credit for State death tax) on an estate of $250,000 consisting of a manufacturing company is $47,700. If the owner wished to insure against the tax it would not be sufficient for him to purchase $47,700 of insurance since that insurance would automatically raise the tax to $62,010. Actually it would take $68,300 of insurance to provide for the estate tax on both the manufacturing company and the insurance. On larger estates the problem is even more difficult. On an estate of $1,000,000, insurance in the amount of $505,000 is required to pay the tax on the original estate plus the insurance.

The estate or death transfer tax and inheritance tax are now the principal items among emergency expenditures incident to death. Physical properties and securities, both liquid and slow, make up the great bulk of the estate of decedents. It is generally extremely difficult to realize quickly from the assets of the normal estate the considerable sums of money that are required to meet obligations. In the case of a large estate tax obligation imposed fortuitously by death, realization becomes even more difficult. Such taxes deplete estates not only by reason of the levy, but by reason of the sacrifice incident to the process of raising the money required to pay the tax.

It would seem that individuals should not be penalized in insuring against death taxes as against fire, tornado, or other damaging visitations upon property. This can be accomplished by exempting from the estate tax all insurance on the life of the decedent which is not payable to the estate.

The amount of revenue involved during this war period is negligible. The percentage of taxable insurance to the total of gross estate assets has never been large. For Federal estate tax purposes in 1933 it was 2.76 percent; in 1937, 2.65 percent; in 1938, 2.20 percent; in 1939, 2.55 percent with the average around 2.5 percent. These figures, of course, include insurance payable to the estate itself and if only insurance not payable to the estate is exempt from the tax, the amount involved would be even smaller. Based upon the present estate tax yield of about $500,000,000, the amount of revenue involved in the taxation of insurance is negligible.

Before life insurance not payable to the estate was subject to tax—as well as subsequently, before the tax becomes so burdensome—taxpayers did provide for death duties through life insurance. It seems manifestly in the public interest to enable them to do so to the limit of their ability. The Government is benefited by prompt payment of taxes. The estate is enabled to pay the tax without sacrifice of assets. Business is not disturbed by avoidable economic distress due to the tax, and many a concern will be saved from being another one of the vital statistics used in computing the death rate of small business.

HOUSE BILL PROVISIONS ON ESTATE INCOME AND ESTATE AND GIFT TAXES

1. Stuart case amendment.

The House bill section 116, amends code section 167 relating to trusts for the maintenance and support of certain beneficiaries. This corrects the undesirable effects of the United States Supreme Court decision in *Helvering* v. *Douglas Stuart*, decided November 16, 1942. The Ways and Means Committee is to be commended for this amendment and your committee should enact it as a measure relieving the inequity of that decision. The Treasury in its testimony before your committee made no objection to this amendment.

2. Valuation of unlisted securities for estate tax.

The House bill section 501 enacts a new provision of the estate tax law requiring the Treasury to consider, among other factors, in valuing unlisted securities, or securities having no record of sales, the value of securities of comparable corporations whose sales are listed. This is a much needed amendment as it relates to such security valuations and follows the method used by bankers in the valuation of securities for purchase or sale where such securities have no known market. The Treasury objection before you on this amendment is without merit and should be disregarded. The amendment should be retained.

3. Certain trustee appointments not taxable as gifts.

The House bill, by section 502, adds a new subsection (e) to code section 1000, making appointments of new trustees of certain discretionary trusts not transfers subject to gift tax. This amendment was enacted to correct the undesirable results of what is known as the Blumberg case and is to be commended. The Treasury objections to this amendment do not appear to have merit.

TWO MORE AMENDMENTS, ADVISABLE

1. Valuation of unlisted securities for gift tax.

The enactment of House bill section 501 for the valuation of certain securities for estate tax should likewise be enacted as an amendment for gift tax valuations. Its enactment in this respect is badly needed.

2. Powers of appointment.

The Current Tax Payment Act of 1943 extended to March 1, 1944, the time in connection with the releases of powers of appointment.

RECOMMENDATION

For the reason that the power-of-appointment provisions relating to the estate and gift taxes are sorely in need of present correction because lawyers and trustees have such a heavy volume of cases that, even in the year since the Revenue Act of 1942, have been physically impossible of analysis and correction, and because little time is left for such correction, between now and March 1, 1944, we recommend that section 811 (f) of the estate tax and section 1000 (c) of the gift tax be amended as follows:

The tax on property subject to a power of appointment should be made to depend upon the result flowing from its exercise or nonexercise rather than upon accidents of draftsmanship as is the situation under the present law. All changes made in the manner of taxing powers of appointment should be made to apply only to powers created after October 21, 1942. Certain technical amendments are also necessary to prevent unintended injustice and hardship.

DISCUSSION

1. In general.

The Revenue Act of 1942 changed the entire concept of taxing property subject to powers of appointment. This act was apparently drafted without a full appreciation of the fact that it was made to apply to innumerable situations which were never contemplated. There will be few insurance policies, wills, or trusts which will not require extensive analysis from the point of view of the provisions of the Revenue Act of 1942.

The present act classifies innocent, normal powers vested in trustees (i. e., powers to encroach on principal for support and maintenance, or in case of accident or sickness) as powers of appointment, although in common parlance they are never thought of as such; it applies retroactively, albeit with a relatively short time to take remedial steps which incidentally may be impossible under the laws of some States; it taxes individuals possessing powers when the individual may have only a remote contingent interest in the property; it can possibly result in a tax being assessed against the donor's enemy or his family by merely giving him a power which can do him or his family no personal good whatever; it can result in property subject to identical powers being subjected to tax in one State and not in another solely because of technical rules applicable in different States; it can result in the same property being taxed several times (i. e., on death of several trustees, even though interest of beneficiaries is not changed); it makes it dangerous for a beneficiary, even though remote, ever to be a trustee or cotrustee without tax penalty, which deprives other beneficiaries of intelligent counsel in a judgment; it may permit a tax on more than 100 percent of the property; it substantially increases the rate of tax on the decedent's own estate, whether or not the decedent's family has an interest in the appointed property; it assesses a gift tax with possible interest and penalties where a donee of a power, without intending to make a gift to anyone, and perhaps through ignorance or poor advice, allows a power to lapse through inaction; it permits a person in military service to take remedial steps within 6 months after the termination of the present war, but if a civilian has a power, exercisable with the consent of a person in military service, the civilian must nevertheless, release within the time specified; it seems to contemplate that a trustee who may be only a remote contingent beneficiary would be subject to tax on the entire trust corpus if he resigns his trust or if he remains a trustee until his death; it treats property subject to a power in the same way as if the donee owned the property, although the donee has an entirely different interest and has few attributes of ownership. It applies to situations where a power is vested in a person who can exercise it only with the consent of a trustee (who is accountable for his acts to other beneficiaries) or of an adverse bene-

fiduciary, and the donee is unable to exercise the power because the necessary consent is withheld.

Although by no means complete, the foregoing are some of the rather shocking results possible under the laws as it now stands.

2. Tax should be based on results instead of accidents of draftsmanship.

Section 811 (f) of the Internal Revenue Code should be amended so that there would be no tax on the exercise or nonexercise of any power of appointment (including a general power) if by such exercise or nonexercise the appointive property passes to the class of persons exempted under the provision of section 811 (f) (2) (A). The policy of Congress is not taxing the exercise or the nonexercise of a power to appoint within the limited class defined in section 811 (f) (2) (A) seems to be sound and if it is sound then there should be no tax upon the exercise or nonexercise of any kind of power if by such exercise the appointive property passes to no others than the persons exempted in section 811 (f) (2) (A). In other words, the tax effect should be the same whether there is exercise or nonexercise of power if, as a result, the property passes to no others than the spouse of the decedent, spouse of the creator of the power, descendants of the decedent or his spouse, descendants (other than the decedent) of the creator of the power or his spouse, spouses of such descendants, donees described in section 812 (d), and donees described in section 861 (a) (3). As used in this description, the term "descendant" includes adopted and illegitimate descendants and the term "spouse" includes former spouse.

As a matter of fairness and logic, the impact of the tax should not depend upon an accident of draftsmanship in cases where a nicety of construction would cause what was intended to be an exempt power to be classed as a taxable power and where the persons taking the appointive property are in the class exempted under section 811 (f) (2) (A).

A similar revision of section 1000 (c) of the Internal Revenue Code applicable to the gift tax should be enacted.

This amendment would eliminate most of the problems involved. In the estate tax it would only be necessary to determine whether or not the decedent had a power at the time of his death and to value the property passing outside the exempt class. The only exception to this would be in the case of powers held by independent trustees.

3. Changes should not be retroactive.

Any change in the situation as it existed prior to the enactment of the Revenue Act of 1942 should not be retroactive. This is a highly technical subject, one which is understood by only the most competent attorneys. While those persons who are represented by competent counsel may be able to cope with the problems involved, it is grossly unfair to penalize those who are unfamiliar with the changes in a law as technical as this.

There are many situations where the drastic effects of the present law cannot be avoided and thousands of others where there is no realization of the problems involved. Unfortunately, every person in the United States does not employ counsel to review his will, his insurance policies and other property dispositions as often as Congress enacts a revenue law. Recognition of this fact is shown by the report of the committee on Federal estate and gift taxes approved by the section on taxation of the American Bar Association. This report specifically recommends that changes in the prior law on this subject be not retroactive.

4. Additional technical amendments.

There are many technical amendments which are necessary to prevent hardship and unforeseen consequences. The following is a partial list:

(a) The statute should clearly exclude from the tax powers which are held in a fiduciary capacity.

(b) The statute should clearly exclude from the definition of taxable powers the power to remove a trustee and appoint a successor.

(c) The statute should clearly recognize the right of a beneficiary to refuse to accept a power.

(d) There should be no gift tax on the nonexercise of noncumulative annual rights of withdrawal.

Senator WALSH. The committee will stand adjourned until 2 o'clock.

(Whereupon, at 1:06 p. m., a recess was taken until 2 p. m. of the same day.)

(The committee resumed at 2 p. m., pursuant to recess.)

Senator WALSH. Mr. Van Winkle. Do you desire to appear before the committee now?

Mr. VAN WINKLE. Yes, sir.

Senator WALSH. What is the subject matter?

Mr. VAN WINKLE. What I imagine we will talk principally about is the Overton bill.

Senator WALSH. That is, you want to protest the Overton amendment to this bill?

Mr. VAN WINKLE. Yes, sir.

STATEMENTS OF JULIAN P. VAN WINKLE AND C. K. McCLURE, REPRESENTING THE STITZEL-WELLER DISTILLERY

Senator WALSH. Whom do you represent?

Mr. VAN WINKLE. I am president of the Stitzel-Weller Distillery, Louisville, Ky.

Senator BARKLEY. I understand there may be other witnesses on this same subject.

Mr. VAN WINKLE. No, sir; this matter has been brought up so hurriedly, there are very few distillers here. We have not had a chance to consult the bankers or the insurance men.

Senator BARKLEY. Your testimony will represent the views of the entire distilling industry?

Mr. VAN WINKLE. It will.

Senator BARKLEY. Not only on the Overton amendment as offered, but also on the suggestion that appeared in the newspapers a few days ago with reference to the shortening of the time for the keeping of liquors in bond before the tax is paid.

Mr. VAN WINKLE. Exactly, sir.

Senator, this matter has been brought up so hurriedly that we have not had a chance—we did not know what we were really talking about or what we had to talk about.

Senator WALSH. I think the committee appreciates that.

Mr. VAN WINKLE. After getting the Overton amendment late yesterday afternoon, we spent most of the night, my son-in-law, who is secretary of our company, and myself, getting a few notes together hurriedly, totally inadequate to cover the situation. As he has written this out in handwriting, I would like to have him read it to you, and if you wish to ask me questions later, I will be glad to answer them.

Senator WALSH. That may be done. Will he come forward? We appreciate the limited time you have had in this matter, and if it is necessary, we may give you further time later on.

Mr. VAN WINKLE. I wish you would, Senator.

Senator WALSH. It may not be necessary.

Mr. VAN WINKLE. The bankers of this country are probably more interested in this thing than we are, and it involves huge sums of money, and we don't even know what the insurance people will say about it. They are loaded to the neck right now with insurance.

Mr. McCLURE. This is Mr. Van Winkle's note made last evening.

We are an independent Kentucky distillery here in behalf of a number of Kentucky distillers, as well as ourselves.

From the stories in the newspapers recently it was obvious that there had been proposed or was about to be proposed an amendment to the bill H. R. 3687, which would in some manner or other limit the bonded period of whisky to 4 years.

On our arrival in Washington 3 days ago, I was advised that the bonded period was to be limited, and since that time we have been unable to obtain a copy of the proposal or any definite information on same.

Yesterday afternoon we obtained a copy of Mr. Overton's proposed amendment. We still don't know whether or not a flat 4-year bonded period is contemplated or whether the Overton amendment is the legislation which has received so much publicity and which has caused our Kentuckians so much concern.

On the possibility that there may be a 4-year bonded period bill in addition to the Overton bill, we will attempt to direct our remarks, so as to cover both. You realize it is not a simple matter to attempt to make an intelligent statement on such short notice on a bill that turns the basic principles of a huge industry upside down, nor is it easy to be accurate in discussing a bill which we now call a phantom because we don't know that it even exists.

The present 8-year bonded period was established August 27, 1894, and has remained in force ever since, with the exception of the prohibition period. When the bonded period was unlimited, for obvious reasons, and as a result of that this long-established regulation had been accepted as unalterable, due to its extended existence and due to its having operated so smoothly and efficiently, with the advent of repeal the basic structure of the present liquor industry was established on this essential premise. Any reduction in the bonded period would destroy the long-range planning which is essential to this industry in the physical, the merchandising, and the financial phase of the business.

First, the physical: With the advent of repeal, on the basis of the assured 8-year bonded period, the distillers constructed plants and invested their capital in the plants, on the basis that they would produce, not a 4-year supply for inventory reserves, but an 8-year supply. This naturally forced the distiller to build a plant of larger productive capacity than he would have built had he been faced with a limited 4-year bonded period.

In addition to the distillery plant itself, he built more warehouses than he would have needed for a 4-year bonded period. The proposed change now forces the distiller, under normal peacetime circumstances, either not to utilize or to scrap this surplus productive capacity and this surplus storage capacity, as undoubtedly he would not desire to pay taxes, insurance, and upkeep on bonded warehouses in which he would have no whisky stored.

Realizing that to merchandise bottled-in-bond straight Kentucky bourbon whisky he would have to produce a product which would properly mature in 4 years, and which would continue to improve in quality up to the 8-year period, he so set his initial formulas and practices of distillation. All Kentucky whiskies need at least 4 years' aging to reach the point at which the whisky is sufficiently cured to provide a marketable product. Some Kentucky whiskies are made in such a manner as not to reach maturity until 6, 7, or 8 years of age. This is a well known and recognized fact in the industry. The length

of time required for maturing depends upon the grain formula and the type of distilling process employed.

If the bonded period should be reduced to 4 years, the distiller would would not have tax-paid storage facilities to store the whisky after it has been tax-paid while awaiting opportunity to bottle same, for the very simple reason that when he constructed his plant, such was not and never had been necessary. The distiller figured that he would bottle some of his whisky at 4 years of age, some at 5, some at 6, some at 7, and some at 8, and he built his bottling houses and installed his bottling equipment to take care of his needs on this basis.

Now, if he is forced to bottle 4-, 5-, 6-, 7- and 8-year-old whisky all at once, he will not have the equipment or the manpower to accomplish this job.

In addition, it is now proposed that our glass quota for the first 6 months of 1944 will be limited to 65 percent of the same 6 months of 1942 under W. P. B. limitation order L–103–B, as amended.

In our plant, we bottled 138,753 cases the first 6 months of 1942, and 136,291 cases the first 6 months of 1943. If we reduced our 1942 figure to 65 percent, as the regulation requires, we will have available for the first 6 months of 1944, 90,189 cases.

If the regulation is extended with no further curtailments for the second 6 months of 1944, we can expect approximately 180,000 cases for the year.

If the bonded period were reduced to 4 years, all whisky in excess of 4 years of age would have to be bottled immediately. We estimate that we would have in excess of 4 years approximately 220,275 cases as of November 1, 1943.

Each month thereafter we would continue to have whisky reaching and passing 4 years of age, and since we produced more whisky in the years of 1940 and 1941 than we did in 1938 and 1939, this load would continue to grow in proportion.

It is estimated that to bottle all whisky in our warehouses now in excess of 4 years of age, plus whisky which will become 4 years old each month for the 12 months of the year, would require 537,540 cases.

When we compare 537.000 cases needed to bottle the whisky with our proposed quota of 180,000, we see the futility of our position. Two-thirds of the whisky we will have tax-paid will have to remain in barrels to evaporate in tax-paid storage, and the one-third that we will be able to bottle will amount to 35 percent less than our total estimated bottling for this year, 1943, and two-thirds, or 358,000 cases which will remain will unfortunately evaporate at the rate of about 5 percent per year.

As we have already paid the excise tax on this whisky, we will find at the end of the year we have paid one-half million dollars in taxes that cannot be passed on to the consumer, because the whisky has disappeared, and consequently there is no commodity to which to add the excise tax. This half million dollars is based on the proposed $9 per gallon tax and not on the Overton graduated-tax scale.

We have still another regulation of the W. P. B. limitation order L–317, which restricts the usage of paper containers to 80 percent of the usage in like quarters of the year 1942.

Present estimates indicate that the container regulation is even more severe than the glass regulation, and thus will curtail bottles

available for the shipping of whisky even further than order L-103-B.

So much for the physical aspect.

Now, for merchandising. The adoption of the 4-year bonded period would almost immediately wipe out the age-old plan of merchandising of bulk whisky to individual wholesalers, rectifiers, and retailers, brokers and investors all over the country, because the prospective purchaser would not buy current distillations which will not mature until 4 years, and which cannot be bottled in bond until it has reached 4 years, with any margin of safety at all.

By that we mean that when the whisky reaches 4 years the buyer has no choice but to tax-pay and bottle the whisky, even though the market may be depressed and he cannot sell his product.

Under the present law, he, of course, could carry the liquor to 8 years so he presently has a 4-year margin of safety.

The sale of bulk whisky is the only sales method that the small distiller can use today, because he cannot compete on a case basis with the large distillers, due to limited capital. The adoption of the 4-year bonded period would eliminate all the quality brands which have been established for older ages. The industry has invested tremendous sums of money establishing those brands to meet a very definite consumer demand for mature whisky. The American distiller will have no fine old whiskies to compete with the Scotch, the Canadian, and the Irish whiskies of older ages coming into this country. This is the position we were in immediately after the repeal of prohibition, and this is the position from which we are only now beginning to recover. A like fate awaits our future export business if the limitation on age is imposed.

As to the financial phase, the staggering sum of money that would be needed to pay taxes upon all whiskies in bonded storage in excess of 4 years of age at one time would be such as to destroy the financial position of hundreds of distillers in the country, not only that, but also a great portion of the licensed rectifiers, the wholesalers and retailers in practically every State in the Union who own warehouse receipts covering whisky in bond. This huge sum of tax money would not be saddled on the distillers alone, but would affect the other mentioned licensed liquor operators to such an extent that it might force a great many out of business entirely. Such a need for immediate tax money would also be placed upon individual whisky investors, brokers, and banks and investment houses that had accepted negotiable warehouse receipts as collateral on loans if the borrowing distiller, rectifier, wholesaler, retailer, or investor could not raise the funds necessary for the tax payment of all whiskies in excess of 4 years of age, the banks would find themselves in the whisky business, and they would be forced to tax-pay and dispose of the whisky in question. Assuming the banks had the funds with which to tax-pay the whisky, they would still be hopelessly enmeshed in the intricate Federal and State regulations covering the distribution of the product.

To give you a rough idea of the tax involved, we offer the following:

It is estimated in our small plant that if all whisky in storage in excess of 4 years of age as of November 1, 1943, were forced out of bond, plus all whisky maturing to 4 years of age in the ensuing 12 months, we would be faced with a total tax bill during the year of approximately $11,675,368 at the proposed new tax rate of $9 per regage proof gallon.

This tax figure, of course, only covers the excise tax on the whisky and does not include any normal tax on the business itself. Our plant is a very small one.

Senator WALSH. How much is that in excess of what you pay?

Mr. MCCLURE. This figure, Senator, if I may answer, is based on the $9.

Senator WALSH. Alone?

Mr. MCCLURE. Alone. That does not include the Overton amendment. We simply have not had time to pyramid all of these costs.

Senator WALSH. Would it be very substantial?

Mr. MCCLURE. It would be much more than this. Of course, under the Overton amendment, $9 is the minimum. It runs from $9 at 4 years old to $16 at 8 years old.

Senator BARKLEY. How much would that $11,000,000 be in excess of the normal tax you pay in the course of your regular business?

Mr. MCCLURE. Well, Senator, if we tax-pay as much whisky this year under this proposal as we did last year, the increase in the tax rate to begin with is 50 percent, so that it would be 50 percent greater if we tax paid the same amount.

Senator BARKLEY. If you had to tax-pay all the liquor you have in storage that is over 4 years of age, which you wouldn't do in the normal course of business, how much would that requirement, in addition to the 50 percent increase in rate, require you to pay all at one time?

Mr. VAN WINKLE. I would say that immediately we would have to borrow five or six million dollars.

Senator BARKLEY. Which you would never do in the ordinary sale of your product?

Mr. VAN WINKLE. Not a cent. Now, how could we borrow five or six million dollars when the full resources of our corporation are only a little over $2,000,000.

Senator BARKLEY. That answers my question.

Mr. MCCLURE. Plus this point, Senator, that when the little distiller goes out to borrow money his greatest asset in the form of collateral is warehouse receipts. Under the proposed tax rate, the tax is about four and a quarter times the O. P. A. selling price on his warehouse receipts, so you see his warehouse receipts as collateral would not be sufficient for him to obtain the money on that basis.

Senator BARKLEY. In other words, if he had to tax-pay all this liquor and couldn't obtain from the banks or other lending agencies the money required by putting up warehouse receipts as collateral, the result would be he would have to dump it on the market in some way in order to get the money to pay it, and you can't sell it to the general public in barrels. You have to bottle it.

Mr. VAN WINKLE. That is right.

Senator BARKLEY. And you cannot get the bottles with which to do that?

Mr. MCCLURE. That is right.

Senator BARKLEY. Under the limitation of the War Production Board you can't do that, so it puts you up a blind alley, in the face of an impossible situation from a financial, industrial, and trade viewpoint--from any viewpoint.

Mr. VAN WINKLE. That is right.

Senator BARKLEY. I didn't want to interrupt your statement.

Mr. McCLURE. I was making the point here that this approximately eleven and a half million tax bill on a plant such as ours, which is a very small independent distillery—we warehouse only approximately 1.2 percent of the total amount of whisky in storage in the United States. The estimate from the State of Kentucky figures of August 31, 1943, which are the latest authentic ones available, show that if all whisky in bond in the State over 4 years of age, plus all the whiskies maturing to 4 years of age during the ensuing year were forced to be tax-paid, the whisky excise tax involved would be approximately $360,000,000.

As Kentucky stores about 50 percent of the whisky in the Nation, it would be reasonable to assume the total excise tax bill for the year for the entire industry to be at least double that of Kentucky, or $720,000,000.

Senator BARKLEY. That is based on the $9 rate?

Mr. McCLURE. Yes, sir. These figures are also based, Senator, on the assumption that all whisky would be withdrawn and bottled as straight whisky. This staggering figure of almost three-quarters of a billion dollars does not take into account that a lot of this whisky will be blended with neutral spirits, domestic and imported, on which there must be paid a like excise tax. The blenders will thus push the whisky excise tax bill well over $1,000,000,000 in 1 year.

We quote the Kentucky figures here since they are the only ones we have available at this time.

Senator BARKLEY. You base your figures on what is known as alcohol proportion in the warehouses in the State of Kentucky?

Mr. McCLURE. Yes; and from the A. T. U. figures we got the total original proof gallons that were in bond in the whole United States.

Senator BARKLEY. Does this situation affect all of them practically alike?

Mr. McCLURE. All distillers.

Mr. VAN WINKLE. Certainly.

Mr. McCLURE. The removal of this whisky from bond by this force would immediately deprive all the State and local governments in which it is stored of that potential ad valorem tax. Under the 4-year bonded period the banks will drastically reduce the amounts and the length of their loans to the industry, in our opinion. We cannot discover as yet who will write the insurance on this tax-paid whisky in storage. Even at present, we are having difficulty obtaining sufficient coverage on our current concentrated high values.

Practically every fact that we have given opposing the 4-year bonded period is also applicable to the proposed Overton amendment. After all, this amendment is in effect a 4-year bonded period. It doesn't say that in so many words, but the result is the same.

First, the Kentucky distiller will be faced with the same problem of bottling his whisky in bond. It must be at least 4 years of age in order to comply with the Bottled-in-Bond Act. If it is a day over 4 years of age, this amendment will assess the distiller $2 more per gallon or $6 more per case. It is possible that the day the whisky becomes 48 months old that the bottling house, particularly in the case of a small distiller, where he has only one bottling premises, and he switches from bottled in bond to tax paid, and vice versa—that the bottling house may be bottling tax-paid whisky, and therefore the dis-

tiller would be forced to leave his whisky in the bonded warehouse until the bottling house was clear for bottling in bond.

This would cause an increase of $6 per case in tax and in the distilleries' f. o. b. price to the wholesaler.

It is impossible, physically impossible, for the distiller to withdraw whisky on the barrelhead—that is, the day it becomes a certain age. All established brands vary slightly in age. If the distiller doesn't have January distillation, he uses December or November, or whatever the next closest older age is that he has available. If he has no 4-year old, he will use 5-year-old, in a 4-year-old brand.

Such a necessity would cause the distiller to have to bill the same brand at widely varied prices. For example, in our own Old Fitzgerald, bottled in bond, we have used and are now using today whisky ranging from 48 to over 72 months in age, so we could have a variance in our price, due to the proposed tax variation, of $16.50 per case at the distillery. Our present O. P. A. ceiling price on this brand is $29.25 per case, on a quart basis, f. o b. distillery, including all present Federal taxes. If we add to this $29.25 the proposed tax increase of $9 per case, if we add the freight and State tax and the O. P. A. mark-up allowance for the wholesaler and the retailer, this particular case can be sold by the retailer in Chicago, assuming freight to be 25 cents per case, at the ceiling price of $5.3 per quart. The same brand containing an older or over 72-months-old whisky, would go to the consumer at $7.41 per quart.

In other words, there is a difference of $2.11 in a quart of whisky, a difference of 39 percent.

If we are having trouble today—and we are—with black-market prices in the liquor industry, think what we will have when it is impossible to have a definite price on a given brand, as in this example.

We have already talked about the shortage of glass, but this shortage under the Overton amendment, as you mentioned, Senator, would have the industry on the rack. If we don't remove our whisky from bond, the tax increases. If we do remove it from bond, we have no glass to put it in. Of course, when we distilled our whisky 4 years ago, in December 1939, we unfortunately did not have the W. P. B.'s glass quota regulation available. If we had, we would have known how much whisky to have made at that time.

I would like to ask also how this pyramiding tax plan would be handled on imports. And, naturally, we are interested in that because we compete with imports. How will this tax plan be handled on a spirit blend? For example, a spirit blend contains 30 percent of whisky at 7 years of age and 70 percent of neutral spirits made currently. Won't this tax, through the price of straight whiskies, far above spirit blends in comparison, if the tax is based purely on the age?

The same argument made earlier regarding available money to pay the taxes applies to this bill also as does the attainment of insurance, for more capital will be required to finance tax-paid whisky and insurance values will be greatly increased.

The apparent purpose of the proposed bill is twofold—to force more whisky into the market in bottles to ameliorate consumer demand, and, second, to step up the collection on the per gallon excise tax in the year 1944 at the expense of similar tax collections in subsequent years.

The bill will not force a material amount of whisky into the consumers' hands, because, first, the industry will have great difficulty

raising the money to pay the tax, which will be well over a billion dollars tax advance in the year 1944. The distiller and the rectifier do not have the facilities or the manpower to bottle this abnormal amount of whisky. If we had the facilities, which we do not have, we still would not have the bottles or the cases.

The liquor industry as a whole has done a phenomenal job of rationing itself and assuring the public of aged whiskies for the duration. Unfortunately, there are a few in our ranks, just as there are in any other industry, who have taken advantage of the present-day situation, but please let us not judge the entire industry by this small minority. The distillers of this country have turned over their entire production to the manufacture of alcohol, so essential to the war effort since October 8, 1942, and some of the larger plants turned over their facilities before that.

Mr. VAN WINKLE. Two years ago.

Mr. MCCLURE. They have not sought and have not received fair profits for their products, but, more important than that, they have received practically no recognition for their valiant efforts. They are not looking for commendation and praise, but they do feel they are entitled to a fair tax bill and to the right to remain in business.

Senator WALSH. The reason for inviting you to appear is that the committee and those in charge of the bill on the floor might know when this bill is offered on the floor the position of the industry. You have been helpful in that respect, regardless of what action the committee may take. We are not sure whether the amendment will be offered on the floor or not, but your information will be helpful to those who seek to take your point of view.

Mr. VAN WINKLE. If the bill is incorporated into the tax measure, we certainly would like to have the time for a real hearing and bring these bankers and insurance people in here and the others that are gravely affected.

Senator BARKLEY. I would like, for the record, to ask Mr. Van Winkle a question or two, because I am aware that the bottling, storage, and sale of liquor is, in a sense, a technical process not understood by everyone, even those in Congress. This whisky which is ordinarily on the market, marked "Bottled in bond," means that that bottle of whisky has remained in a charred barrel within a Government-regulated and controlled warehouse for not less than 4 years. It cannot be bottled in bond under 4 years.

Mr. VAN WINKLE. That is right.

Senator BARKLEY. You bottle it, and as you bottle it you pay the tax on it.

Mr. VAN WINKLE. Not necessarily, Senator.

Senator BARKLEY. When you take it out of the warehouse.

Mr. VAN WINKLE. You can bottle in bond and still leave that case in bond.

Senator BARKLEY. Yes; you can leave it there without the payment of the tax.

Mr. VAN WINKLE. Yes, sir.

Senator BARKLEY. But you cannot take it out and put it on the market without the payment of the tax?

Mr. VAN WINKLE. Certainly not.

Senator BARKLEY. That is indicated by the little green or red strip of paper that is on every bottle marketed in the United States now.

Mr. VAN WINKLE. Yes, sir.

Senator BARKLEY. Under the present law, and under the custom of the trade for 50 years, you have the right to determine what proportion of your liquor that is bond shall remain there more than 4 years, up to as long as 8 years, and you can feed that out to the trade as the trade demands it, and it is generally supposed—not that I know much about it—but it is generally believed that a bottle of liquor that has a label on it that shows it is 6 years old or 7 years old is more desirable than one only 4 years old.

Mr. VAN WINKLE. Yes.

Senator WALSH. It has a green stamp on it.

Mr. VAN WINKLE. The stamp indicates exactly when it was made and when it was bottled.

Senator BARKLEY. That is a well recognized trade practice and understanding among all the people interested in the consumption of liquor, as I understand it.

Mr. VAN WINKLE. Yes, sir.

Senator BARKLEY. The distillery in that case, and all cases, owns and has constructed the warehouse in which this liquor is stored.

Mr. VAN WINKLE. Yes, sir.

Senator BARKLEY. It is known as a Government warehouse, but it is not owned or Government constructed.

Mr. VAN WINKLE. The distiller builds the warehouse and the Government carries the key.

Senator BARKLEY. The Government carries the key.

Mr. VAN WINKLE. That is right.

Senator BARKLEY. Then when you get ready to bottle it, you have to have the bottles in which to put it, because they can't put it on the market in the barrel.

Mr. VAN WINKLE. No, sir.

Senator BARKLEY. During the aging process, whether it is 4 years, 6 years, or 8 years, a certain percentage of that liquor has been evaporated.

Mr. VAN WINKLE. Yes, sir.

Senator BARKLEY. Through the process of aging.

Mr. VAN WINKLE. Yes, sir.

Senator BARKLEY. In 4 years an ordinary barrel, containing 45 gallons, when it is put into the warehouse, will be evaporated down to what?

Mr. VAN WINKLE. That depends entirely on the cooperage, the character of the cooperage, whether it is good or bad, the way the distiller takes care of his whisky, whether he takes good care of it, which a good distiller will do. He will go into a bonded warehouse, and he will have his men in the bonded warehouse every day. We have about 20 men that do nothing but hunt leaks, and when we find a leaker we either stop up that leak——

Senator BARKLEY. What would be the fair average? I have been told that in the course of 5 or 6 years a 45-gallon barrel will evaporate down to about 36 gallons. Is that true or not?

Mr. VAN WINKLE. Senator, the Government, after exhaustive study—and I think this Congress recently passed a new outage bill. The old outage bill was known as the Carlyle bill—the old outage bill was hardly adequate to take care of the excess. They have extended that and the present outage bill is as per this card.

(The card referred to is as follows:)

Schedule of statutory allowances for loss by leakage and evaporation

Period of storage in warehouse		Maximum allowance, casks of 40 wine gallons capacity or more (proof) gallons)	Period of storage in warehouse.		Maximum allowance, casks of 40 wine gallons capacity or more (proof) gallons)
More than—	Not more than—		More than—	Not more than—	
None	2 months	1.5	39 months	42 months	10.0
2 months	4 months	2.5	42 months	45 months	10.5
4 months	6 months	3.0	45 months	48 months	11.0
6 months	8 months	3.5	48 months	51 months	11.5
8 months	10 months	4.0	51 months	54 months	12.0
10 months	12 months	4.5	54 months	57 months	12.5
12 months	14 months	5.0	57 months	60 months	13.0
14 months	16 months	5.5	60 months	63 months	13.5
16 months	18 months	6.0	63 months	66 months	14.0
18 months	21 months	6.5	66 months	69 months	14.5
21 months	24 months	7.0	69 months	72 months	15.0
24 months	27 months	7.5	72 months	75 months	15.5
27 months	30 months	8.0	75 months	78 months	16.0
30 months	33 months	8.5	78 months	81 months	16.5
33 months	36 months	9.0	81 months	84 months	17.0
36 months	39 months	9.5			

No guaranty of outage on whisky that has been in bond more than 7 years.

Each 2 months, for example, you can lose one gallon and a half from the original gaging. If you lose 2 gallons, you pay tax on a half gallon that you don't get. Down to 4 years you are allowed—I think you are allowed to lose 11½ gallons. If you lose 12½ gallons, you pay a tax on 1 gallon you don't get.

Now, if your cooperage and your attention to your packages is proper, you probably won't lose that much, but you will always have some excess.

Now, again, on this proposed bill of Mr. Overton's, if we have a gallon or two excess every day or two, at $16 a gallon, that would break the Bank of England.

Senator CLARK. The Federal outage bill is figured on average experience, isn't it?

Mr. VAN WINKLE. Yes, sir.

Senator CLARK. That is supposed to be the average?

Mr. VAN WINKLE. Yes, sir.

Senator CLARK. And that is figured in the retail price of liquor; consideration is given to the outage in the retail price?

Mr. VAN WINKLE. Exactly.

Senator BARKLEY. If you were required to pay tax on this at the end of 4 years, and you couldn't get the bottles and had to leave it in the warehouse, it would continue to evaporate?

Mr. VAN WINKLE. Exactly.

Senator BARKLEY. So that you would have to pay a tax on liquor that you don't have when you take it out?

Mr. VAN WINKLE. Yes, sir.

Senator BARKLEY. You spoke of the financing of this. As I understand it, most distillers of reasonable size have to finance their operations through bank loans?

Mr. VAN WINKLE. Certainly.

Senator BARKLEY. And that has been recognized because these warehouse receipts representing the liquor in these warehouses controlled

by the Government, and to which it has the key, are negotiable instruments?

Mr. VAN WINKLE. Yes, sir.

Senator BARKLEY. And they are put up as collateral?

Mr. VAN WINKLE. In large quantities.

Senator BARKLEY. In large quantities?

Mr. VAN WINKLE. Yes, sir.

Senator BARKLEY. Do you know offhand, or can you estimate, how much?

Mr. VAN WINKLE. No; I can't, Senator, because we haven't had the time to go into that. We could get a good deal of the information on that in the course of a little while, but I know one thing, that I was reliably informed just since I have been here, that there is a bank in Chicago lending $48,000,000 on warehouse receipts. Now, suppose, for example, the people that have banked that paper, when the time comes to tax pay this whisky under this schedule, clamp down on us. That bank is not going to loan enough money to taxpay that whisky and we will have to abandon it, and the banks will find themselves with millions of dollars of Government whisky on their hands, and you can't get any insurance on it. Don't forget that. We can hardly get insurance now, and if we had this load on it no insurance company in the country could carry it.

Senator BARKLEY. In other words, if this should become law you would be compelled, in addition to what has been already borrowed on the warehouse receipts, representing this liquor, to go and borrow more money to pay the tax?

Mr. VAN WINKLE. Borrow 10 times as much.

Senator BARKLEY. Then you would be compelled, in order to get that money, if you got it at all, to put it on the market at once, and you can't do that without the bottles to bottle it.

Mr. VAN WINKLE. Exactly so.

Senator BARKLEY. So it leaves you up a blind alley.

Mr. VAN WINKLE. Absolutely.

Snator WALSH. Do you want the committee to consider further witnesses if the matter assumes serious proportions?

Mr. VAN WINKLE. We certainly do, Senator.

Senator WALSH. Very well.

Mr. Walker.

STATEMENT OF THE HONORABLE FRANK C. WALKER, POSTMASTER GENERAL OF THE UNITED STATES

Senator WALSH. I suppose you wish to discuss with the committee the proposed tax on postage?

Mr. WALKER. Yes; I do. I do it with some hesitation, Senator. I wouldn't want you to think I am presumptuous, coming here on my own. I was not asked here, but a representative from the office was, but I was very interested in the problem at hand, and thought I would personally like to present our views on the matter.

Senator WALSH. We will be pleased to hear you.

Mr. WALKER. I am somewhat handicapped. I did not know I was to appear until 11:30 this morning. In order to facilitate matters I did draft very hurriedly a statement that I would like to present to

the committee. At a later time, if it is agreeable to the committee, and they want further information, I would like to submit a further statement or brief.

Senator WALSH. That can be done.

Mr. WALKER. I have given careful consideration to the tax bill as it relates to the proposed increases in postal revenues. Based on the amount of mail handled during the fiscal year 1943, and assuming that there would be no decreases in volume because of increased rates, the following increases would be had in postal revenues:

Estimated 1943

	Estimated number	Revenue	Increase	Additional revenue H. R. 3687
First-class local delivery	[1] 4,341,656,000	$88,056,000	2 cents to 3 cents	$42,416,000
Air-mail	1,000,000,000	60,435,000	6 cents to 8 cents	20,161,000
Third-class	4,267,000,000	60,000,000	Double	60,000,000
Fourth-class	800,000,000	156,000,000	3 percent[2]	10,000,000
Money orders	347,090,000	36,870,000	66⅔ percent	24,580,000
Registered mail	95,204,000	19,913,000	33⅓ percent	6,764,000
Insured mail	114,370,000	9,960,000	Double	9,633,000
Cash on delivery	43,609,000	6,077,000	do	6,077,000
Total		436,363,000		179,636,000

[1] 1942.
[2] Minimum, 1 cent each parcel.

Senator CLARK. That is the total increase under the House bill?

Mr. WALKER. Assuming the transactions do not decrease.

Senator CLARK. If the volume remained the same, it would increase the revenue from carrying the mail about $179,000,000?

Mr. WALKER. Correct, sir.

The Post Office Department does not wish, however, to make an estimate of what these proposed increased postage rates will bring. There are too many factors entering into the problem, and past experience is not necessarily a good guide.

Here is some history for your information. The rate on local letters was changed from 2 to 3 cents July 6, 1932. The number of pieces of mail decreased apparently on account of increased postage from 4,183,000,000 to 2,702,000,000. The rate was put back to 2 cents on July 1, 1933, and the mailings on local letters gradually increased until in 1942 they were approximately what they were in 1932.

There was, of course, a downward trend in business in 1932 and 1933 and the decrease in local letter mail was not entirely due to increased postage rates.

Senator CLARK. Mr. Postmaster General, if I might interrupt there, let me see if I understand this figure correctly. Is it true that when the rate is increased the net revenues of the Post Office Department decrease?

Mr. WALKER. Decrease; correct, sir. In 1932 and 1933, however, business did decline, as the Senator will remember.

Senator CLARK. I understand.

Mr. WALKER. The rate on post cards (picture post cards) was increased from 1 to 2 cents on April 15, 1925. The result was the tremendous decrease in revenues on this class of matter. It was estimated at the time that this amounted to over $8,000,000.

Personally, from studies I have made of this, I believe it is excessive but there was, in any event, a large loss of revenue.

The rate of Government - inted postal cards was increased from 1 to 2 cents on November 3, 1917. During 1916 and 1917 there were printed for the Post Office Department 2,160,000,000 of these cards. During 1918 and 1919 there were printed but 1,174,000,000 cards. The rate was reduced to 1 cent on February 24, 1919.

It is because of these experiences that I have been loath to recommend to the Congress an increase in our postal rates on special services without having exact and dependable information.

Upon taking up my duties as Postmaster General I found that there was a surprising lack of such data on hand and that the great increases in postal business during the last few years had prevented our administrative officers from giving the attention they would have liked to this vital problem.

Every effort was made by me to develop a fact-gathering organization and some headway was made, but depleted forces and insufficient funds prevented the headway being made that I would have liked. I presented our difficulties to Congress and last year $50,000 was appropriated for the services of trained business executives and accountants to assist in our studies. Adidtional funds were allowed also for the assignment of eight experienced postal men for research and development work.

I might say that the year previous, which was shortly after my first year in office was completed, I made a recommendation at that time along the same lines.

In the 5½ months since this money has been available excellent progress has been made.

The services of Mr. Charles A. Heiss and Mr. Allan B. Crunden, former comptroller and assistant comptroller of the American Telephone & Telegraph Co., who have wide experience in problems similar to our own and experience in fixing of rates, were obtained by me. They have brought about improvements in our fact-gathering methods. They have cooperated with me and my subordinates in devising what they believe is a scientific revision of our postal rate and special services problems. I expect fully to be able within 60 days to suggest changes affecting our entire rate structures, both postal and special services.

Under authority granted by the Seventy-eighth Congress, approved June 7, 1943, the President is authorized during the period ending June 30, 1945, to proclaim such modifications of postage rates as after a survey by him he may deem advisable by reason of increase in business, interests of the public, or the need of the Postal Service.

Acting under this authority, I hope to be able within the next 60 days to propose changes in our postal rates on parcel post and third-class mail and, possibly, second-class mail, which will eliminate to a considerable extent at least, the losses of some $18,000,000 on parcel post and $24,000,000 on third-class matter. We want to make these changes in such a manner that we will continue to retain our business and not tax it out of existence.

Changes in our special services rates must be through congressional action. Studies have been completed on our special delivery, money order, registered, insured, and C. O. D. services, and I hope to begin

transmitting to the Congress within the next 3 weeks data for proposed legislation for increase of rates for these services that can be justified fully.

I realize the amount of work and study made by the Ways and Means Committee and by you gentlemen concerning postal rates. I do wish, however, because of the fact that you gave me money 5½ months ago to make a study of this vast and complicated problem, that you would permit the Post Office Department to make changes in postage rates through Presidential proclamation, under your authority, as I believe you will find that we have done a good job in a limited time. Should it be found that you cannot approve the results of our work, the authority to change the rates can be readily taken away and rates made through legislative action.

I wish also that you would permit the Department to present legislation for changes for the rates of our special services, as such changes will be made as the result of study by experienced postal officers and the trained business specialists obtained by me from the American Telephone & Telegraph Co.

Senator BARKLEY. One question that you may or may not want to answer. The people in Congress, all of us, feel pretty well justified that the Post Office Department is self-sustaining. That is, it receives enough revenue from mailings to pay the expense of carrying the mails to the people. It has never been regarded as a money-making institution for the Government, outside of the services it renders. What is your opinion, if you care to express it, on the propriety of using the Post Office Department and the mailing facilities for the purpose of making up revenues for other purposes?

Mr. WALKER. I feel very decidedly, Senator, that the Postal Department is a service agency. I think there has been a fine tradition in the Postal Department, and I think we should adhere to that policy. I don't think it should be made a money-making agency. I think it should carry itself, and I see no reason why that should not be done. Over the years it is true that we have not done it, but I see no reason why we cannot keep our finger on the pulse of the business of the country and watch the Department closely and arrange our revenues and allocate them to each special service that we have, so that each special service bears its own fair proportional part, and I think the Department can be made in a businesslike fashion to carry the load, but I don't think it should ever be the desire that it be made a profit-making organization.

Senator CLARK. This may not be a fair question to ask you, because you may not be in a position to make any definite forecast, but if you have an impression in your mind as to what will be the effect on the revenue if the changes you contemplate making go into effect—in other words, do you think it will decrease or increase the revenue?

Mr. WALKER. You mean based upon the proposed changes that the Department contemplates?

Senator CLARK. Yes; and considering all other factors that will have any bearing on it. Do you think if these changes are put into operation the income will be larger or smaller?

Mr. WALKER. I am hoping we can get the revenue commensurate with the service we are rendering, and not interfere with the kind and character of service we are giving. In other words, I think certain

parts of the mail service are not carrying their correct proportion, but I don't want to add a heavy burden to any particular class of service, and I don't think that is necessary at all. I would rather not at this time express a definite view as to what changes should be made. We are making a survey, as I indicated, of our second-class mail. I don't feel that great changes should be made in that at all. I think in some cases they have been poking a lot of fun at us about Esquire, but I think there are certain kinds and characters of magazines it was never contemplated should come under the heading of giving current information or devoted to the arts and sciences. Some of these magazines cost us as high as $350,000 to $500,000 a year. I don't think that Ben Franklin and some of the men who encouraged these subsidies in the early days ever intended it should go to a certain type. I think magazines and newspapers that really are dedicated to conveying current information or dedicated to the arts and sciences come under that rule, but I see no reason why we should subsidize some magazines that I don't think come under that category.

Senator CLARK. I didn't ask you to be specific, but I just wondered if you had formed any impression as to what would be the result in the aggregate.

Mr. WALKER. I think an analysis and examination of second-, third-, and fourth-class mail, and the special services, such as money orders and registered mail will place us in a position where in some instances we might cut, and in other instances we might increase, but that each particular service will bear its fair proportion without working any hindrance to any business enterprise or interfering with the fine character of service carried on by the Postal Department over the years.

Senator CLARK. Mr. Postmaster General, I am particularly interested in the subject of air mail and air-mail rates and air-mail services. As I understand it, the House bill increased the rate from 6 cents an ounce to 8 cents an ounce.

Mr. WALKER. Yes; it does, Senator.

Senator CLARK. Now, it seems to me, and I should like you to check my information on that, it seems to me that the record shows that the decrease in air-mail rates—and I think air mail is very important. It is not only the poor man's telegraph but it is in many ways superior to the telegraph for a great many purposes for everybody—but the increase in that revenue to the Government has accompanied a reduction in air-mail rates; is that correct?

Mr. WALKER. I think in the main that is correct.

Senator CLARK. For instance, when you started out in 1927, when you had an air-mail rate of 10 cents for half an ounce or fraction thereof, you never got above 400,000 pounds of air mail. Then when the rate was reduced to 5 cents for the first ounce, 10 cents for each additional ounce or fraction, you increased the air-mail carriage and the net revenue from that to the Government, although at that time it was a minus quantity. Then, when you increased the rate to 8 cents for the first ounce, and 13 cents for each additional ounce or fraction, there was a substantial diminution. Then, in July 1934, when you imposed a rate of 6 cents for each ounce or fraction, the carriage at that time was a little over 400,000 pounds, and that has gone up to 2,000,000 pounds; isn't that correct?

Mr. WALKER. Yes.

Senator CLARK. At the present rate. In other words, that accompanied a diminution in the rate. Now, originally the air-mail postage business was a loss to the Government. It was a subsidy paid to the air lines; isn't that correct?

Mr. WALKER. Correct, Senator.

Senator CLARK. But by the reduction in the rate and the selling campaign carried on by the Department and by the air lines and everybody else to make this service desirable to the people of the United States, it has come to the point now that it is so far from being a subsidy that there is a net revenue paid, I understand, for this year of $30,000,000.

Mr. WALKER. My assistant, Mr. Purdum, is particularly proud of his air mail.

Senator CLARK. I think he should be proud of it. The point I am getting at is, whether we increase or decrease the net revenue to the Post Office Department—and that is the primary consideration—by increasing the rate. It is my theory, based on the statistics of previous operations, that you are likely, by increasing the rates, to decrease the net return to the Federal Government. Don't you think that is a fair statement?

Mr. WALKER. I think there are other factors in it, but in the main I think I agree with you, Senator. Our air mail has increased more in the last year than in any other one period. We had about half of our airplanes taken out of the domestic service approximately 8 or 10 months ago. Our air mail increased 75 percent in that period. We have been handling about 75 percent increase in air mail with half the number of domestic planes we used last year. That tends to prove your argument.

Senator CLARK. In other words, the theory of the House increase in rates is based on a very simple computation; if the volume remains the same and you increase the rates, you increase the revenue by the same percentage you increase the rate.

Mr. WALKER. That does not apply in business.

Senator CLARK. But if the increase in rates brings about a diminution in volume, you decrease the revenue to the same extent, don't you?

Mr. WALKER. Yes; and I think it would be a serious mistake to do it arbitrarily. I am in accord with you, Senator. I recently told the Civil Aeronautics that I would, with great hesitation and with much thought and consideration, give any further subsidiaries to air companies. I think they are getting on a basis where they are becoming entirely unnecessary.

Senator CLARK. With few exceptions they are not on a subsidy basis, but they are actually rendering a profit to the Post Office Department, which they ought to do. That same thing generally runs through all the postal structure, does it not?

Mr. WALKER. Yes.

Senator CLARK. What I mean to say is, you have to consider the factor of increase or decrease in rates and the volume of traffic, to arrive at the question whether it is a revenue-producing change or not.

Mr. WALKER. Yes, we do. Take on your third-class mail. Third-class mail, on account of the fact that we are doing no national advertising today, third-class mail dropped about 20 percent, I think.

We had a drop from 1941 to 1942 of 11 percent, from 1942 to 1943 of 10 percent; we will have an additional drop in our third-class mail this year, and if you double the rate, and you have this drop of 11 percent, 10 percent, and there will be an additional drop this year, if you add 50 percent on it, they just won't be able to use third-class mail at all.

Senator CLARK. What I am getting at, it is not possible for any man or any set of men to just get together and take the figures on postal operation of the last year and figure that by increasing them 10 percent you increase the revenue 10 percent. You might decrease it 10 percent.

Mr. WALKER. Or you might decrease it 20 percent.

Senator CLARK. You might decrease the volume more than you increase the revenue.

Mr. WALKER. I am entirely in accord with that thought, and I think it would be very bad if we arbitrarily increase the rates.

Senator CLARK. It seems to me that all the considerations in the House bill revolve about the theory that the volume will remain the same and that by increasing the rate you automatically, to the same extent, increase the revenue.

Mr. WALKER. Yes.

Senator CLARK. Whereas in practice that has not been true, has it?

Mr. WALKER. It has not.

Senator CLARK. You certainly have got to consider the effect of an increase in rates on your volume.

Mr. WALKER. You would put a lot of magazines and papers out of business.

Senator CLARK. As I understand, this cost provision is not intended as an aid to the postal operation at all. It does not profess to be that. It is supposed to be an increase to the general account in the Treasury.

Mr. WALKER. It is for tax purposes.

Senator CLARK. It seems to me that unless they consider all the factors that enter into the postal operation it may have the exactly reverse effect on the general revenue.

Mr. WALKER. I don't want to find myself in the position of telling either the Ways and Means Committee or your committee what to do, but from the standpoint of the Department I think it would be very regrettable if they arbitrarily fixed rates.

Senator CLARK. I am not asking you to volunteer anything.

Mr. WALKER. I don't want to find myself in the position of trying to tell your committee what to do, and I don't feel that way about it, but I think it would be very regrettable if we did not have the opportunity of making a study, such as we have been making. We have lost 33,000 men in the service. I haven't nearly enough men in my inspection service or in other departments. Our volume of mail has increased terrifically.

I did get $50,000 to make this analysis, and I think we are doing a good job. I think it would be regrettable not to take advantage of that study.

Senator CLARK. I want to ask you a very plain question and you don't have to answer it unless you feel like doing it. You started out your statement by giving us some figures on net increases in revenue, based on the present volume of postal operations. You don't have to

answer this if you don't have the figures that justify you in answering it. Do you believe that these increases in the House proposal would actually increase the national revenue at all?

Mr. WALKER. On your local delivery I gave you a pretty good example of what we earned formerly. On air mail, in view of the demand for air mail, we might get an increase, but I wouldn't want to venture an opinion; on third-class I am satisfied not only you would not get $60,000,000 increase, but I am satisfied we wouldn't get as much revenue as we are getting today. On fourth-class, by reason of the soldiers being overseas, we might hold our own on parcel post. I doubt it. But we are playing right into the hands of the express companies. If we double our rates in a lot of situations, or if we increase our rates, it would not be good business. We have to make a study of the different zones.

In some places I think our rates are higher than theirs, in others lower. I don't want to interfere with private business, but I think we should be on a basis where they are not going to take the business away from us, and in some of these situations they would do just that. On money orders and registered mail and insured mail, I think we are giving a fine service for little money. I think we could put on some increase that would not hurt the public. On the other hand, if we go up too high, it will just throw the business into the banks and they will use checks and some of them will send money through the mails.

Senator WALSH. Could the increased rates, as a result of the study you contemplate recommending, be enacted by Executive order?

Mr. WALKER. On our special services we have to have legislation. That is, the money orders and insurance and special delivery and registered mail and services of that kind. We have to get legislation for that, which I am proposing to submit. Temporarily I think we can get an Executive order on these others, but I would like to see legislation eventually. This is the first time in 24 years that we have had a surplus in the Postal Department.

Senator WALSH. I understood you to say your studies provide for instituting the changes you will recommend through an Executive order.

Mr. WALKER. Congress has given us authority to do this by Executive order in all cases except special services.

The CHAIRMAN. Thank you, Mr. Walker.

Senator WALSH. Mr. Parker.

STATEMENT OF LOVELL H. PARKER, REPRESENTING THE FOREST INDUSTRIES COMMITTEE ON TIMBER VALUATION AND TAXATION

Mr. PARKER. Mr. Chairman and gentlemen of the committee, my name is Lovell H. Parker, Edmonds Building, Washington, D. C. I appear in behalf of the Forest Industries Committee on Timber Valuation and Taxation. Our committee is representative of those who own forest property in all parts of the United States; such as timber operators, loggers, lumber manufacturers, operators of pulp and paper projects, and naval stores operators.

Our committee is convinced that certain inequalities and discriminations exist in present Federal income-tax laws as applied to the

timber industry which should be taken care of in the pending bill. We will first describe these conditions and then will suggest a fair and equitable remedy based on long-recognized and well-established tax principles.

The most glaring inequality resulting from the operation of the present tax law in the case of timber owners and operators arises from the fact that a timber owner who cuts his own timber does not get the benefit of the capital gains treatment which he would get if he sold his timber outright on the stump.

Under the capital-gains provision of existing law, only one-half of the gain arising from the sale of a capital asset held over 6 months is included in the taxable income of individuals. Furthermore, a maximum effective rate of 25 percent is provided for both individuals and corporations. Thus, all taxpayers, whether with large incomes or with small, receive substantial tax relief, which relief should be extended to taxpayers who cut their own timber. Standing timber is certainly a capital asset, and it is proper that it should receive this capital-gains treatment, and it does when it is sold outright to another. However, if the timber owner cuts his own timber, he is denied this capital-gains treatment and, therefore, all increment in value from the date of acquisition to the date of cutting is taxed as ordinary income at the maximum applicable income tax rate. This is true even though this increment in value has accrued over a long period of years.

At present tax rates the above inequality is very serious. It practically forces timber owners to sell timber which they should, for sound business reasons and in the public interest, cut themselves. For example, it can readily be computed that, under the rates of present law, if a man sells his timber outright before cutting at a profit of $150,000 his tax will be $37,500 and he will have $112,500 left after taxes. On the other hand, if he cuts his own timber and then realizes the same profit his tax will be at least $107,512 and he will have only $42,488 left after taxes. It must be apparent that a tax saving of $60,000 on a profit of $150,000 furnishes a very compelling argument for a man to sell his timber outright instead of cutting it himself. Many operators bought their timber over 30 years ago and over those years the value of the timber has more than doubled.

The inequality in tax just pointed out is not confined to large transactions. For instance, in the example just given, if the profit had been $50,000 instead of $150,000, the tax saving by outright sale would have been approximately $7,260. The same inequality exists in the case of very small transactions and of taxpayers with very small incomes. Corporations are in practically the same situation as individuals. The corporation which sells its timber outright pays a maximum tax of 25 percent, while the corporation which cuts its own timber pays a tax of from 40 to 80 percent.

The timber industry does not now receive, and has not for the last 25 years received, the special tax treatment accorded to practically all other natural-resource industries. The special treatment referred to in the case of these other industries was inaugurated in 1918, and the method then used has since been perfected and given more general application. Through percentage depletion, the great natural resource industries producing oil and gas, metals, and coal, have been encour-

aged to develop their properties. This has proven to be a wise policy. Theoretical losses of revenue on account of this depletion allowance have been more than made up by having a greater volume of income to tax over the years. Moreover, it is worth billions of dollars, in this present war emergency, to have our natural resources developed to a point where they can give us present production. If these industries had not been given encouragement by our tax laws, they would not have been so developed. Practically all the natural-resource industries, of lesser size, have also been given special tax treatment. As before stated, the great forest industry has not been given the special treatment given the other natural industries, great or small.

The practical effect of this discrimination may be readily visualized from the following data computed from the official statistics of income for 1939:

Percentage of depletion allowance to gross sales

	Percent
For lumber and timber basic products	5
For petroleum	20
For metal mines	10

There are other inequalities and discriminations. Another inequality arises because of a recently adopted policy of the Bureau of Internal Revenue. Under this policy, a timber owner who sells his timber on a so-called cutting contract, under which he retains an economic interest in the property, is held to have leased his property and is denied the capital-gains treatment formerly allowed.

A discrimination also exists in the treatment of the development expenses incurred in connection with the forest industry in comparison with the development expenses incurred in the case of oil and gas wells. Expenditures for planting, pruning, thinning, trails, roads, fire lines, and so forth, could consistently be considered development expenses and be allowed as deductions from gross income.

The principal inequality of existing tax law affecting timber owners and operators which puts the taxpayer who cuts his own timber at a serious tax disadvantage in comparison with the taxpayer who sells his timber outright can be cured by a fairly simple amendment to the Internal Revenue Code providing that—

PROPOSAL NO. 1

In connection with the cutting of timber, the excess of the fair market value of such timber at time of cutting over its regular depletion allowance (its adjusted cost or March 1, 1913, value) shall be recognized as a capital gain (as it actually is) and taxed at the capital gains rate instead of at the ordinary rates as at present.

Senator WALSH. What is the present rate, 25 percent?

Mr. PARKER. That is the capital-gains rate. The other rate, of course, is the graded rate. For individuals, it is really 25 percent. It is the effective rate—50 percent of 50 percent. You take 50 percent of the income into account, and then tax it 50 percent. Such an amendment would not only cure the principal inequality now existing as between taxpayers within the industry, but it would also go far in removing the principal discrimination now existing against the timber industry in comparison with the other natural resource industries which receive special tax treatment appropriate to them.

The inequality mentioned with respect to timber owners who sell their timber under so-called cutting contracts can be cured in a similar manner by an amendment to the Internal Revenue Code providing that—

PROPOSAL NO. 2

Where an owner sells his timber on a cutting contract under the terms of which he retains an economic interest in the property, the excess of the price received over the basis of the timber in the hands of the taxpayer shall be recognized as capital gain and taxed as such.

The discrimination which exists in connection with charging off development expenses can be cured by an amendment to the Internal Revenue Code providing that—

PROPOSAL NO. 3

The taxpayer may write off as current expense any expenditures which he makes primarily for forest protection, conservation, or improvement, or for reforestation.

The technical amendments necessary to carry out the above-mentioned proposals are submitted with this statement but will not be read unless the committee so desires.

Wise public policy is to encourage forestry. The amendments are urged in order to cure serious inequalities and discriminations, but it should be clearly recognized that their enactment will also remove a great deterrent to the practice of forestry by private owners.

Senator CLARK. These manufacturers who have gone in for reforestation and protection and conservation, they are covered over a period of years.

Mr. PARKER. Yes, sir.

Senator CLARK. How are they to be deducted from the timber converted into lumber?

Mr. PARKER. Our amendment would make it optional with the taxpayer whether to deduct it from his ordinary income or not. If he started what they call a tree farm, if he started to plant trees, and he was not going to receive any income at all from the property for 20 years, he would likely, probably capitalize those expenditures. On the other hand, if he is operating, cutting timber, and planting some, and going on on a continuous basis, whereby he gets an annual income, he would in many cases like to charge the development expense on new tracts of property to his current income.

Senator CLARK. That is assuming he is in the business of buying timberlands and cutting timber. But the man who first cuts off all his timber and thereafter wants to reforest, how would he handle it?

Mr. PARKER. He would have to capitalize it. If he has cut all his timber off—and that is the reason it is made optional—and that is not a new departure. As I pointed out in the oil industry they allow development expense to be capitalized or expensed at the option of the taxpayer.

Senator CLARK. It seems to me that we ought to encourage reforestation, improvement of land that has been cut off, by offering some inducement to have that done, maybe by allowing deductions as you suggest.

Mr. PARKER. The main part of that reforestation, I think, will be done by people in that business that have an income from business currently.

Senator CLARK. Yes.

Mr. PARKER. And they would like to charge that off against their current income, because that does of course somewhat reduce their tax, but it gives them some money to spend.

Senator CLARK. It would be an inducement for them to reforest.

Mr. PARKER. That is correct.

Senator CLARK. Very well.

Mr. PARKER. Indeed, good forest management will be strongly stimulated by such amendments and the long range plan of the forest industries to bring about the continuous productivity of the forests will be fulfilled. The amendments are of enormous public interest, for they would tend strongly to—

(1) Improve the protection of forests.

(2) Improve the reproduction of forests after cutting or fire.

(3) Increase the average volume growth per acre and improve the quality of the wood produced.

(4) Stabilize the holding of forest properties in the same ownership and management over long periods of time—an essential of sound forest management.

(5) Create, develop, and expand "tree farms"—sustained yield of forest-management units.

(6) Give greater economic security to labor, to forest industries, and to communities dependent upon forest production.

(7) Increase forest resources of the United States.

(83 Stabilize forest-industry operations, resulting in greater true net income available for Federal income taxation—thus preserving and enhancing a substantial source of Federal income.

The enactment of the proposed amendments would be a constructive act of wise public policy; it would expand forest productivity to meet the great future demands for forest products; it would put the industry in a position where it could furnish a substantial amount of post-war employment.

Finally, lumber has become one of the most critical war materials. Production of paper and other forest products is likewise deficient. Yet the present tax laws discourage and severely penalize log and lumber production at the very time that the national interest requires more production. Especially is this true in the case of timber which has been carried for a long period of years and on which the deductible allowance under the present tax laws is only a small fraction of its present replacement value.

If Congress wants to promote a general practice of forestry on privately owned forest lands, it will eventually modify these laws along the lines which we have proposed. We urge you to do it now—in the interest of forestry, of post-war employment and of maximum war production of forest products now.

In conclusion, it is recognized that this committee is especially anxious to conserve the time devoted to these hearings. Much more could and should be said, but inasmuch as a full statement was made on this subject before the Committee on Ways and Means of the House on October 14 of this year, it need not be repeated here. Copies of the record referred to have been filed with the clerk of

your committee for your convenience. This record shows that our proposals on their merits made a favorable impression on the Committee on Ways and Means.

In closing, I wish to point out the great hazards the timber industry faces such as fire, insects, disease, wind, and so forth. As a practical matter these hazards cannot be insured against. In my opinion these hazards are as great as the hazards and uncertainties of any other natural resource industry. Reasonable reserves are necessary to meet losses from the causes mentioned, and to encourage future development.

The treatment the forest-industries committee urges is justified (1) in order to allow forest owners and operators to manage their properties according to sound business practices instead of being governed by tax considerations; (2) in order to correct present serious tax discriminations; (3) in order to give a tax treatment suitable to the circumstances of the industry, which, without the possibility of insurance, must face serious physical and economic hazards over long periods of time; (4) in order to put the industry in a position where it can meet present needs and provide post-war employment; and (5) in order in the public interest to promote better protection of forests, and to encourage and expand the practice of forestry.

The forest-industries committee pleads for this treatment in this bill, made applicable to the year 1943 and subsequent years. The industry will even then be 25 years behind the other industries in receiving the special tax treatment properly applicable to it.

Mr. Chairman, I have cut my statement as much as possible, and as you stated, I brought with me three witnesses, who are practically all connected with the timber industry, and can give you their troubles at first hand.

Senator CLARK. If your amendment were adopted, what effect would that have on the revenue?

Mr. PARKER. I think in the long run that it would show no loss to the Government, and possibly a greater revenue, because you would maintain the industry in a condition where it could make money and pay the tax. There might be some slight loss in the first year or two that this new proposal was in effect.

Senator CLARK. As I understand your position, it is you think the timber industry has been somewhat discriminated against and should be given the same treatment given to mining?

Mr. PARKER. I do, Senator. I don't think they have received comparable treatment, and the same treatment might be asked for, but it doesn't seem, after careful study, to be available to the timber industry in the same form as is provided in the case of the other natural resources.

Senator WALSH. Thank you.

The CHAIRMAN. Mr. Thompson.

STATEMENT OF DAVE THOMPSON, SECRETARY-TREASURER, ANGELINA COUNTY LUMBER CO.

Mr. THOMPSON. Mr. Chairman and gentlemen of the committee, my name is Dave Thompson. I am secretary-treasurer of Angelina County Lumber Co., with whom I have been associated for the past 30 years. This company was founded in May 1887, 56 years ago,

when it began lumber manufacturing operations at Keltys, Tex., and has through the years continuously operated without interruption to this date. It is the oldest lumber manufacturing institution in Texas from the standpoint of same location, and has had almost no change in ownership, and is managed by the son of the founder.

The company owns a little in excess of 100,000 acres of land, a large percentage of which was owned as of March 1, 1913, although there have been some purchases and sales since that date. The March 1, 1913, value of timber has been largely depleted. Subsequent purchases of land and merchantable timber along with good forestry practices, lead us to believe that if Federal tax laws permit, we can operate perpetually with the timber we have and are growing, subject, of course, to the natural hazards to which timber is subject and against which we cannot insure ourselves.

The management of this company began good forestry practices many years ago and has employed technical and trained forest personnel in an effort to so manage its timber supply as to achieve continuous operations. It has required tedious and expensive reforestation practice over the years to increase both growth and quality of its timber resources. Now we are wondering whether we were right in adopting this policy and are questioning whether we can afford to continue it. In this respect our company is more or less typical of lumbering and other forest industries over the Nation, whose future existence in continuous ownership and good management depends upon tax treatment which at least does not confiscate our capital investment.

Our company had a timber depletion allowance of $2.08 M feet on timber which we cut from the latter part of 1938 through most of 1942. During this time a small percentage of other timber acquired in more recent years was cut on which we had a depletion allowance ranging from $3.85 in 1939 to $7.97 M feet log scale in 1942. The timber cut and depleted at $2.08 M feet log scale had a market value of $8. The low basis of cost for depletion of this timber cut, namely, the residue of our 1913 valuations, or cost, resulted in false earnings and highest surtax and/or excess profits tax as on most of the increase in growth and value of our timber accumulated during the past 30 years.

I have gathered depletion data from other Texas manufacturers, together with a record of timber sales in East Texas by the United States Forest Service, the Texas Forest Service, also sales by farmers and other small landowners. I wish here to state that United States Forest Service sales during the past 5 years, of millions of feet of pine stumpage in our part of East Texas resulted in prices ranging from $8.35 per M feet in 1938 to as high as $15.56 per M feet in 1943.

From these figures, which I would like to file for your examination, you will observe that manufacturers who are cutting their own timber are allowed as a tax reduction substantially less than the value of the timber and in some instances practically no deduction whatever.

The value of timber like ours is necessarily accumulated over a long period of time, during which it is grown under practice of good forestry involving selective cutting, often replanting, policing, protection from fires and other hazards. Yet, in our own case under our present Federal tax laws, the increment or appreciation in value above the 1913 depletion base or cost is regarded as realized during

the year in which it is cut, and all realization above that basis is taxed as ordinary income at full normal and excess-profits rates. We can, of course, sell our timber outright to somebody else and be subject only to the capital gains tax of 25 percent. But we don't want to do that. We want to produce lumber for the war, and we want to keep our timber and our timber lands growing more timber so that we can provide employment after the war. We are doing just that, but we are being severely and unfairly penalized because for every $10 worth of trees we are now cutting into lumber we will realize after taxes only about $3.60 which does not go very far toward enabling us to replace these capital assets which we are using up. Also, there are other companies in the South which have no tax deduction whatever on their timber which they have held for many years. They are being penalized even more severely.

Under the present Federal tax provision many forest industries owning their own timberlands will be forced to discontinue operations and sell, thus destroying continuity of ownership and discouraging productive management of forest properties. Again, when forest industry corporations distribute by dividend to stockholders the small earnings left after taxes, the stockholders likewise, if in a high bracket, are left in many instances not over 10 to 15 percent of the replacement value of the timber.

Mr. Parker has suggested to you a simple and practical remedy for this situation. If you will amend the income-tax law and permit the increase in value of the timber grown or held over a long period of years to be taxed as a capital gain, regardless of whether it is sold outright, sold on a cutting contract, or cut and manufactured by the owner, you will largely remedy this inequitable and intolerable situation. The amendments proposed by Mr. Parker should be enacted now. They will help forestry and they will help war production. The amendments which he proposes are fair. They give no forest owner an advantage over other forest owners. They can be readily administered. They are consistent with the tax treatment of other natural resources.

The Federal Government already owns over one-sixth of our forest area, to assure a future supply of forest products and to protect our resources, such as wildlife, prevention of soil erosion, etc. Tens of millions of dollars a year are expended by the Government for these purposes. If Congress will provide us a fair basis for taxing income from the cutting of timber grown or held for a substantial period, expenditures will gradually decline because it will be in our own interest to maintain our forest lands in a productive condition growing more trees to provide more raw material and more dependable employment in our industries.

Only the Congress can make these needed amendments. Failing to do so will bring serious consequences to forest owners who cut and process their own timber, and also will destroy the plan and dream of forest owners over years for continuity of forest ownership and operation.

Mr. Chairman, I wish to submit a statement of the timber depletion of the Southern yellow-pine timber cut for lumber and sale of Southern yellow-pine timber by United States Forest Service, Texas Forest Service, and small landowners.

Senator WALSH. That may be made a part of the record.

(The table referred to is as follows:)

Statement of timber depletion of southern yellow pine timber cut for lumber and sale record of southern yellow pine timber by United States Forest Service, Texas Forest Service, and small landowners—All in East Texas area, according to data gathered by Dave Thompson, Nov. 26, 1943

	Price per M feet					
	1938	1939	1940	1941	1942	1943
Company A			$3.76	$2.34	$1.95	
Company B			1.31	1.25	1.21	
Company O			5.50	5.53	5.54	$5.54
Company D			4.45	4.30	4.56	4.63
Company E			5.41	5.41	5.41	5.41
Company F			1.93	1.93	1.93	1.93
Company G		$3.945	3.99	4.036	4.117	4.17
Company H:						
Own	$2.08	2.08	2.08	2.08	2.08	
Purchased	5.80	3.85	7.24	8.53	7.97	8.05
Timber sales by U. S. Forest Service:						
In East Texas area	[1] 8.35	[1] 9.87	[1] 8.77	[1] 10.60	[1] 12.80	12.90–15.56
Their advertised bid	7.27	8.33	7.97	8.94	10.27	10.21
Timber sales by Texas Forest Service in East Texas area	10.00	4.00	9.00	11.30	None	11.80
Timber sales by small landowners in East Texas area	7.00	8.00	9.00	10.00	11.00–13.00	12.00–15.00

[1] This is top of price range but in no instance less than advertised bid.

1942 REPORT OF 98 SOUTHERN PINE MILLS

	Per M
Depletion:	
Own timber	$4.767
Forest Service timber	11.01
Other purchased timber	7.43

STATEMENT OF WAYNE G. MILLER, EXECUTIVE SECRETARY, FOREST FARMERS' ASSOCIATION

Mr. MILLER. Mr. Chairman, the organization which I represent has members in the 12 southeastern States representing the great southern forest area and a considerable proportion of that membership has small ownership, and I should like to add an expression of the viewpoint of the small land owner who is operating under the present tax situation, to the effect that there is such an impressive advantage over selling his land with his timber that a great many of them are actually being dispossessed of their land. That may or may not be justifiable from various angles.

Senator WALSH. He makes a contract to have it cut and the land thereafter may be valueless.

Mr. MILLER. That is true, and it is a question—

Senator WALSH. How they shall reproduce?

Mr. MILLER. There is one lumber company in central Mississippi which at the beginning of the war was a very small operation, but this business of buying timber with land just naturally was imposed upon its operations, and somewhat to the surprise of the principals of that company, they find they now own about 80,000 acres of land which appears on their books at a cost of not above 50 cents per acre. That means if that land is rehabilitated and goes into production, their deductible expense will not be sufficient to justify them operating their own timber as long as they continue to buy under the present system from their neighboring small owners.

The proposed remedies which have been outlined here are, as it seems to our people, a solution to the problem. I think we have here the happy situation of the seller and the buyer agreeing upon a policy.

Senator WALSH. Thank you, sir.

There is a gentleman here from Florida, Mr. Wolfe, who has asked to be called because he wants to return to Florida tonight. Is Mr. Wolfe here?

Mr. WOLFE. Yes, Mr. Chairman.

Senator WALSH. You are president of the Smith Engineering & Construction Co.?

Mr. WOLFE. No; I have with me Mr. Smith, who has a statement he wishes to make, and then I would like to supplement that with a few remarks dealing with my experience with renegotiation.

Senator WALSH. Very well.

STATEMENT OF CHARLES W. SMITH, PRESIDENT, SMITH ENGINEERING & CONSTRUCTION CO., PENSACOLA, FLA., AND VICE PRESIDENT, HIGHWAY CONTRACTORS' DIVISION, AMERICAN ROAD BUILDERS' ASSOCIATION, WASHINGTON, D. C.

Mr. SMITH. Mr. Chairman and gentlemen, I am Charles W. Smith, president of the Smith Engineering & Construction Co., of Pensacola, Fla., and vice president of the contractors' division of the American Road Builders' Association, Washington, D. C. We consider it a privilege to be able to testify before this committee with regard to the effect of the renegotiation law on contractors engaged in the construction of military roads, airports, and other war facilities.

Our purpose in being here is to endeavor to show the adverse effect of this law on our industry. We are not here to persuade you to repeal or change this law so that we may derive excess profits from this war as we do not want anyone, including ourselves, to make excessive profits.

It is submitted that the present act was not written or intended by Congress to apply to construction contracts awarded on the basis of competitive billing. The use of the term "renegotiation," employed in the language of the act, clearly implies and presupposes that the act refers to contracts which were negotiated contracts at their inception. During the early days of the war public invitations to bid on completed plans and specifications were abandoned and reliable established contractors were summoned to appear individually for a negotiated conference. Discussions were held concerning the type of contract to be performed, the ability of the concern to do the work, and the terms of the proposed agreement. The Government and the particular concern were negotiators and the agreement consummated as a result of their negotiations is properly referred to as a "negotiated" contract. The foregoing procedure was followed because due to the war and our resulting national crisis the time element was of primary importance and in order to insure completion of the contracts as rapidly as possible the Government found it necessary in many instances to eliminate time-consuming procedure.

However, "negotiated" contracts should be and are easily distinguished from the common type of contract used almost exclusively by the Government prior to the national emergency and which is now

employed in most instances. By this I mean the agreements awarded on a competitive basis by the following procedure: Public invitation to bid on completed plans and specifications; submission of bids upon the same terms and conditions by all bidders; and subsequent award of contract based on the competitive bid. This type of contract, because of its competitive nature alone, guarantees to the Government a fair and equitable price.

Senator CLARK. I happen to know of some cases where the Government is trying by the very process of negotiation to renegotiate contracts let on competitive bids.

Mr. SMITH. We are contending that they are applying the renegotiation rate on competitive bids, and that due to the competitive nature of our business, highly competitive and hazardous, road building, airport building, and the fact that our industry has not changed now is no different from the industry before the war——

Senator CLARK. Are you contending that the contracts by negotiations are entitled to have preference over the contracts let on competitive bids?

Mr. SMITH. No, sir; we are contending that the contract by negotiation, there is no reason why it should not be renegotiated. If you as an engineer call me as a contractor and negotiate a contract with me, with no competition, there is no reason why, after we have completed the job, you should not call me in and see if I have made an excess profit, and see if it should not be renegotiated. We contend our business is highly competitive.

Senator WALSH. You contend that when you get a competitive bid contract it should not be renegotiated?

Mr. SMITH. Yes, sir.

Senator CLARK. I misunderstood you. In other words, the same principle ought not be applied?

Mr. SMITH. No, sir.

Senator CLARK. To contracts which have been let as the result of competitive bidding as to contracts which have been negotiated?

Mr. SMITH. No, sir.

Senator CLARK. The basic thory of the renegotiation is that they are negotiated contracts instead of competitive contracts?

Mr. SMITH. Yes, sir.

Senator CLARK. I agree with you entirely.

Mr. SMITH. In order that negotiated contracts might be subject to the same guaranty, Congress enacted the renegotiation statute which in our opinion gives recognition to the basic distinction between these two types of contracts. Recently the term "negotiated" contract has been used by Federal agencies to describe contracts which are awarded on the basis of competitive bidding based on completed plans and specifications. Plainly, such a title for this type of contract is a misnomer as in fact it is just open competitive bidding.

Now, gentlemen, I would like to bring to your attention some of the specific phases of the law which work an undue hardship on the road-building industry. The act, as it now stands, is objectionable in the following respects.

Senator WALSH. They are competitive bids, just the same as bids that were not submitted to competitive bidding?

Mr. SMITH. Yes, sir.

Senator WALSH. In the case of negotiated contracts that are not subject to competitive bidding, in some cases they are allowed loss, but I don't think they do in competitive contracts.

Mr. SMITH. No, sir; in competitive bids you offer your bids sealed.

Senator CLARK. In the case of competitive contracts they do not give you any credit at all for any savings you may make by superior methods.

Mr. SMITH. No, sir. In competitive bids or sealed bids, the fact that they are sealed means you may have 20 competitors, or you may not have any—you don't know. You have to bond the job, and if it costs you more money than you bid, it comes out of your pocket. If you make what they call excessive profits, they take part of it away from you.

Senator CLARK. I have in mind a particular case illustrating this, Mr. Chairman. It didn't happen to be a road-building contract; it was a clearing contract. They asked for competitive bids and the successful bidder bid several hundred thousand dollars less than the next lowest bidder, and he bid within $100,000 of the departmental estimate. It so happened that he used different methods; instead of taking in a lot of bulldozers and expensive machinery, he got manpower and performed the operation at a lesser cost than might be anticipated on a negotiated contract.

Mr. SMITH. Yes, sir.

Senator CLARK. Now, they are coming along trying to take away nearly all of his profits on a competitive bid by applying the rule of negotiated contract to that, that is, take away from him all the advantage of his own superior management and superior methods.

Mr. SMITH. Yes, sir; they are working to break down the economics of the construction business, which means to me that the road contractor or any contractor has to have profits from good jobs to offset the losses on bad one, and if he doesn't, he will go broke.

Senator CLARK. And they are also trying to do away with the whole theory of competitive bidding?

Mr. SMITH. Yes, sir.

Senator WALSH. But where there is a joint contract it doesn't allow that to be considered in connection with an individual contract, where the contractor is in the joint and in the individual contract?

Mr. SMITH. That is the inequity we call to your attention. It is very unfair. You can actually have a loss in the year and they can still take money away from you.

Senator WALSH. I think we get your point.

Mr. SMITH. The act is unfair to the contractor, for it provides that the Government can require a refund of profits, but does not allow the contractor to be reimbursed for any loss which he might suffer. Nor does it allow losses on war contracts to be offset against gains on such contracts in all cases.

The failure of the act to provide definite standards for determining what are excessive profits makes it impossible to assure uniformity of treatment between contractors engaged in the same type of operation.

Needless to say, the hazard of loss is great in a construction contract awarded on a bid basis and the contractor is entitled to a fair and just profit for undertaking the risk. Such risk frequently results in a loss due to factors peculiar to the industry beyond the contractors' control,

such as inclement weather and difficult subsurface conditions, and since the Government will not adjust a contract to take care of any such loss, certainly it should allow a profit on successful jobs sufficient to justify engagement in this hazardous line of business. Every concern of this type, including the oldest and the best, encounter unforeseen and unanticipated conditions over which they have no control, and if contract profits are cut below a reasonable profit, I predict, without fear of contradiction, that it will result in bankruptcy of the industry. Since the act does not provide with any degree of certainty what sort of standard of yardstick is to be applied in demonstrating profits, it is impossible for the contractor to ascertain in advance what amount of profit will be allowed. From a financial point of view, this uncertainty seriously handicaps the contractor in obtaining bank credits and in establishing policies governing dividends and reserves.

Another important point is that the effect of this act is to allow the contractor his cost plus a percentage over cost. This removes the incentive for efficient and economical operations by treating the efficient and inefficient alike.

Senator CLARK. On these cost-plus contracts there is no element of risk whatever?

Mr. SMITH. No; the Government takes the loss.

Senator CLARK. And therefore on any reasonable theory the holder of a cost-plus contract should be entitled to a very much less percentage of profit.

Mr. SMITH. Yes, sir.

Senator CLARK. Than the competitive-bidder contractor who takes the risk and has to pay his own loss.

Mr. SMITH. Yes; and ordinarily it has worked out that way. The cost-plus job has been handled on small percentages and it has worked out. However, it does not promote efficiency and it does waste manpower.

Senator CLARK. It costs money, manpower, and everything, in the end.

Mr. SMITH. Yes, sir.

A high-ranking officer of one of our governmental construction services made a statement during a conversation with me a few weeks ago which brings this point out very clearly. He stated that since the renegotiation law came into effect he had noticed a number of cases where as soon as the contractor realized that his job was a good one and that he was going to make a sufficient sum of money to be affected by renegotiation, the contractor seemed to lose all interest in the job and began spending his time on a tougher job or on some other phase of his business. You can see that this results in a break-down in efficiency, increase in cost, and delay in delivering the job.

We frankly believe that if the law were amended so that jobs let by competitive bids were not affected by renegotiation, the Government would get the same prices on our work. Because of extra incentive created in the contractor by the fact that he has a small interest in every dollar of profit coming from the job, he would hold down cost and speed up production. As a result he would pay into the United States Treasury more money through taxes alone than through taxes and renegotiation combined under present procedures.

Another thing that gives us concern is that the act, in its present form, leaves to individuals, without restraint the power to conduct our

business. Where legislative authority is delegated, Congress, in our opinion, should prescribe a policy, standard or rules for the guidance of those charged with the responsibility of administration. Needless to say, the act does not establish any fixed standards for determining what are excessive profits.

It is also submitted that the act in its present form, as respects its application to contracts entered into prior to passage of the act is unjust. One of the most sacred things to both man and Government is the validity and sanctity of their contract. If this fundamental of business is broken down, our business and country will be ruined.

While I do not have the exact figures, it would seem that the number of persons charged with the duty and obligation of administering the Renegotiation Act requires a substantial pay-roll expense. The act now applies to eight departments of the Federal Government, and each of these departments have set up individual administrative agencies.

Senator CLARK. You would be willing to have this exemption you are talking about not applied, where there is collusion?

Mr. SMITH. Certainly.

Senator CLARK. That has been to the Government a very important element, particularly in shipbuilding. That is, you would be willing to have the qualification that that should not apply where there is evidence of collusion?

Mr. SMITH. Yes, sir.

Senator CLARK. In other words, what you are talking about is bona fide competitive bidding?

Mr. SMITH. Bona fide competitive bidding. If there is any evidence of collusion, of course, the courts will handle that and in case you don't think you have sufficient competition, that the prices are too high, a man can be called in and it can be turned into a negotiated contract. You can call in the prospective low bidder and negotiate with him and put it under the renegotiation law.

This would appear to be a duplication of expense and effort. It is believed that the governmental expense incurred in the collection of renegotiation refunds represents a large portion of money recovered. It would also be astounding, if the figures were available, to ascertain the amount of time, which is so precious at present, consumed by company executives, as well as Government and military officials, when that same amount of time could be used so advantageously by increasing production and promoting our war efforts. In this connection it should also be remembered that our manpower shortage is becoming more and more acute every day.

It is even suggested that some of our essential airplane factories might have to be closed down due to manpower shortage. Surely, in these trying times, it would be far wiser to utilize the manpower which is now administering the Renegotiation Act in the production of war materials or military service, particularly so, when approximately 79 to 90 percent of excessive profits will be recovered under the Revenue Act.

Senator CLARK. While you speak for the highway and airport construction industry, what you say applies to everybody who is engaged in competitive bidding.

Mr. SMITH. It really does, sir.

Senator CLARK. You are not qualified to speak for them, but what you say applies to everybody who is engaged in competitive bidding as against negotiated contracts; is that correct?

Mr. SMITH. Yes, sir; that is correct.

Gentlemen, I have endeavored to present to you, as briefly and clearly as possible, the predicament of the highway and airport construction industry. As previously pointed out, we are opposed to unreasonable profits and our position in appearing before your committee is only one of seeking relief from a situation which threatens to retard and impede the completion of essential war facilities and at the same time constitutes a direct and real threat to the American system of free enterprise.

In consideration of the foregoing, we respectfully petition this committee for relief and ask your favorable consideration of the following changes in the renegotiation law.

We feel that all of the changes in the present law which are proposed in H. R. 3687 are beneficial to our industry and should be seriously considered by this committee. However, there are other modifications which we wish to propose.

That a provision be inserted making it mandatory upon the War Contracts Price Adjustment Board to exempt from renegotiation all construction contracts upon which sealed bids or sealed offers have been received. We submit that the purpose of the renegotiation law was to prevent excessive profits in the sale of war materials to the Governmnt, the prices of which could not be ascertained with reasonable certainty in advance either because the article had not been manufactured before or had never been made in the huge quantities which the war demanded. The construction industry, however, operates no differently today than it did in the years before Pearl Harbor; therefore a contracting officer was in just as good a position to determine in advance whether a low bid was fair and in the best interest of the Government before as well as after Pearl Harbor. Having received sealed bids or sealed offers and having awarded the contract to the qualified low bidder, in all fairness, should prohibit the contract from being reopened at a later date. If the contracting officer did not think that the low bid was fair and equitable he could have imposed upon the low bidder the necessity of performing the work either on a cost-plus-a-fixed-fee basis or through negotiated contract. Thus the war effort could not be held up.

That a provision should be inserted premitting a contractor to carry over losses incurred in one fiscal year into the following fiscal year as a deduction from profits made in the second year and also permitting a contractor to carry back losses incurred in one year as a credit against profits made in the prior year. The intent of the law, we think, was to prevent excessive profits during the war period and not to reflect a loss upon a contractor who had a real good year and then a real bad year.

That all competitively bid contracts entered into prior to April 28, 1942, be exempted from the act.

Senator CLARK. Why did you fix that date?

Mr. SMITH. That was the date the renegotiation law was put into effect, and we think it should not be retroactive. If it is not written in your contract, when you make it, there is no reason to change it after it is made.

Senator CLARK. Wait a minute. There is a reason, as I see it, for not making the provision for renegotiation retroactive as to competitive contracts, but as I understand your proposal here, you are asking for the exemption of all contracts.

Mr. SMITH. No, sir; this applies to jobs let competitively. Any job let under a negotiated contract could be renegotiated.

Senator CLARK. The theory being there that the negotiated contracts were made in contemplation of renegotiation?

Mr. SMITH. Yes, sir.

Senator WALSH. The reason for that was it was pointed out the contracts were made and contracts negotiated before that time.

Mr. SMITH. Yes, sir.

That a contractor's renegotiation should include all of the war contracts completed in a fiscal year and also his share of any joint venture, known as coadventures, in which he was involved during the same fiscal year. As the law is now being administered it is quite possible for a contractor to make a profit on a joint venture, have it renegotiated and the excessive profits returned while at the same time he was suffering losses on his individual war contracts and the Renegotiation Board refusing to consider the individual contracts jointly with the coadventure.

In other words, you can actually use money on your year's business and they will still claim you owe them money in excess profits and take more money away from you.

Senator CLARK. Just a minute. I am not certain I understand that. Suppose you are engaged in the construction business; you engage in certain business on a competitive basis and make money on it. That is out. Then you engage as a joint operation in certain other contracts.

Mr. SMITH. I am speaking entirely of war contracts.

Senator CLARK. I understand, but in this proposition you are undertaking to make a joint return so far as the Government renegotiation?

Mr. SMITH. Yes, sir.

Senator CLARK. I don't see any reason for that. In other words, I don't think you can eat your cake and keep it, too.

Mr. SMITH. Here is the story. As road contractors in our industry, there are jobs that come up—I am an asphalt contractor, and there is a large cantonment to be let and I want to bid on the asphalt work in connection with that job, and I combine myself with another contractor who is a concrete paving contractor, and we bid the job jointly. We have operated this way throughout the years. We will bid in the name of both companies, and maybe the job is so large that neither one of us are financially strong enough or have sufficient equipment to do it alone, so we combine and bid the job. On my particular part of the job, the units that I bid on can easily be separated. I do my part of the work, and the concrete contractor does his part of the work, and when the estimate comes in it can be split so many dollars to me and so many dolars to him. So far as the profits on that job are concerned, that is just like a subcontract, but in this renegotiation set-up, when you act now as a coadventurer, and sometimes you are invited to do it by the Government, they want that considered separately and at the same time I am doing a job as a coadventurer with another contractor, I may have war contracts of my own individually, and I may make $100,000 on those

jobs. I may lose $100,000 on the job that is the coadventure job. Then the renegotiation board will not let them be lumped together. They will take the profits away from me on my individual job and I have to stand the loss on the job where I am a coadventurer. There is no reason, it is all the same work—there is no reason it should not be lumped together and one compensate for the other, or offset the other. There is no fairness in it. We didn't intend to break a man or take unfair advantage of him when we set the law up.

Senator WALSH. I believe the law permits you to combine a series of individual contracts for renegotiation.

Mr. SMITH. Yes, sir.

Senator WALSH. But where there is a joint contract, it doesn't allow that to be considered in connection with an individual contract, where the contractor is in the joint and in the individual contract?

Mr. SMITH. That is the inequity we call to your attention. It is very unfair. You can actually have a loss in the year and they can still take money away from you.

Senator WALSH. I think we get your point.

Mr. SMITH. In concluding, we would like to say that we hope our objections to the renegotiation law in its present form have been substantiated and that this honorable body will see fit to grant us relief from a burdensome statute which threatens our very existence. We realize that this is a tremendous problem and hope that you, in your wisdom, will be able to save our industry.

Thank you.

Senator WALSH. Mr. Wolfe, do you wish to amplify this?

Mr. WOLFE. Yes, sir.

STATEMENT OF H. E. WOLFE, PRESIDENT, H. E. WOLFE CONSTRUCTION CO., ST. AUGUSTINE, FLA.

Mr. WOLFE. It will take me just a minute. I want to call the committee's attention to my experience with renegotiation. This comes from a joint contract entered into between the H. E. Wolfe Construction Co. and J. B. Michael Co. for work done at Smyrna, Tenn., the contract totaling approximately four and a half million dollars.

Senator WALSH. That was for the Army and Navy?

Mr. WOLFE. An Army project.

Senator WALSH. Competitive bidding?

Mr. WOLFE. Competitive bidding. We were told that our bid was approximately $600,000 under the second bidder. We went to work and performed the work. Now, the contracting officer said to us that our work was performed in a most efficient and satisfactory way.

Soon after we had completed the job the contracting officer told us the renegotiation law had been passed and asked us to submit a statement of our work, which we did, and he reviewed the figures and said he did not consider we made excessive profits.

Then we were summoned to Atlanta on several occasions and then to Washington and then back to Atlanta and then to Nashville on one occasion, with the result that we were told we made $214,000 in excess profits. We were not told by what method they arrived at this, neither were we permitted to see the figures as they were compiled by the renegotiator.

Following this conference, on November 10—I would like to submit this for the record—we received a letter from the War Department, in which the Under Secretary of War said that a unilateral agreement had been entered against us, jointly and severally, in the amount of $214,000; that methods would be pursued to try to collect.

Senator CLARK. You have received all your money under the contract?

Mr. WOLFE. We had already received the money.

Senator CLARK. Had you any other contract with the Government?

Mr. WOLFE. Not jointly; no, sir.

Senator CLARK. In some cases I learned that the amount was assessed against other contracts.

Mr. WOLFE. That is right.

(The letter referred to is as follows:)

WAR DEPARTMENT,
OFFICE OF THE UNDER SECRETARY,
Washington, D. C., November 10, 1943.

Subject: Renegotiation of H. E. Wolfe Construction Co., Inc., and J. B. Michael & Co., joint contractors and coadventurers on War Department contracts W-612-eng-688, W-612-eng-753, and W-612-eng-733 pursuant to section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended

H. E. WOLFE CONSTRUCTION CO., INC., and J. B. MICHAEL & CO.,
Joint Contractors and Coadventurers.
(Attention: Mr. H. E. Wolfe.)

GENTLEMEN: I have reviewed and given careful consideration to the matters raised by you at your meeting of October 21, 1943, with Mr. Amberg in connection with the renegotiation of contracts W-612-eng-688, W-612-eng-753, and W-612-eng-733 with the War Department Price Adjustment Board and have reached the conclusion that the proposal heretofore made to you by the War Department Price Adjustment Board should be affirmed. I have therefore made a unilateral determination that $214,000 of the prices and profits realized by H. E. Wolfe Construction Co., Inc., and J. B. Michael & Co., joint contractors and coadventurers on War Department contracts W-612-eng-688, W-612-eng-753, and W-612-eng-733 subject to renegotiation pursuant to the provisions of section 403, are excessive. A copy of such unilateral determination is inclosed herewith.

Very truly yours,

ROBERT P. PATTERSON,
Under Secretary of War.

DETERMINATION OF EXCESSIVE PROFITS, PURSUANT TO SECTION 403 OF THE SIXTH SUPPLEMENTAL NATIONAL DEFENSE APPROPRIATION ACT, 1942, AS AMENDED

Whereas H. E. Wolfe Construction Co., Inc. (hereinafter called "Wolfe") and J. B. Michael, an individual trading as J. B. Michael and Company (hereinafter called "Michael") as joint contractors and coadventurers, hold contracts with the War Department subject to renegotiation pursuant to the provisions of section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended (hereinafter referred to as the Act), said contracts being:

W-612-eng-688 as modified and amended
W-612-eng-733 as modified and amended
W-612-eng-753 as modified and amended

and

Whereas renegotiation has taken place between the Under Secretary of War and Wolfe and Michael, pursuant to the provisions of the Act, for the purpose of eliminating excessive profits realized by Wolfe and Michael under said contracts; and

Whereas, as a basis for said renegotiation, the Under Secretary of War considered financial, operating, and other data, submitted by Wolfe and Michael or obtained by the Under Secretary of War from governmental or other reliable sources, relating to the profits realized by Wolfe and Michael under said contracts; and

Whereas Wolfe and Michael have each been granted full opportunity to submit such additional information and to present such contentions as either of them deem material in determining the excessiveness of said profits and the renegotiability of such contracts, at hearings of which due notice was given and data and information so furnished or obtained and each of the contentions so presented;

Now, therefore, pursuant to the authority and discretion vested in the Secretary of War under the provisions of the Act, and duly delegated to the Under Secretary of War under subsection (f) thereof, it is hereby found and determined:

That $214,000 of the profits realized by Wolfe and Michael under said contracts are excessive.

That in connection with the payment or discharge by any means of the amount of excessive profits determined hereby to have been realized by Wolfe and Michael, they shall respectively be credited with the amount, if any, of which they shall respectively be entitled under Section 3806 of the Internal Revenue Code as computed by the Commissioner of Internal Revenue.

That Wolfe and Michael are directed to repay such excessive profits less such tax credits, if any, to the Treasurer of the United States and that Wolfe and Michael are jointly and severally responsible for such repayment.

That the excessive profits so found and determined shall be eliminated by any of the methods provided in the Act or any combination thereof; and the Commanding General, Army Service Forces, and the Commanding General, Army Air Forces, are hereby authorized and directed to take any and all action which may be necessary or desirable to effect such elimination.

ROBERT P. PATTERSON,
Under Secretary of War.

NOVEMBER 10, 1943.

Mr. WOLFE. Following this letter, I received a letter from the United States engineers, which I would like to submit for the record.

(The letter referred to is as follows:)

WAR DEPARTMENT,
UNITED STATES ENGINEER OFFICE,
Jacksonville, Fla., November 30, 1943.

H. E. WOLFE CONSTRUCTION CO., INC.,
St. Augustine, Fla.

GENTLEMEN: The Secretary of War in a unilateral determination of excessive profits dated November 10, 1943, has found that H. E. Wolfe Construction Co., Inc., and J. B. Michael & Co., joint contractors and coadventurers under War Department contracts W-612 Eng. 688, 733, and 752 have realized excessive profits in the amount of $214,000 and directs the withholding of this amount from moneys due or to become due to H. E. Wolfe Construction Co., Inc.

In accordance therewith, the following amounts approved for payment and due you under existing contracts are being withheld by this office pending further instructions from the War Department Price Adjustment Board:

CONTRACT W-436 ENG. 10210 COVERING CONSTRUCTION AT MACDILL FIELD, FLA.

Estimate No. 9, period Oct. 16-31, 1943	$39,955.07
Estimate No. 10, period Nov. 1-15, 1943	45,003.38
Total	84,958.45

CONTRACT W-436 ENG. 10264 COVERING CONSTRUCTION AT WEST PALM BEACH, FLA.

Estimate No. 6 (final), period July 26 to Oct. 27, 1943 (total)	$29,709.65

CONTRACT W-436 ENG. 10627 COVERING CONSTRUCTION AT PINECASTLE, FLA.

Estimate No. 2, period Sept. 30 to Oct 15, 1943	$10,630.60
Estimate No. 3, period Oct. 15-30, 1943	17,248.57
Estimate No. 4, period Oct. 30 to Nov. 15, 1943	17,864.51
Total	45,743.68
Grand total withheld	160,411.78

You will be informed promptly of any adidtional amounts withheld pursuant to the above-described determination.

Very truly yours,

D. W. GRIFFITHS,
Colonel, Corps of Engineers,
District Engineer.

Mr. WOLFE. This letter advised me that this amount of money would be withheld from the H. E. Wolfe Construction Co., the total amount being $214,000. We have already paid taxes on the profits that are accrued to us from this contract. I think we had a two-thirds interest. Now they are withholding this $214,000, which is more than 20 percent of the total worth of the H. E. Wolfe Construction Co. We have other contracts with the Government. We depend on collecting for our work to carry on our business, and it finds us in a rather embarrassing position to have this money withheld.

We wrote to the Under Secretary, and I would like to submit a copy of that letter.

(The letter referred to is as follows:)

JACKSONVILLE, FLA., *November 19, 1943.*

HON. ROBERT P. PATTERSON,
Under Secretary of War,
War Department, Washington, D. C.

DEAR SIR: In response to your letter of November 10, 1943, entitled: "Renegotiation of H. E. Wolfe Construction Co., Inc., and J. B. Michael & Co., joint contractors, and coadventurers on War Department contracts W-612-eng-688, W-612-eng-753, and W-612-eng-733 pursuant to section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended."

As you know, these parties have all along protested renegotiation of these contracts because, as we see it, the statute relied on is inapplicable in the circumstances of this case. We now renew that protest. Subject to this protest we would welcome a judicial review of the entire controversy, and I have to suggest that Government counsel in conference with Mr. Upchurch and myself endeavor to prepare an agreed statement of facts upon which the rights of the parties concerned may be expeditiously presented to the proper Federal courts for determination. We do not wish to be understood as conceding that if there were liability it would be a joint and several liability.

GEORGE C. BEDELL,
(Speaking in behalf of H. E. Wolfe Construction Co., Inc., and J. B. Michael & Co.)

Mr. WOLFE. As I said, we wrote a letter to the Under Secretary, proposing to sit down in conference and arrive at a statement of facts. So far we have not had a reply to that letter.

Senator WALSH. When did you send the letter?

Mr. WOLFE. November 19. This is our experience with renegotiation. It is designed, it looks to me, to put us out of business.

Senator CLARK. Mr. Wolfe, isn't this the crux of your contention, leaving out the details of this particular contract, that as to negotiated contracts in general, and particularly as to cost-plus, fixed-fee, and cost-plus contracts, the Government puts itself in the position of insurer against loss?

Mr. WOLFE. That is right.

Senator CLARK. Whereas in the case of a competitive contractor, he takes his own insurance against loss, and he must necessarily take that into consideration in making his bid?

Mr. WOLFE. That is right.

Senator CLARK. And the position of the competitor is not at all the same as that of a contractor under a negotiated contract, and that the

renegotiation theory, and the renegotiation statute essentially was to take out the surplusage that would come in through these negotiated contracts, and particularly through the cost-plus, fixed-fee, and cost-plus-percentage contracts, which does not apply to you.

Mr. WOLFE. That is correct.

Senator CLARK. That is the crux of the whole business, isn't it?

Mr. WOLFE. That is right.

Senator WALSH. The matter is still pending with the renegotiators?

Mr. WOLFE. Well, they have frozen my money. I don't know whether it is pending or not.

Senator WALSH. I should say it was pending until you get it.

Mr. WOLFE. And as I stated, that represents more than 20 percent of our entire worth.

Elaborating a little further on what Mr. Smith said, we wrote to the Board and asked permission, if we were going to be renegotiated, to take out the two-third interest in this contract and throw it in with the other contracts that we had and renegotiate it on an over-all basis, but we were refused that permission.

Senator CLARK. Mr. Wolfe, do you know who actually turned you down on your proposition?

Senator WALSH. He had correspondence with the Under Secretary.

Senator CLARK. Well, we had some correspondence put in here from the Under Secretary the other day. I have an idea the Under Secretary doesn't know very much about these contracts. What particular fellow turned you down? I would be interested to know that.

Mr. WOLFE. We have met with several boards. The first board we met with was in Atlanta; from there we went to Nashville and there we met with Mr. Loving and Mr. George B. Heels. Following that meeting we came to Washington and met with a board here, headed by Major Jewet. We had two meetings here in Washington and went back to Atlanta and had two more meetings over there, and I was so busy I couldn't attend the remaining meetings, so I sent my representative, but I understand that Mr. Heels was the chairman of the board and the same board was there.

Senator CLARK. Was there anybody on any of these boards that ever built any roads or knew anything about this business?

Mr. WOLFE. Those I knew haven't built any. I didn't know all the gentlemen on the board.

Senator CLARK. There may have been a few sleepers around that had built them, that you didn't know about.

Mr. WOLFE. I didn't know all the gentlemen on the board.

I thank your honors, Senator.

Senator WALSH. We appreciate your appearance.

Mr. Shreve.

STATEMENT OF EARL O. SHREVE, CHAIRMAN OF THE GOVERNMENT CONTRACT RELATIONS SUBCOMMITTEE OF THE WAR COMMITTEE OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

Senator WALSH. You are vice president of the General Electric Co.?

Mr. SHREVE. Yes. I am representing the National Association of Manufacturers on renegotiation.

Senator WALSH. You represent the latter organization rather than the General Electric Co.?

Mr. SHREVE. That is right, Mr. Chairman.

Mr. Chairman and gentlemen, industry is in thorough accord with the view of Congress that there shall be no inordinate profits made out of this war. We have sincerely and earnestly registered our opposition to war profiteering. Months before Pearl Harbor, the National Association of Manufacturers took a firm position on this principle.

The National Association of Manufacturers has studied the renegotiation statute knowing that every honest manufacturer wants just one thing—victory—and as quickly as humanly possible. American manufacturers will provide enough arms and equipment—unexcelled by any fighting nation—on time to win that victory.

We appreciate that your committee is well acquainted with the history of this statute, and its stated purposes. To conserve your time, therefore, we have tried to reduce our recommendations to a statement of specific objectives.

In reviewing this statute, we recommend that your committee give serious consideration to these suggestions:

I. We submit that, since the present tax structure has demonstrated its effectiveness in recovering excessive profits, there is no longer any need of a separate renegotiation statute for this purpose. We recommend withdrawing the authority to recapture profits already earned. Our suggestion has been that January 1, 1943, be considered as the effective date for suspending the recapture provisions of the Renegotiation Act.

Many reasons support this recommendation, but I refer you to these which are more important.

First, the Revenue Act of 1942, the effects of which were unknown at the time of enactment of the renegotiation statute, has accomplished very effectively the "recapture" of corporate profits. The increase of the excess-profits tax from its maximum of 60 percent at the time the statute was enacted, to its present maximum of 90 percent has been responsible for this result.

The following table of manufacturing profits and taxes clearly reveals the effectiveness of the Revenue Act of 1942 in recapturing excessive war profits.

Sales, taxable net income, Federal taxes, and net after taxes for all manufacturing corporations

[In millions of dollars]

Year	Receipts	Net income before taxes	Total taxes	Net income after taxes	Net income after taxes as percent, gross	Net income before taxes (percent)
1941	92,531	9,612	5,078	4,534	4.9	53
1942	119,676	12,112	8,684	4,428	3.7	66
1943	[1] 145,000	[1] 14,400	[1] 9,900	[1] 4,500	3.1	69

[1] Estimates based on National Association of Manufacturers compilations of reports from 2,296 companies.

Source: Figures for 1941 and 1942 are from the Department of Commerce, Survey of Current Business, June 1943.

This table conclusively shows how effectively present taxes prevent any excessive profits. Expanding volume of manufacturing activity

in the past 2 years has not been accomplished by an expanding volume of manufacturing net profits after taxes. The rate earned on sales has steadily declined.

As a matter of fact, the major portion of the amounts which have been returned to the Government by the process of renegotiation would have been recovered in excess-profits taxes.

In addition, your committee is well aware that substantial amounts have been returned by war contractors through voluntary refunds.

Second, the effect of renegotiation in the case of the post-war reserve provision and other relief provisions provides an excellent illustration of the danger of nullification of congressional intent by action of administrative agencies.

Congress last year, after careful deliberation, declared in order to safeguard industry's ability to reconvert quickly to peacetime production and to provide civilian jobs at the war's end, that taxpayers should be permitted to retain as a tax-free post-war reserve 10 percent of the excess-profits tax levied.

The renegotiation law nullifies all the care and exactness with which legal provisions creating this reserve have been written.

You gentlemen readily understand that whatever is taken before taxes by renegotiation reduces the amount of profits subject to excess-profits tax, and therefore the amount of the 10 percent of excess-profits taxes which is to be retained for post-war employment.

As a result, a company's post-war reserves are determined in the final analysis not by Congress but by administrative action—seeming, in effect, to delegate taxing powers to an administrative agency.

It would be theoretically feasible for the entire post-war reserve to be wiped out by renegotiation.

Actually, reserves have been substantially reduced in this way in many cases.

I repeat, I think this is one of the best examples I can think of to illustrate what happens when Congress delegates taxing authority to individuals and substitutes their judgment for the language of the law.

Third, industry and procurement officers alike now have adequate cost experience on all but a relatively few products so that they can establish more exact cost estimates than were formerly possible. As a result, initial contract prices can be set at proper levels. While it has been true that many companies were called upon to make articles previously unknown to them or to make known articles in volumes exceeding all past production records; these conditions, if they should recur in the future, will doubtless recur in only a relatively few instances.

This third reason was recognized in the recommendations of the Special Senate Committee Investigating the Defense Program. In part 5 of its report No. 10 that committee stated:

> 7. An important objective of renegotiation should be the writing of its own death warrant by utilization of early war experience in late war contracting.

We recommend that with the replacement of the recapture clause by the revenue act, the forward pricing policy and voluntary price reductions be retained. If there be any doubt that such authority exists, it should be clearly outlined in the statute.

This procedure is suggested in conformity with our conviction that the determination of prices is a function of procurement, while the determination of final profits is a function of taxation.

If it should be the decision of this committee or Congress that these basic revisions of the statute are not feasible at this time, we recommend the following amendments:

Reducing the number of contracts subject to renegotiation by amending the statute.

(1) To include the definition of subcontractor originally proposed by the War Department. This definition excludes orders or agreements to furnish (*a*) raw materials; (*b*) standard commercial fabricated or semi-fabricated articles ordinarily sold for civilian use; and (*c*) articles for the general operation or maintenance of the contractor's plant.

(2) To exempt orders or agreements to furnish standard commercial fabricated articles ordinarily sold for civilian use.

Exemptions of these contracts should be specifically stated in the law, and not left to the discretion of the Price Adjustment Boards.

Court review: In our opinion, a renegotiated company should have the right of judicial review of determinations made by the Price Adjustment Boards. To make that review effective, provision should be included that funds due the manufacturer under his contract cannot be withheld by the secretaries until final action by the court.

Full allowances should be made for the estimated tax liability of a contractor, in determining profits subject to renegotiation. It is completely unrealistic to assume that there is any such thing as "profits" before payment of taxes. Therefore, we recommend that renegotiation be after taxes.

The Price Adjustment Boards should be required to observe definite standards in determining excessive profits, and in this connection, Congress should direct the Price Adjustment Boards to give special weight to the financial condition, history, and fiscal policies of the particular company being renegotiated, instead of placing too great reliance on comparison with other companies in the same industry.

We recommend that provision be made to protect renegotiated companies against losses in future years. Recaptured funds should be held in escrow by the Treasury for the account of the renegotiated company, to cover possible losses in subsequent years in which renegotiation may occur.

As industry is faced with the now imminent prospect of cut-backs or terminations of Government contracts, a provision of this nature becomes exceedingly important.

Allowances for post-war reserves: This subject has, as you know, been discussed at some length. We recognize that it is a matter primarily to be handled in the tax bill, which it is not my purpose to discuss, but I do urge that if it should be made a part of the tax bill, Congress should direct that it be an allowable deduction for purposes of renegotiation. In fact, we urge a definite amendment under which Price Adjustment Boards would be required to allow in the renegotiation procedure all items of deductions and exemptions allowed for tax purposes.

Steadfastly opposed to profiteering, industry is deeply concerned with building peacetime economy which will provide a maximum of jobs. We are determined to maintain our war record of production in days of peace. Industry can attain this goal only by having the necessary working capital available and ready to put to work at a moment's notice.

We endorse the proposal that the Price Adjustment Board must, upon request of the contractor or subcontractor, furnish a statement in writing of its determination of the facts used as a basis therefor, and of the reasons for such determination.

If the filing of financial data with price adjustment boards is to be made mandatory within a prescribed period of time, then we urge an amendment requiring the price adjustment boards to proceed with renegotiation within 6 months after the filing of such data. Otherwise, the company should be deemed not subject to renegotiation.

Assuming that repeal at this time is not feasible, we nevertheless recommend an amendment that will fix a definite time for terminating the Renegotiation Act. Provision in the present bill making termination of the statute dependent upon cessation of hostilities as proclaimed by the President or concurrent resolution of Congress is too uncertain.

(The following statement was submitted for the record:)

STATEMENT OF PAULSEN SPENCE TO THE COMMITTEE ON FINANCE OF THE SENATE OF THE UNITED STATES

Mr. Chairman and gentlemen of the committee, my name is Paulsen Spence. I am the founder of the Spence Engineering Co., Inc., of Walden, N. Y. Our company manufactures automatic steam regulators, and allied equipment. To date we have manufactured only our standard line. We have had more orders offered to us than we have been in a position to accept.

The recommendations I am about to make are based on the belief that the great majority of the Members of the Congress, reflecting the opinion of the great majority of our citizens, believe:

1. That no action should be taken by the Congress that would retard the production of those goods that our fighting men need to successfully wind up this war in a hurry.

2. That we should not only retain private enterprise but endeavor to make it more equitable and encourage it to produce full employment in the future.

3. That the national debt should be liquidated as promptly as practical after the emergency has passed.

As I am concerned primarily with excess-profit taxes on a small corporation, I would like to suggest that for the purpose of levying excess-profits taxes you divide corporations into the following groups:

Group 1: Corporations having an invested capital of more than $100,000,000, which I shall refer to as "super corporations."

Group 2: Corporations having an invested capital of between $15,000,000 and $100,000,000, which I shall refer to as "large corporations."

Group 3: Corporations having an invested capital of between $1,000,000 and $15,000,000, which I shall refer to as "medium corporations."

Group 4. Corporations having an invested capital of less than $1,000,000, which I shall refer to as "small corporations."

I have arbitrarily divided these corporations on this basis from my personal observation of many corporations. I believe this to be their proper classification.

I have no opinion as to what excess-profits taxes should be exacted against super and large corporations. They doubtless will be represented by learned men who can give you complete information regarding their problems.

In my testimony before the Senate Finance Committee (see p. 453 of hearings on H. R. 7378, Revenue Act of 1942) I stated that our company anticipated total sales in 1942 of $464,341.32, with a net profit of $50,500. Actually we delivered $502,510.07 but, due to the fact that the excess-profits tax removed all incentive for efficiency, our net profit was only $20,602.07. We paid Federal taxes of $13,120.23 (before renegotiation).

We have the necessary plant facilities, technical staffs, and manpower available to easily turn out $1,000,000 per year; but, inasmuch as the excess-profits tax law would take 90 percent of all earnings above the $20,000 figure mentioned, we would not have the working capital necessary to finance this increased volume of business.

The invested-capital method is not equitable, as it makes no allowance for a corporation that knows how to turn out a large volume of work with a small invested capital. In other words, it put a premium on inefficiency.

The average earnings method is not equitable, as it makes no allowance for thousands of small corporations connected with the capital-goods industry. For example F. W. Dodge's reports shows that the construction industry with which our company is connected was comparatively quiet between 1929 and 1941.

Had we been able to retain 60 percent of our earnings we could then anticipate sufficient working capital to turn out the $1,000,000 volume mentioned; and had we been able to retain 60 percent of our profit the incentive for efficiency would have been there and our net profit probably would have reached the figure of $108,000. On this basis the Treasury would have received $43,000 instead of $13,000. Had we been able to salt away $65,000 in 1942 we would have been able to increase our production in 1943 to approximately $1,500,000 which would mean that, on the same basis, the Treasury would receive $65,000 taxes in 1943. It looks to me as if the Congress is "penny wise and pound foolish."

In the minds of many it is more important to prevent us from making a little money than it is to allow us to pay more dollars in taxes and provide future jobs, in other words, they wish "to cut off their noses to spite their faces." They seem to be unable to realize that it is only business that produces income. There is no other source. It is business that makes the wheels go around. No saying was ever more axiomatic than "What helps business helps you."

It is rather paradoxical that those who are most vociferous in their solicitude for labor are the same ones who demanded the excess-profit tax. One wonders if they are really solicitous of labor or if they are using this as a blind to bring about a totalitarian socialism.

These 2 years would have added $151,000 to our working capital and with this additional working capital we could go right ahead with a number of new products that we have developed and are ready to market as soon as the emergency is passed. This would mean that, instead of reducing our employees from approximately 100 to probably 50, we would have been able to increase our employment to probably over 200. This would not only have insured jobs for all of our servicemen when they return but would have given jobs to other people employed in strictly war plants.

1. Some will argue that our increase in business is due entirely to the war. This is not true because if there had been no war, our volume would be about equal to what it now is. Furthermore, our product is of a permanent nature which means that every one we sell now, will be one less to be sold after victory. To be consistent, these same persons should argue that most of the high wages paid to workingmen are the result of the war and therefore the Federal Government should confiscate all their increased dollar "take home."

2. Others will argue that ours is an isolated case, that we should apply for relief under section 722. Our case is not isolated, but typical of thousands of small corporations. Section 722 is too vague and relies entirely on the discretion of the Treasury which in its testimony before your committee has indicated that it is not concerned with the solvency of small corporations. Furthermore, the war will have been won before the Treasury acts on 722 and the relief will be of no advantage to the war effort.

I would venture to predict that if the Congress should see fit to follow my recommendation the net dollar tax that will be paid into the Treasury during the next 10 years, by small corporations, their employees, and persons living in their respective communities will be 10 times that of the amount that will be paid if the present law is retained.

The present tax law probably unintentionally tends to favor the supercorporations and to penalize the small corporations. If a corporation doing a billion dollars worth of business is allowed to retain 2 percent of its earnings it would have $20,000,000 left. With $20,000,000 they could buy out or start up twenty $1,000,000 concerns.

I believe that most thoughtful students of the situation agree that the principal cause of our economic dislocation is that the control of the economic system is being more and more concentrated and unless this concentration is halted some form of a totalitarian socialism is inevitable. If we wish to retain constitutional government we must have private enterprise, and private enterprise cannot continue to exist where 396 supercorporations own 44 percent of the corporate wealth of the United States.

B. If we are going to expand our economy in order to create more employment, most of this expansion will be by corporations. Surely our large and super-corporations are large enough. New corporations will in the main come under the heading of small corporations, so the only possible avenue of expansion that is left is the small and medium corporation. Small and medium corporations cannot expand without capital and as I have already pointed out, capital can only be secured from earning.

I, therefore, submit that public interest demands that no excess-profits tax be exacted from any corporation having less than $1,000,000 invested capital; any that only a graduated tax should be exacted from corporations having an invested capital between $1,000,000 and $15,000,000.

Alternatively, I have the honor to suggest that you allow any corporation with an invested capital up to $1,000,000 to earn 10 percent on its net sales without exacting an excess-profit tax and/or renegotiation. There would be no objection to renegotiation if the law was definite, but as it is it is, "delegation run wild." Surely 10 percent net is not excess profit.

In lieu of the suggestion made above you might wish to consider the desirability of exempting from excess-profits taxes that part of the income of small corporations, not exceeding 10 percent of the net sales, that is reinvested in the business.

Another deterrent to full production which has probably escaped your notice is the question of excess inventories. Many small corporations like ourselves, in order to be reasonably prompt in their deliveries, require large inventory. If Germany should suddenly surrender and our unfilled orders were to be canceled we would be hard put to find enough cash to pay our present taxes. Some provision should be put in the law so that under such circumstances the Federal Government would take over this excess inventory and credit it against our taxes.

It seems to me that all this talk about "the Government providing jobs" is just so much nonsense. How is a Government with a $200,000,000,000 debt going to provide any jobs? It is impossible to overemphasize the fact that taxes will only be paid by a prosperous business and business cannot be prosperous as long as Congress enacts "heads I win, tails you lose" tax legislation."

I wish to reiterate that if the Congress insists on confiscating practically all the earnings of small corporations, the following will happen:

(*a*) The Treasury will receive mighty few dollars in taxes after the calendar year of 1944.

(*b*) Millions of workingmen and returning veterans will be tramping the streets looking for jobs.

In my testimony before your committee last year I endeavored to show you what would happen if a confiscatory tax was levied against small corporations. The figures I have cited proves that my statement was correct. Had the Congress not been so greedy, the Treasury would have received many thousands of dollars more than it did from the Spence Engineering Co., Inc., and thousands of other small corporations.

This is the time to inject some horse sense into the tax law. It should have been done in 1941. Put it off another year and irreparable damage will be done to our economic system.

Ours is a typical, small-town, American enterprise that has been built up under the patent system. Our pay roll is an important source of income for the community. Practically all profits made by this corporation from its inception have been plowed back into the business. This confiscatory excess-profit tax will harm the working and trades people of Walden a great deal more than it will the stockholders of our corporation, because most of the stockholders are so endowed by nature that they will be able to look after themselves even under totalitarian socialism.

Senator WALSH. Mr. Lenihan.

STATEMENT OF JAMES LENIHAN, REPRESENTING THE PAUL SMITH CONSTRUCTION CO., TAMPA, FLA.

Mr. LENIHAN. Mr. Chairman, we are here to respectfully request that the law and the administration thereof be so broadened as to insure that its primary purpose of preventing or recapturing excessive profits may not at the same time be converted in fact to an instrument whereby the Government is unjustly enriched to the serious loss and, too frequently, to the ruin of the contractor. All will agree, I

think that neither Congress nor the executive authorities intend any such harsh and unjust results. And yet, just such results can and do occur.

For example, in our own case the situation is this: Presently there is pending for renegotiation before the Price Administration Section of the South Atlantic Division engineer of the War Department the 1943 business of Paul Smith Construction Co. under contracts with the War and Navy Departments. If it is found that such business resulted in a profit to the company in excess of that permitted by the law, such excess profits will of course be returnable to the Government.

In February 1943 the Paul Smith Construction Co. entered into contracts with the National Housing Agency, Federal Public Housing Authority of the United States, for the construction of two housing projects. These were constructed and completed in the year 1943 and are located within and on the Government reservation at Camp Gordon Johnston, Fla. Without negligence on the part of the company and due to a series of circumstances beyond its control, the company suffered very severe losses on the contract. These facts are attested to by the commanding officer of Camp Gordon Johnston in a letter to the company dated September 1, 1943, a copy of which letter I submit for the record.

In the renegotiation of its 1943 business with the War Department, the company has sought to have due allowance made for its losses on its similar business in 1943 with the Federal Housing Authority. But it has been officially advised that such business cannot be considered and allowed for on the ground that the law prescribed the particular departments and agencies of the Government to the business of which it applies; that the Federal Housing Authority is not among the departments and agencies so designated, and that, therefore, there is no authority in the Board to so consider and allow for the losses sustained by the company under its contracts with that Authority. Copy of that letter, dated September 14, 1943, is submitted herewith.

Here, then, is a situation which, if relief is not accorded, leaves the Government in an anomalous and, we think, an indefensible position. The company in 1943 performed work for the same Government and the work so performed was of the same general kind and character, to wit, construction work. Had the work been done at Camp Gordon Johnston under several contracts with the War Department, those contracts, as well as contracts performed at other camps for that Department, would be considered in the aggregate to the end that, in equity and justice, the over-all allowable profit would be arrived at by an equitable balance of the losses on one contract against the excess profit on another. But here, notwithstanding that the business was of the same general kind and character as that which is the subject of renegotiation under contracts with the War Department, and notwithstanding that the housing is actually located on a War Department reservation and occupied by military and civilan personnel, the business under the contracts with the Federal Housing Authority cannot be considered and no allowance can be made for losses thereon simply because the law mentions the War Department and makes no mention of Federal Housing Authority.

Obviously, we think, no such harsh and unjust results are seriously intended and, of course, they do not comport with any idea of fair dealing between a government and its citizens. We make no objection

to the principle of preventing and recapturing excessive profits on war work; indeed, the principle is essential to the very preservation of orderly and just government. It is to be emphasized, however, that the interested parties are the Government and its citizens and not particular departments or agencies and the citizens, and, of course, the principle necessarily must be grounded in justice, equity, and fair dealing between the Government and its citizens. We submit that where the Government demands, as it has the right to demand, that its citizens in their business with it shall not profit excessively out of its war necessities and efforts, it has the corresponding duty and obligation to see to it that the Government itself shall not profit by technical and fine distinctions as to the presence, absence, or limits of authority of the particular departments or agencies with which the business happens to have been conducted.

We think that, in simple justice, not only to contractors but also to the dignity and honor of the Government, this law should be amended so as to take care of the situation and analogous situations such as that which I have described. We think, too, that the law can be so amended as to create no unnecessary complications in the administration thereof. The appropriate phraseology to be employed in such amendment and the appropriate point for its insertion are, of course, matters which may well be left to this committee and its experts in legislative draftsmanship. As a suggestion, however, we believe that the following would be appropriate.

That there be inserted after line 20, on page 102 of the bill, the following:

(VII) Upon request of the contractor or subcontractor, the losses sustained by such contractor or subcontractor in the performance of work or furnishing of supplies for or to any department, agency, or bureau of the Government whether or not such department, agency, or bureau is specifically mentioned in this act: *Provided, however,* That such losses shall be confined to losses sustained since April 28, 1942.

and that the roman numeral "VIII" be substituted for the roman numeral "VII" in line 21 on page 102 of said bill.

(The documents referred to are as follows:)

WAR DEPARTMENT,
OFFICE OF THE DIVISION ENGINEER,
Atlanta, Ga., September 14, 1943.

PAUL SMITH CONSTRUCTION CO.,
Box 1912, Tampa, Fla.

GENTLEMEN: This will acknowledge receipt of your letter of September 11, 1943, addressed to Col. R. O. Whiteaker of this Price Adjustment Section requesting that your Federal Public Housing Authority contract, project FLA-8181 and 8182, covering construction at Camp Gordon Johnston, Carrabelle, Fla., be considered together with your other 1943 renegotiable business.

Subsequent to discussions in this office, Mr. Harry W. Loving, Chief of the Price Adjustment Section, Office, Chief of Engineers, visited this price adjustment section on August 27 and 28. During Mr. Loving's visit to this office your problem was presented and it was determined at that time by Mr. Loving, speaking on behalf of the Chief of Engineers, that your Federal Public Housing work referred to above cannot be included in your renegotiable business for your 1943 fiscal year.

Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, and the Military Appropriation Act, 1942, approved July 1, 1944, does not provide for the renegotiation of contracts awarded by the Federal Housing Authority. At present, contracts awarded by nine departments or agencies are subject to renegotiation and are listed as follows: War Department, Navy Department, Treasury Department, Maritime Commission, War

Shipping Administration, Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation, and Rubber Reserve Company.

This price adjustment section regrets that regulations do not permit the consideration of this work in the renegotiation of your 1943 business. It is hoped that this explanation is sufficient and that this price adjustment section may expect your continued full cooperation in such matters as you have demonstrated in the past.

For the division engineer:

Sincerely yours,

GEORGE B. HILLS,
Chief, Price Adjustment Section,
South Atlantic Division.

September 1, 1943.

PAUL SMITH CONSTRUCTION CO.
Tampa, Fla.

(Attention Norman F. Six.)

DEAR SIR: Your contract with the National Housing Agency, Federal Public Housing Authority called for the construction of two projects, that is, R IV Initials CBA-Fla-8181 and 8182. Date of beginning construction February 11, 1943, and estimated date of completion April 27, 1943.

(*a*) The above construction has been completed and is located on the Government reservation, Camp Gordon Johnston, Fla.

(*b*) The above projects were constructed for and will be used only by civilian and military personnel in the war effort.

(*c*) Several factors have entered into and caused delays in the dates of completion, as for example: The location of the camp area—the lack of railroad facilities—the lack of interest of subcontractors, due to the location of the camp—the lack of transportation and housing facilities for laborers interested in the construction of the above projects.

(*d*) There has been a constant difference in labor rates as several airfields and the shipyards in Panama City, Fla., are all located within traveling distances of local labor pools. This has meant a tremendous turn-over in various types of labor due to the fact that higher wages were paid by other concerns.

(*e*) In the face of all of these difficulties it is appreciated by this headquarters that your organization has shown a very definite interest and spirit of cooperation in bringing this project to its completion.

(*f*) It appears that the quality of the work in this project has not been slighted even in the face of the above obstacles.

(*g*) The undersigned has had occasion to be in the area during the complete period of construction and I am definitely aware of the above obstacles.

It is my understanding that the date of completion has been extended to September 1, 1943.

While there has been considerable delay in completing the above listed projects it is felt that a big percentage of the delays were caused by conditions over which the contractor had no control.

I am writing you this information so that it may be a matter of record that the undersigned is definitely familiar with conditions as they existed during the above construction period.

Yours very truly,

WALTER E. SMITH,
Colonel, Infantry,
Commanding.

STATEMENT OF HOWARD S. MORRISON, REPRESENTING THE WAUSAU, WIS., GROUP OF PAPER MILL OPERATORS

Mr. MORRISON. Mr. Chairman and gentlemen of the committee, my name is Howard S. Morrison, of Wausau, Wis. I appear in behalf of what is known in the trade as the Wausau, Wis., group of paper-mill operators and lumbermen, which group manufactures bond papers, food containers, kraft paper, and paperboard in Wisconsin, Michigan, and the State of Washington, and also operate several sawmills in the Lake States region and in the West.

At the meeting before the House Ways and Means Committee, Mr. Colin Spencer presented a plea for fair treatment for timber growers in the South and submitted some very interesting pictures of tree growth. I have with me some pictures of a tree plantation in Wisconsin now covering 12,000 acres of plantings by Tomahawk Kraft Paper Co. during the past 12 years. The Mosinee Paper Mills Co. is now contemplating entering into the same sort of undertaking, but there is a question in the minds of some of the directors as to its advisability because of the tax situation.

The Marathon Paper Mills Co. bought a tract of 50,000 acres of land in northern Michigan 20 years ago at a cost of $5.40 per thousand feet. Its carrying charges to date have been $2.25 per thousand feet, from which carrying charges its income-tax benefit has probably been not more than 15 percent of the $2.25, yet as it cuts this timber, which it is doing, the hardwoods into lumber and the softwoods into pulpwood, it is taxed at the top excess-profits rates on the realization of these carrying charges and also the profit between $7.65 per thousand feet and the fair market value of the timber, which value is about $9 at the present time. A capital-gains tax on the difference between $5.40 and $9 would be fair and equitable.

The Wausau group of men have practiced reforestation for many years. One of their companies, the Wisconsin & Arkansas Lumber Co., through a practice of leaving a few seed trees on each acre, made it possible for Southern International Paper Co. to add 150,000 acres of desirable second growth to its holdings in Arkansas. And Wausau Southern Lumber Co. and Marathon Lumber Co., at Laurel, Miss., gave birth to the Masonite Corporation with its enormous acreage of reforestation and its present inestimable value to the war effort.

Unless some encouragement is given to timber owners for the present and future such practices will not continue and no one should expect them to continue.

During the past month I have attended two meetings in which the certified public accountants of lumber concerns have recommended that production be curtailed to the point where the excess-profits credit base is earned and thus prolong the operating life of the company. The proposition in both cases was turned down and urgently needed war production will continue during the duration in spite of the great financial sacrifice involved.

If the difference between the depletion base and the fair market value of the cut timber each year is taxed as a realized capital gain such propositions should not be suggested and no doubt in some cases this would lead to increased production which we are all so desirous of obtaining.

Senator WALSH. Mr. Phillips.

STATEMENT OF ED P. PHILLIPS, REPRESENTING PHILLIPS MACHINERY CO., RICHMOND, VA.

Mr. PHILLIPS. Mr. Chairman, my name is Ed P. Phillips, and I represent the Phillips Machinery Co., a partnership, consisting of Art Backstrom and Ed P. Phillips, of Richmond, Va.

I am just a little fellow; I am not a big businessman.

We handle construction and industrial equipment, selling, servicing, rebuilding, remanufacturing, and leasing both new and used equipment.

I feel that the law is a dangerous one, vicious, un-American, destructive to both industry and Government and is delaying the war effort. The Renegotiation Act has no right of appeal, it is discriminative, impossible of administration, and it represents taxation without representation.

Yesterday afternoon, by accident, I happened to meet two fellow distributors in Washington, one from the west coast and one from the Midwest and we made a comparison of our experience and figures on renegotiation. I want to give you the benefit of that comparison so that you can see just how this law is being administered.

The companies to which I refer have representatives in the audience and they shall be delighted to answer any questions which you may desire them to do.

In my case our profits before taxes were 19.5, and after taxes 4.1; salaries allowed. As partnerships do not have salaries for partners, the renegotiation panel used the drawing accounts of the two partners, which amounted to a total of $20,000 and established this amount as allowable salaries for renegotiating purposes.

Total renegotiable business covering several hundred small contracts and purchase orders, $1,675,204.

The amount of the refund demanded by the War Department before taxes, $170,000.

The refund was demanded in cash, even though we had paid three-quarters of our taxes. I advised them that if they thought I could pay three-quarters of my taxes and also pay them $170,000 in cash, they were crazy.

Senator WALSH. What was the total amount of your contracts that were renegotiated?

Mr. PHILLIPS. $1,675,204. Now, I want to compare my figures with those of the Howard Cooper Corporation.

Senator WALSH. What was the total of his contract?

Mr. PHILLIPS. The total amount of his renegotiable business was $1,780,000.

Senator WALSH. How much did he have to pay back?

Mr. PHILLIPS. He had to pay back $96,000.

They were allowed $70,000 in officers' salaries as compared with $20,000 in partners salaries in our own case.

Senator WALSH. Were you both engaged in the same business?

Mr. PHILLIPS. We are in the same business—renting, selling, rebuilding, and servicing construction machinery.

Here is another important fact: They demanded cash from me. I told them that was impossible. They later made arrangements so that the refund could be paid on or before December 1, 1944, regardless of whether or not I had collected any refunds on my taxes from the Internal Revenue Department. In the case of the Howard Cooper Corporation, they were given 2 years in which to make payments on their refund. There is discrimination, gentlemen, and I don't mean maybe.

There is another point which I would like to bring out. When they first renegotiated the Howard Cooper Corporation they gave them a clean bill of health, without any demand for refund. The Signal Corps handled the first renegotiation and their figures were based on a 19.5 percent before taxes and a 4.1 after taxes, which was the same as ours; but still they clipped us for $170,000. The law was

later changed, adding more departments and they renegotiated them again, and that is when they established the figure of $96,000 to be refunded.

Senator WALSH. Did they give them an E award?

Mr. PHILLIPS. They should have.

I would like to mention the third case, the Thomas W. Rosholt, of Minneapolis, Minn., whose representative is also in the audience. This is a very odd case and I am sure it will be interesting to you gentlemen. This firm received a clean bill of health. It so happened that when the renegotiators walked into their office they discovered that they were 12 days late, by reason of the 1-year provision in the renegotiation law, that renegotiation must start within 1 year after the close of the fiscal year. This firm gets a clean bill of health.

There are three cases and all three are treated differently.

If you care to ask either one of these gentlemen any questions, they are in the audience and will be delighted to come up and answer them.

I started in business at the age of 22 and have been in business for 18 years.

All of our bids were competitive bids, there were no negotiated contracts and there was plenty of competition. Only a small percentage of our business was direct with the Government. In fact, practically all of it was with sub-sub-subcontractors, and with prime contractors. We had no Government aid of any kind on plant, machinery, or money. All contracts were signed and delivery completed before the effective date of this law. On all prices of our merchandise, our cost was fixed, what we paid for it, our selling price was fixed, our rental prices were fixed and our service rates were fixed by the Office of Price Administration.

Every piece of merchandise handled by us, as distributors, is considered standard commercial articles, but still they renegotiated us.

We differ from the cost-plus-fixed-fee contractor, who had no gamble. We gambled a great deal and our losses could have been tremendous, as we had invested more than $1,000,000 in rental equipment leased to the Government.

Most of our present inventory is frozen by the War Production Board by reason of various rules and regulations and that inventory is subject to severe depreciation in the event of an immediate cut-off of this program.

We are a service organization and not agents.

Our problem is in 1942, as well as in 1943 and because of the war program we expanded tremendously and invested more than a $1,000,000 in additional equipment on items of construction, industrial, and motor truck equipment, and it presented quite a problem and quite a bit of worrying.

Our entire facilities went into action on war work, serving projects in 37 of the 48 States.

There was no guarantee from the Government, as our contracts read that they rented the equipment for 1 month or more and at one time we had $1,300,000 worth of equipment that could have come back within 24 hours after the end of the first month's rental.

Our case was handled by a panel, and we don't like to have a panel of five inexperienced men tell us what we are to be taxed. That, gentlemen, is the duty of Congress. After many conferences of

several hours each, we were advised by the panel that we had no appeal.

Just recently I wrote a letter to Judge Patterson, the Under Secretary of War, asking that my case be reviewed by the over-all board, and not a panel, and his answer indicated that this might be possible, however, the reply was not signed by Judge Patterson and the representative who wrote the letter had served on our panel previously and told me that by reason of the fact that he had been on my panel, that was the equivalent of the main board review and I could not get any other review from that board.

The panel refused to put their conclusions in writing or give me a bill of particulars and I asked them to put in writing why and how they reached the $170,000, this they refused to do. In fact, they were afraid to do it. They couldn't defend it, in my opinion.

The future of our industry doesn't look any too good. We all know that there is estimated to be 60 to 70 billion dollars in surplus war materials at the end of the war. When and if that comes our markets will be destroyed for a long time unless there is some action taken to have orderly control.

Let me quote a few items here, with regard to figures on renegotiation quoted by members of both the House and Senate, and also by members of the Renegotiation Board.

Colonel Browning, on page 17, part I, Ways and Means Committee hearings, stated that 20 percent was allowed before taxes and 4.1 percent net after taxes, and still they renegotiate us. Part I, page 23, Mr. Karker, former Chairman of the Price Adjustment Board, stated average after renegotiation and taxes 5.23, and in my case 4.1 after taxes and before renegotiation.

Part 6, page 1692, Truman committee reports, Senator Brewster quoted that the 1942 income tax would recapture anything excessive.

The panel refused to visit my plant, but other panels did visit the plants of other distributors.

My case was the first from this idustry handled by this particular panel and it will be the only case, as they have now specialized distributor panels to handle cases from our industry.

Congress delegated their powers to the administration, the administration delegated them to the Under Secretary of War, and the Under Secretary of War to the main board, and the main board to a sub-board, and the sub-board to a panel, and that is where our case is being handled, with a panel.

Our recommendation is just this:

There was and now is unjust treatment in 1942 in connection with renegotiation and when there is anything wrong, that wrong should be righted.

All amendments proposed and passed by the House should be retroactive to the original date of the law, April 28, 1942.

Standard commercial articles should be exempted and be made mandatory by the law instead of an administrative decision.

Mr. Karker, part 3, page 249, Ways and Means Committee hearings, challenged the Ways and Means Committee and he challenged industry, also, to get down to specific cases. I accepted that challenge and appeared before the Ways and Means Committee and I also appeared before a closed executive session of the Ways and Means

Committee, due to some of the interesting and revealing facts in my case.

When I appeared before the Ways and Means Committee I requested that the panel handling my case come before that committee. The committee asked for it and the administration refused to send over the panel for appearance before the committee, and I don't blame them, because they couldn't back it up if they did, in their decisions on my case.

I want to challenge the administration at this time to bring before this committee that panel and let them tell you how they arrived at the figures they gave to me—in actual figures, not in just a lot of baloney and a lot of conversation.

Gentlemen, as a small businessman, I plead to you to give this serious consideration, as it is doing a lot of damage to the war effort, and is taking up the time of a lot of men which should be devoted to things of more importance.

I have skipped, due to the shortage of time, many important factors, however, I have tried to high-light the main items and I thank you very much for the privilege of appearing here before you.

The CHAIRMAN. Thank you very much.

(The following figures were submitted, by Mr. Phillips, for the record:)

Comparison between a normal and war business

Net profit on actual business done in 1942, including normal and war business, total of both, $2,251,699.13, of which $1,675,204.82 was termed renegotiable business and on this renegotiable business the Government demanded a refund of $170,000 before taxes, which leaves, after taxes and after renegotiation, net profit of	$74,067.99
Had this company declined war business and proceeded in a normal manner, eliminating an investment of more than a million dollars in new equipment for lease to the Government, and not expanded their organization to handle war business and worked normal working hours and working days, instead of working nights, Sundays, holidays, and 16 to 18 hours per day, the net profits on this normal operation, based on a total volume of $500,000, after taxes	65,036.85
By comparing the 2 above figures and by reasons of increased taxes, plus renegotiation, we actually gained in distributable profits on an increased volume of $1,675,204.82 war business, after taxes and after renegotiation	9,031.14

The above figures exclude an amount of $20,000 allowed, as salaries before taxes, for both partners, $11,700 for one partner and $8,300 for the other.

Analysis of results of renegotiation on basis of $170,000 demanded by Government

BEFORE RENEGOTIATION

Phillips' tax, present basis, Federal	$275,176.92
Backstrom's tax, present basis, Federal	57,981.62
Total Federal tax for partnership	333,158.54

AFTER RENEGOTIATION

Phillips' tax	155,496.92
Backstrom's tax	31,540.48
Total tax for partnership after renegotiation	187,037.40
Amount of tax to be refunded by Internal Revenue Department direct to Phillips	146,121.14

Refund demanded by War Department renegotiation panel	$170,000.00
Amount of tax refund by Internal Revenue Department direct to Phillips (86 percent)	146,121.14
Net cost of renegotiation without State refund (14 percent)	23,878.86
State of Virginia refund	5,100.00
Final net cost to Phillips Machinery Co. and actual net recovery by Government	18,788.86

SCHEDULE OF EARNINGS AND TAXES FOR 1942 AFTER RENEGOTIATION

Net profit after renegotiation but before taxes		$269,264.42
Phillips' Federal income tax	$155,496.92	
Backstrom's Federal income tax	31,540.48	
Phillips' State income tax	6,404.38	
Backstrom's State income tax	1,754.65	
		$195,106.43
Balance after taxes and renegotiation		$74,067.99
Percent of profit to volume—		
Before taxes and after renegotiation		12
After taxes and renegotiation		3.29
Gross volume of business, including normal and renegotiable		$2,251,699.13
Renegotiable volume		$1,675,204.82

If salaries comparable to officers of other equipment distributors allowed, net profit after taxes and renegotiation would be 1½ percent (actually 1.51 percent).

Schedule of earnings and taxes for years 1936 through 1943

	1936	1937	1938	1939
Net profit	$40,032.63	$28,894.56	$19,791.09	$42,018.14
Federal income tax paid by Phillips	5,208.35	3,058.50	2,037.50	5,967.52
Federal income tax paid by Backstrom	241.12	177.98	146.21	404.53
State income tax paid by Phillips	1,045.16	760.78	516.65	1,121.45
State income tax paid by Backstrom	123.38	105.26	96.21	180.83
	6,618.01	4,122.52	2,896.66	7,674.33
Balance after taxes	33,414.62	24,772.04	16,894.43	34,340.81
Percent of profit to volume before taxes	14.2	12.2	8	14.4
Percent of profit to volume after taxes	11.8	10.5	6.9	11.8
Gross volume of business	$281,681.72	$236,906.83	$246,196.77	$290,938.81

	1940	1941	1942
Net profit	[1] $102,771.57	$436,134.66	$439,264.42
Federal income tax paid by Phillips	33,402.94	236,997.79	275,176.92
Federal income tax paid by Backstrom	3,501.85	48,528.24	57,981.62
State income tax paid by Phillips	2,627.12	10,743.62	10,434.38
State income tax paid by Backstrom	612.17	2,732.02	2,774.65
	40,144.11	299,001.67	346,417.57
Balance after taxes	62,627.46	137,132.99	92,846.85
Percent of profit to volume before taxes	19.4	25.4	19.6
Percent of profit to volume after taxes	11.8	8	4.1
Gross volume of business	$529,314.53	$1,719,781.66	$2,251,699.13

[1] This amount is $25,798.50 greater than the net profit shown in auditors profit-and-loss statement for 1940. The reason is that in December of 1941, the Department of Internal Revenue ruled that this should be taken as profit for 1940 and changed our method of accounting.

Schedule of salaries and wages

[In preparing this schedule, only a portion of our personnel is shown but each department is represented]

Employee	Position	1936	1937	1938	1939
Ed P. Phillips	Partner [1]	$5,200.00	$6,150.00	$6,100.00	$7,077.25
Arthur Backstrom	do.[1]	3,550.00	4,180.00	4,150.00	4,621.50
F. Hazelgrove	do.[1]	2,565.00	3,150.00	3,150.00	
H. N. Taylor [2]	Manager mechanic Washington plant.[1]	2,166.66	2,376.66		3,037.09
R. C. Nesbitt	Field engineer Washington plant.[1]			2,650.00	2,862.80
L. A. Dillon	Senior mechanic Washington plant.[1]				1,869.92
A. A. Arbogast	Field engineer Richmond plant [1]			2,270.00	2,360.65
A. W. Faulkner [4]	Master mechanic Richmond plant.[1]	1,758.33			1,930.83
H. A. Michaels, Jr.[5]	Mechanic Richmond plant [3]		1,136.66	1,256.67	1,469.26
Mrs. Virginia McDonnell	Secretary [1]	1,500.00	1,812.50	1,890.83	2,062.86

Employee	Position	1940	1941	1942
Ed P. Phillips	Partner [1]	$7,135.00	$9,603.75	$11,700.00
Arthur Backstrom	do.[1]	4,930.00	7,004.00	8,200.00
J. N. Gibson	Manager Washington plant [1]		2,992.50	4,250.00
H. N. Taylor [2]	Master mechanic Washington plant [1]	3,450.00	3,952.50	4,675.00
R. O. Nesbitt	Field engineer Washington plant [1]	3,150.00	3,685.00	4,365.00
L. A. Dillon	Senior mechanic Washington plant [1]	2,202.20	2,367.00	3,331.28
R. L. Jenkins	Manager truck division [1]		4,537.50	5,850.00
A. A. Arbogast	Field engineer Richmond plant [1]	2,440.00	2,924.25	3,675.00
L. H. Scott	Auditor [1]		2,222.50	3,225.00
A. W. Faulkner [4]	Master mechanic Richmond plant [3]	2,094.31	2,607.74	
H. A. Michaels, Jr.[5]	Mechanic Richmond plant [1]	1,615.79	2,033.92	2,437.44
Mrs. Virginia McDonnell	Secretary [1]	2,215.00	2,685.00	3,325.00

[1] Monthly basis.
[2] Out from Mar. 5, 1938 to Feb. 13, 1939.
[3] Hourly basis—increase due to overtime.
[4] Out from Aug. 31, 1937 to June 18, 1938.
[5] Faulkner resigned May 31, 1942 and Michaels took his place as master mechanic at the Richmond plant.

The purpose of this schedule is to show that partners and employees salaries have been more than reasonable in amounts and normal in their increases. The personnel shown represents a cross section of our employees, each department being represented. The highest paid employee was R. L. Jenkins. There is not now, and there never has been, a relative of either partner or of any employee on our pay roll which is in accordance with a policy of the company which was established when the partnership began and is still in force. The partners as well as the key employees worked hard and put in long hours during all of this period and especially so during the past 2½ years. Therefore the key employees of our organization really were entitled to much greater bonuses and increases for 1942 than they received but we were blocked in this by the Wage Stabilization Act.

Many distributing firms engaged in the same business and who operate as corporations, pay the heads of their firms salaries ranging from $25,000 to $75,000 per year.

STATEMENT OF HAROLD QUINTON, VICE PRESIDENT, SOUTHERN CALIFORNIA EDISON CO., LOS ANGELES, CALIF.

Senator WALSH. You may proceed, Mr. Quinton.

Mr. QUINTON. Mr. Chairman, much has been said about the unequal tax burden shared by corporate stockholders but I would like to add just a brief thought on that subject. Actual experience in our company offers an illustration.

Our gross revenue and our net income before taxes are very much greater today than they were in the years prior to the war, but our taxes have increased so disproportionately that today our net income

after all charges is less than it was during the pre-war years. In the years 1936 to 1939 we earned an average of $2.28 per share on our common stock. This was a regulated earning—regulated by the Railroad Commission of California, and based on a fair return—not an excessive return. In 1942 we earned $1.57 per share on our common and we may earn in the neighborhood of $1.40 in 1943. This reflects a decrease in earnings of approximately 85 cents per share compared with the normal or base period average of $2.28. It was caused entirely by increased Federal taxes. Our stockholders, therefore, are contributing an extra 35 percent per share to taxes for the war effort before they even begin to calculate their increased individual taxes on their decreased dividend.

Our stock is not closely held by persons of great wealth. We have more than 90,000 shareholders who own an average of 71 shares each of our $25 par value stock or 18 shares each on a $100 par basis—an average investment of about $1,800 on today's market. We have only 1 stockholder holding fractionally more than 1 percent of the total stock, and no others own as much as 1 percent. Many thousands of these stockholders are women and minors. Many thousands have held their stock since original issue. Many are company employees in the lower-income brackets, many are consumers and a very great many dependent on their dividends for their livelihood. I believe this is a fair cross-section of corporate stockholders Nation-wide. This group, it seems to us, is deserving of your further consideration.

This was the group in our company that provided the basic capital which made a great public service possible in southern California. The production and distribution of electricity requires extraordinarily large amounts of capital. Whereas I believe the average investment in plant per employee in industry in the United States has been estimated at $5,000, our company has an average investment in plant of more than $100,000 per employee.

The so-called average investor or small stockholder of 50 to 100 shares has always been the basic source for such capital, but his present position is not an encouraging one and surely his burden should not be increased. In 1942, 30 cents of every dollar received from consumers was disbursed by the company in direct taxes. In 1943 this total tax bill will take 34 cents of every dollar received from our consumers. Federal taxes account for 68 percent of the total taxes. And for 1943 Federal taxes will account for 74 percent of our total taxes.

I want to emphasize these last statements. Our consumers will pay us a total of approximately $57,000,000 in 1943. That is our gross revenue, our gross sales. Of this $57,000,000 we will disburse approximately $19,500,000 in direct taxes.

These conditions are not peculiar alone to our company. Composite income statements have been released by the Federal Power Commission covering the years 1937 to 1942 of all class A and class B electric utilities representing 95 percent of the entire privately owned electric utility industry in the United States (financial record of the electric utility industry 1937–42, Federal Power Commission, Washington, November 1943). Comparing 1942 with 1937, these statements show that:

1. Total operating revenues increased 27 percent.
2. Taxes increased 100 percent.

3. Net surplus earnings available for common stockholders decreased 19 percent.

These stockholders were the group in our company that risked their savings in the remote wilderness of the High Sierras in dams, tunnels, and reservoirs. They built hundreds of miles of transmission lines over barren lands in anticipation of future need and growth. They also built steam plants to insure continuity and reliability of services. Their substantial contribution is reflected in many ways in our community—in its whole basic development—in lower power costs—in a high degree of rural electrification—in a very dependable and prompt service in the present emergency—in rendering, together with others in the industry, one of the few services during this emergency which, as expressed by Mr. Krug of the War Production Board, has been neither "too little nor too late."

In 1939 our sales totaled a little less than 3 billion kilowatt-hours. In 1942 we sold over 4 billion kilowatt-hours. The increase was sold at less than half the average rate of all sales in 1939—and the job was done with a reduction of 15 percent in manpower compared with 1939. This is the stockholders' further contribution to the war effort. The stockholders' contribution is also reflected in the company's low cost of credit which has been a large factor in a long history of rate reductions. Those reductions should be resumed as early as possible after the war but they will depend in a large measure on continued earnings and continued low-cost capital for rehabilitation, modernization, and expansion of service. We ask that this be kept possible through the normal processes of private enterprise—that that enterprise be not destroyed by excessive taxation.

Two suggestions are offered for the consideration of your committee. The first relates to the electrical energy tax of 3⅓ percent provided by section 3411 of the Internal Revenue Code. It has never been clear to us why electrical energy, which is considered so essential to the public welfare that it appears to require very extensive governmental regulation, should be classed with sporting goods and perfumery and taxed as a luxury. Nor why energy produced in a publicly owned municipal plant is any different from the energy produced in a privately owned plant. This tax is levied on the corporation and as rates for services are fixed (certainly as a practical matter, for the duration) it cannot be passed on to the consumer but again must be absorbed by the stockholder. It involves seemingly disproportionate administrative costs.

The tax is determined annually in respect of revenue from more than 20,000,000 meters in the privately owned electric utility industry and the accounting alone is a substantial undertaking. The revenue from some 600,000 meters is taxable to our company. Government auditors were engaged in our offices for approximately 6 man-years in the examination of our electrical energy tax returns for the 8 years 1932 to 1940. More than 10 man-years were required of our own personnel in connection with these examinations. While the electrical energy tax in the case of our company amounts to approximately $850,000 annually, it is a deduction for excess profits tax purposes at 90 percent so that the net annual revenue derived therefrom by the Treasury Department is only $85,000.

When the administrative and collection costs to the Treasury Department and to the utility are considered, it seems doubtful if the

net income from this course justifies the levy. There is the further factor involved as stated before that this tax is not levied on revenue from the electrical energy sold by municipal plants. This is a condition of which we are particularly conscious in our highly competitive area. We ask your favorable consideration of, either (1) the repeal of the tax, or, (2) provision for its levy against consumers, as in the manner of the transportation and communications taxes, or, at the least, (3) its equitable application to revenue of municipal as well as privately owned utilities.

The second suggestion for your consideration relates to the excess profits tax. It is a third alternate formula for the calculation of that tax and was first formally presented by Mr. Harold V. Bozell before the House Ways and Means Committee. It has been presented here by Mr. Bozell, and I will not take your time in discussion of its technicalities.

However, Mr. Bozell referred in his remarks before the House committee to studies which had been made by representatives of the Railroad Commission of the State of California, and I should like to add just a few remarks regarding those studies. They were begun actively during the writing of the Revenue Act of 1942 and continued through to September of this year. The Research Staff of the Commission arranged numerous meetings with representatives of the utilities in the State and numerous proposals for amendment of the excess profits tax provisions were considered. The effect of these proposals was tested by their application to the 1942 tax returns of the companies. Many suggestions were rejected as being too limited in the number of companies affected or overliberal in their resulting relief.

Mr. Bozell's formula was among those examined. It was tested by application to the 1942 returns of 16 major utilities in the State, representing 95 percent of the electric and gas customers of the privately owned utilities in the State. It was found that the formula did not relieve all the utilities from all excess-profits taxes, but it did accord a very modest relief from the injustice and practical confiscation which results to some of the companies under the present code. It did remove, in some degree, purely normal earnings from the excess-profits classification. The formula was submitted for examination to several southern, eastern, and middle western utilities which are, also, seriously affected by the present code, and, as in the case of the California utilities, it was found to accord only modest relief.

It is the considered judgment of those of the research division of the staff of the California Railroad Commission who were engaged on this study, and of those of us who assisted in the studies, that Mr. Bozell's plan will reach the greatest number of those utilities which are the most seriously affected under the present code, but will accord to them only a very reasonable and modest reduction in tax. I have stated that 34 percent of our gross revenue of 1943 will be disbursed in direct taxes. Under Mr. Bozell's proposed alternate formula, we will still disburse 31 percent of our gross revenue in taxes.

Now we have been asked: Why should the utilities be placed in a special class for taxation? The answer is that they are adversely affected, in comparison with other industries, when subjected to the general provisions of the code. The fact of this condition is apparent and has been demonstrated by several studies. One study was made

of 89 major companies representing 9 different industries. Comparison was made of the net income of these companies per share of common stock in 1942 with their average net income for the pre-war years 1936 to 1939. This was the result: 10 out of 10 railroads reported increased net income; 10 out of 10 aircraft companies reported increased net income; 9 out of 10 steel companies reported increased net income; 8 out of 10 automobile companies reported increased net income; 7 out of 10 oil companies reported increased net income; 7 out of 10 metal companies reported increased net income; 6 out of 10 chemical companies reported increased net income; 6 out of 9 motion-picture companies reported increased net income; but 9 out of 10 electric and gas utility companies reported decreased net income. This decrease was solely and directly the result of increased taxes.

The reason that other industries are not similarly affected is that their excess profits in relation to their normal profits of the pre-war period are relatively very much greater than in the utility industry. Ours is a regulated revenue. As a practical matter we simply cannot increase our rates. They have in fact been reduced. Whereas the gross revenue of the utility companies has increased 20 percent since 1939, it is not uncommon to find the gross sales in other industries increasing 100, 200, and 1,000 percent and more. As a result these other industries have large enough excess profits so that the 10 percent which they retain of such profits after taxes more than makes good the deficiency in their normal earnings which is created by the increased normal and surtaxes.

I have a hypothetical case. Assume that our average normal net earnings before taxes in the pre-war years 1936 to 1939 totaled $10,000,000. The prevailing corporate tax rates in those years averaged approximately 16 percent, leaving a net income available to stockholders of $8,400,000. Today, assume a net income before taxes of $12,000,000. The first $10,000,000 of this, that is, the normal part of this profit, would be taxed at 40 percent, leaving $6,000,000 available for stockholders, or, a deficiency of $2,400,000 compared with the pre-war years. This deficiency may only be made good from the excess profits of $2,000,000. But we retain only 10 percent or $200,000 of those excess profits. This, together with the amount of so-called normal profits which we retain, totals $6,200,000, or a deficiency of $2,200,000 compared with our normal net income in the years 1936 to 1939.

It is solely a matter of volume of excess profits. If a corporation's excess profits are large enough it may retain enough 10-cent pieces out of each dollar of its excess profits to equal or exceed the deficiency in its normal income which is created by the increased normal and surtaxes. If it does not have excess profits, or, if the excess profits are small in relation to its normal income, it is bound to report smaller earnings than in the pre-war years. The 40 percent normal and surtaxes simply take too much of the normal income.

Just one more thought, but in my opinion this is important: The very high Federal taxes on utilities are beginning to invite measures by local authorities, designed to siphon off moneys that would be paid by utility companies to the Federal Treasury, through such devices as temporary rate reductions, refunds to electric customers or heavy local excise taxes which are deductible in computing Federal

taxes. Such moves have come up for formal or informal consideration in Michigan, Ohio, Indiana, Arkansas, and elsewhere.

So far the appeal to patriotic motives by the utility companies and the regulatory commissions has been effective in resisting the local pressure, but the moves indicate that Federal taxation of utilities has reached a level where it may backfire.

Mr. Chairman and gentlemen, it has backfired. This morning I learned that the city council of Detroit has levied a 20 percent excise tax on the revenues of the Detroit Edison Co. The announcement appeared in yesterday's New York Times. I am not speaking for the Detroit Edison Co., but I know something about their figures, and I estimate that, if the ordinance holds up, $10,000,000 of the taxes of that one company alone will be diverted from the Federal Treasury to the city of Detroit.

Admittedly, some of the utilities have excess profits due to the war, but the peculiar and discriminatory effect of the present code is demonstrated by the anomaly of declining net profits for stockholders in contrast with increasing excess profits and increasing excess-profits taxes. For these several reasons we endorse the amendments which have been suggested by Mr. Bozell.

Finally, let me emphasize that we are quite aware that wartime taxation must bear heavily upon every citizen. To accept such burdens is a patriotic duty in which, I am sure, our stockholders are glad to participate. The suggestions which I have endeavored to present are not for relief from taxation which is merely burdensome; rather, they are for the removal of inequities which will result, we believe, in the long run, in a sounder national economy, greater post-war production and, hence, in a greater public benefit. I trust that you will find, upon consideration of the suggestions, that they are constructive and in the public interest.

Senator WALSH. Let me compliment you upon your fine presentation. We thank you very much indeed.

STATEMENT OF L. D. ROMIG, ASSISTANT COMPTROLLER, SOUTHERN CALIFORNIA GAS CO., LOS ANGELES, CALIF.

Mr. ROMIG. Mr. Chairman, this statement is being made on behalf of Southern California Gas Co., a corporation organized October 5, 1910, under the laws of the State of California with its principal office located at 810 South Flower Street, Los Angeles, Calif. The principal business of the company is that of a public utility acquiring, gathering, compressing, transporting, distributing, and/or selling natural gas to domestic, commercial, gas engine, industrial, and wholesale consumers in Los Angeles, San Bernardino, Ventura, Kern, Riverside, Kings, Tulare, and Fresno Counties in the State of California. The number of cities, towns, and communities served as of December 31, 1942, was 131 with an estimated population of 2,945,000. As of the same date, the company served 829,276 domestic and commercial customers and 2,432 industrial and gas engine customers.

This appearance before the Finance Committee of the Senate is being made in order to point out some of the inequities of the present law as applied to public utilities and to recommend certain proposals for relief.

The heavy increase in Federal tax burdens under the existing law has gravely reduced the equity income of many public-utility companies. A review of the earnings available for common stock reported for utility companies for 1942 shows almost without exception a reduction in earnings as compared with the average of the reported earnings for the base-period years of 1936 to 1939. A similar review for railroads, major aircraft, automobile, steel, chemical, metal, and oil concerns shows a tremendous increase in earnings per share of common stock in 1942 as compared with the average of the base-period years. The greatest single factor causing the decline in utility earnings is the increase in Federal taxes. The stock of utility companies generally is widely held by small investors, many of them with fixed incomes. A reduction in dividends amounts to a real sacrifice by these people. All except 44 shares of the company's 1,152,000 shares of common stock is held by Pacific Lighting Corporation. The stockholders of Pacific Lighting Corporation number more than 17,000. In addition to the common stock, Southern California Gas Co. has over 7,300 holders of 6 percent cumulative preferred stock of which 942,938 shares are outstanding.

The reported earnings per share of common stock of Southern California Gas Co. for 1938 were $4.04, and for 1939 were $3.51. In 1942 the reported earnings were $3.02 per share, a reduction of $1.02 per share from 1938, and 49 cents per share from 1939. The net income of the company subject to Federal income taxes, as shown by the returns of the company, for 1942 exceeded 1938 by $1,342,349, or $1.17 per share of common stock and 1938 by $1,719,535, or $1.49 per share of common stock. This convincingly shows that while the net earnings of the company before Federal income taxes have substantially increased, the earnings available for common stock have materially declined as a result of the heavy Federal tax load.

One of the results of the ever-increasing corporate taxes is to greatly increase the disparity in the tax burdens carried by consumers of privately owned versus publicly owned utilities. In the city of Los Angeles, the company is in competition with the municipality owned electric system, which is tax exempt. With the great increase in hydroelectric power from Boulder Dam, the competition becomes more acute. In 1939 the company's provision for taxes was $5,012,491.59, or 14.44 percent of its gross operating revenues. In 1942 the provision for taxes was $7,362,797.53, or 17.78 percent of gross operating revenues. Federal taxes increased from $1,460,943.22 to $3,741,464.50, or an increase of 155 percent. The operating revenues increased from $34,709,269.64 to $41,401,995.44, or an increase of 19.3 percent. The heavy tax burden carried by privately owned public utilities makes competition with publicly owned utilities increasingly difficult, and the situation will not be cured until the need for additional national revenue overbalances the resistance to taxation of publicly owned utilities.

Under normal peacetime operations a regulated public utility is permitted to earn a fair return on its base rate—i. e., the present fair value of its property used and useful in the public service—after paying all of its expenses, including taxes. With the increased Federal normal tax and surtax rates and with increased pay roll and other costs as a result of the war, few utilities are able to earn the fair rate of return normally permitted. Under close rate regulation, such as

we have had in California continuously for more than 30 years, no utility should incur excess-profits taxes until it has earned the rate of return permitted by regulatory bodies.

The effect of the present excess-profits tax law, however, is that in many cases where the utility has not earned the permitted rate of return, nevertheless a considerable part of its normal net income becomes subject to excess-profits tax rates. This is contrary to the purposes of the present law which ostensibly are to recapture war-created, and therefore abnormal, corporate profits.

In analyzing the income and excess-profits-tax returns of our company we find the following items of income normal to its business which are subject to excess-profits tax:

1. Normal earnings equal to 5 percent of the average base period income is subject to excess-profits tax, since the company computes its excess-profits credit under section 713 of the law.

2. In 1940 the company refinanced its entire outstanding bonded indebtedness. As a result of this refinancing, annual interest and amortization charges were reduced from the amount of similar deductions in the base period. This entire saving in fixed charges produces, under the law, income subject to excess-profits tax.

3. The company does not derive any benefit from the growth formula under section 713 (f) of the present law, since the earnings of the last half of the base period are less than the first half. The result of this situation as applied to our company, and the same will apply to many other utilities where net income did not parallel the growth during the base period, is that earnings derived from additional investment in the business made after December 31, 1939, are subject to excess-profits tax under the rigid formula of the law.

The above-mentioned three items are not all of the items normal to the utility business that are, under the peculiarities of the law, subject to excess-profits taxes, but they are the most important ones applying to us.

One of the principal inequities in the present excess-profits-tax law is that utilities are not permitted to deduct normal taxes and surtaxes before determining excess-profits net income. A utility does not have any true excess profits until all taxes and expenses are paid.

An analysis recently made by the railroad commission of the State of California, of the Federal income and excess-profits taxes applicable to major utilities in California based on 1942 operations shows a wide divergence among utilities in the point of incidence of excess-profits taxes. The "point of incidence" is the rate of return the utility may earn on its rate base before excess-profits taxes become effective. This rate varied from 4.67 to 7.03 percent, which means that all earnings of the utility over the "point of incidence" are subject to excess-profits taxes. In the majority of cases, the "point of incidence" was less than the rate of return normally allowed to utilities under its jurisdiction.

In connection with this study, the commission considered the proposal to amend section 711 (a) (2), section 714, and section 26 (e) prior to its submission to the Committee on Ways and Means of the House of Representatives on behalf of the independent telephone companies of the United States by Mr. Harold V. Bozell, president of General Telephone Co., New York, in October 1943. This proposal is for a third alternate method of computing excess-profits taxes which will be available only to utilities, and will permit such com-

panies to earn the same rate of return on their invested capital for the current year after taxes as was earned during the base period year after taxes.

The effect of this amendment, as indicated by the study of the California Railroad Commission, will raise the point of incidence for those companies hardest hit by the present law to a point more nearly approaching the fair rate of return allowed by the commission.

It will not operate to give relief in all cases, but it will expedite regulation and give relief where the need is the greatest.

We are in entire agreement with its objectives and urge upon Congress the enactment of this proposal into law.

Senator WALSH. Thank you very much.

STATEMENT OF W. J. McCOY, TREASURER, SOUTHERN COUNTIES GAS CO. OF CALIFORNIA

Mr. McCOY. Mr. Chairman, when the excess-profits tax measures were in the process of becoming law, it was recognized by Congress that some special provisions should be made to afford relief to taxpayers with respect to certain abnormalities. Consequently, section 721 (Internal Revenue Code), abnormalities in income in taxable period; and section 722 (Internal Revenue Code), general-relief constructive average base period net income were adopted. Insofar as privately owned public-utility companies in general, and the company I represent in particular, are concerned, very little relief is afforded under these two sections. I will not elaborate on the afore-mentioned sections of the revenue act and they are referred to here merely to emphasize the fact that Congress has given recognition to abnormalities in taxable net income.

I believe, however, that Congress has not given consideration to the special nature of the income of public-utility companies, and there are several aspects of this situation of concern to the gas utility industry. Most assuredly the gas industry expects to carry its equitable share of financing the war. However, in an effort to safeguard the future of the industry and to avoid the possibility of the impairment of credit, it is the object of this statement to direct your attention to provisions of the present tax law which are deemed to be discriminatory and unjustly burdensome upon the gas industry in general, and the Southern Counties Gas Co. of California in particular. By way of illustration, attention is directed to an increase in taxable income for the years 1942 and 1943, during which years abnormal conditions are created by reduced maintenance work which cannot be done by reason of the shortage of material and manpower. This maintenance work is deferred and when material and manpower become available, costs for 2 or 3 years after the war will be in excess of normal. A reserve to provide for such deferred maintenance costs might be made by appropriate charges against current income, but under present tax laws such charges to income would not be allowed as deductions as ordinary and necessary business expenses.

While the excess-profits provisions of the act were ostensibly devised to recapture war-created and therefore abnormal corporate profits, they have nevertheless gravely reduced the normal equity income of many utilities. In several cases, of which I have knowledge, earnings have been depressed to a point where impairment of credit is imminent

and may prevent the financing of property additions to serve new areas that are being developed to accommodate an extraordinary growth in population, particularly in southern California.

That the law in its present form affects public utilities to a greater extent than other industrial corporations is shown convincingly by a recent analysis in which the 1942 common-stock earnings of 10 representative companies in each of 9 major industries were compared with the average earnings for the period 1936–39. The study included the following industries: Electric and gas utilities, railroad, steel, oil, aircraft, automobile, chemicals, metals, and motion pictures. All industries except the public utilities showed substantial gains in 1942 over the base period, while the utilities group declined by 28 percent, and only 1 company of the 10 had increased earnings.

In California, all public-utility companies have been continuously regulated since 1912 by the California Railroad Commission, which commission obtains its authority from the Public Utilities Act adopted in 1911, the year in which the Southern Counties Gas Co. of California was organized. The commission has wide powers as to service, rates, accounting, and financing, and keeps itself well informed as to the operations of the companies under its jurisdiction. Although the commission is not committed to allowing a fixed rate of return, it may conclude that a company would be permitted to earn a maximum of 6⅔ percent on its rate base (i. e., the present fair value of its property used or useful in the public service). This does not mean that the net income of the company can be as much as 6⅔ percent on the rate base. It means that the company may be permitted to earn (if it is able) said rate of return, out of which must come interest on debt, amortization of discount of bonds, and so forth, and dividends on preferred and common stocks. Earnings of the California utilities companies are being reviewed constantly by the commission and as a result many rate reductions have been ordered during the past 30 years. From the foregoing it is evident that utility companies in California have for many years enjoyed no more than a fair return on their respective rate bases, and with the application of the excess-profits-tax features of the present revenue act, net income is being reduced to an extent not only damaging to the interests of the companies but to that of the public as well. A study relative to the effect of the excess-profits tax on utility companies was recently made by the research department of the California commission, and from the data collected a report was compiled from which the following is quoted:

> This report analyzes the effect of the 1942 Revenue Act upon the earnings of major California utilities for the calendar year 1942 and shows the maximum effect of the provisions of the 1942 Revenue Act upon these earnings after adjusting the tax payments to exclude unusual or nonrecurring items.
>
> Federal taxes on income of a corporation consist of the normal income tax, a surtax and an excess-profits tax. The method of computing the excess-profits tax as provided for in the Revenue Act of 1942 has created certain problems directly affecting the earnings of public utilities. Prior to the calendar year 1942 the major utilities in California generally escaped payment of the excess-profits tax due to a credit which was created substantially for the refinancing of the funded debt. It is expected that commencing with the operations for the calendar year 1943 that in practically every instance this credit will disappear and the companies will be confronted with the maximum provisions of the revenue act.

The fact that a regulated public utility is subject to the excess-profits tax creates a number of questions relative to the earning position of the company during the current year, if it was the intention of Congress to tax excess earnings of corporations it is also implied that the measure of these excess earnings would be reasonable and uniform as between companies and as between classes of corporations. An analysis of the major utilities in California has disclosed an unequal distribution in the tax burden due particularly in the application of the excess-profits tax provisions. Assuming that these major utilities would have no excess-profits carry-over credit and that other unusual or nonrecurring items were eliminated from the tax returns, one of the largest utilities would begin paying an excess-profits tax when the rate of return on the commission's rate base exceeded 4.67 percent and in another instance a utility rendering similar service in California would not be subject to the excess-profits tax until its return on the commission's rate base had exceeded a rate of return of 9.58 percent. Between these 2 rates of return 14 other major utilities begin to pay an excess-profits tax upon their earnings. This variation in the percentage of earnings on the commission's rate base indicates the injustice accorded regulated utilities under the 1942 act. Certain utilities in California will be earning a rate of return at a point where the financial integrity of the company will be impaired.

From the analysis of the provisions of the present revenue act and the effect of the tax law upon the earnings of this group of utilities, it is impossible to make a general statement explaining the variation in the rate of return the company may earn before creating an excess-profits-tax liability. In one instance it was found that a company which had refinanced its funded debt would be required to pay an excess-profits tax upon the savings it had consummated through the reduction of its bond interest in the magnitude of $1,000,000. In other words it is possible without an increase in gross revenue that a company would be required to pay a substantial excess-profits tax.

The regulatory commissions of the various States are aware of the damaging provisions of the excess-profits tax to the utility companies, and at the meeting of the National Association of Railroad and Utilities Commissioners in Chicago, September 15, 1943, the following resolution was adopted:

Whereas under the provisions of the 1942 Revenue Act, regulated public utilities are subject to an excess-profits tax, and

Whereas it is claimed that through the application of the provisions of the 1942 Revenue Act unusually large and discriminatory excess-profits tax liabilities are being created as between classes of regulated public utilities and between utilities furnishing identical service; and

Whereas through its application, the excess-profits tax will reduce the net earnings of the regulated public utility in some instances to a point where constructive and effective utility regulation can no longer be continued: Now, therefore be it

Resolved, That this convention authorize the President to appoint a special committee to study the effect of the excess-profits tax upon the net earnings of the regulated public utility, and that this special committee prepare the amendment or amendments deemed necessary or make such other recommendation for changes in the 1942 Revenue Act as in its opinion will provide relief from unreasonable and unjust excess-profits-tax liabilities and report such recommendations back to the executive committee.

There is abundant evidence to show that there is a necessity for a lightening of the burden of Federal taxes under present laws, and much data have been assembled to support these contentions and statements.

As an effective means for alleviating the tax burden upon public utility companies it is urged that the Finance Committee of the Senate give consideration to the suggested amendments to section 711 (a) (2), section 714, and section 26 (e) (Internal Revenue Code) as submitted to your committee, on behalf of the independent telephone companies of the United States by Mr. Harold V. Bozell, president, General Telephone Co.

Senator SHAW. Thank you very much, sir.

Senator WALSH. I am submitting for the record at this point an additional statement by Mr. John J. Crawley, president of the William H. Wise & Co., Inc., which he has forwarded to the committee.

(The statement referred to is as follows:)

NEW YORK CITY, *December 3, 1943.*

Hon. WALTER C. GEORGE,
Chairman, Senate Finance Committee, Washington, D. C.

DEAR SIR: I wish to supplement my remarks made before your committee on December 1, 1943, having to do with the subject of postage, title IV of the 1943 Revenue Act, and to have this letter made a part of my official testimony.

Without going into too much detail, I would like to give you some idea of the intricacies of the entire postal rate structure by attempting to analyze briefly the effects of the amendment suggested by Mr. William C. Wood of the National Association of Business Papers. Mr. Wood also appeared before your committee on December 1. The proposed amendment is repeated here for your convenience:

"The rate of postage on third-class matter shall be 2 cents for each 2 ounces or fraction thereof up to and including 8 ounces in weight except that the rate of postage on books, catalogs, seeds, cuttings, bulbs, roots, scions, and plants not exceeding 8 ounces in weight shall be 1½ cents for each 2 ounces or fraction thereof.

"Except that on library books described by the act of May 29, 1928 (45 Stat. 940), and on books described by the act of June 30, 1942 (56 Stat. 462), in parcels not exceeding 8 ounces in weight the rate shall be 4 cents a pound or fraction thereof:

"*Provided*, That the rate of postage on third-class matter mailed in bulk under the provisions of the act of May 29, 1928 (45 Stat. 940), shall be 16 cents per pound or fraction thereof except that in the case of books, catalogs, seeds, cuttings, bulbs, roots, scions, and plants the rate shall be 10 cents for each pound or fraction thereof:

"*Provided, however*, that the rate of postage on third-class matter mailed in bulk under the provisions aforesaid shall be not less than 1½ cents per piece for other than local matter and not less than 1 cent per piece for local matter."

In my opinion, the adoption of such an amendment would be grossly unfair in that the net effect of it would be to continue the present substantial subsidy, which I estimate at $22,000,000 annually, for the benefit of those users of the third-class mail who are the recipients of the benefits of the present bulk mailing rate of 8 cents a pound. Generally speaking, this rate is used by mail-order-catalog houses and third-class-magazine mailers and other users of heavier pieces of third-class mail.

It seems important to note that the amendment suggested by Mr. Wood increases the rate for books weighing less than 8 ounces and it increases the minimum piece rate at which third-class letter mail can be mailed, while at the same time it actually reduces the piece rate for third-class magazine and catalog mailers. This on top of the fact that third-class letter-mail users are presently paying the same bulk piece rate and a bulk pound rate 50 percent in excess of the catalog and third-class-magazine mailers.

Under new War Production Board rulings it is expected that all commercial users of printed matter, and this includes circulars, catalogs, third-class magazines, and all sorts of printed advertising matter, will have to reduce the consumption of the weight of paper by 25 percent as a conservation measure. This means that the mailers of catalogs or magazines, presently weighing 4 ounces, will have to reduce their over-all weight to about 3 ounces. Circular letter mailers presently using 1½ ounces of paper per piece will have to reduce the weight to 1 ounce.

While Mr. Wood's proposal for an amendment implies an increase in the bulk-mailing rates on printed matter from 8 cents to 10 cents per pound, the fact is that under the War Production Board rulings the piece rate under the present rates for 3-ounce catalogs or magazines is at 2 cents each and under Mr. Wood's recommendation will become 1⅔ cents each. Therefore, an actual reduction of 6.25 percent in the piece rate and gross revenue to be expected by the Post Office Department.

In regard to circular letter mail, Mr. Wood's proposal takes an entirely different slant in spite of the fact that we, too, will have to reduce the amount of paper consumed by 25 percent; that is, from 1½ ounces to 1 ounce per piece, he recommends an increase in our per-piece rate from 1 cents to 1½ cents per piece—a direct increase of 50 percent.

Obviously, such a compromise would be to the advantage of catalog and other printed-matter mailers who, under the present rulings of the Post Office Department, while privileged to mail their material at 1 cent a piece, provided they weigh 2 ounces or less, have not had occasion to use 1-cent-a-piece rate. The reason for this is that most of their pieces—in fact, the general average appears to be 4 ounces per piece and therefore the practical minimum rate of postage of 2 cents a piece. (See testimony of Mr. T. Q. Beesley also, on December 1, 1943, to the effect that three large mail-order houses mailed approximately 88,000,000 pieces on which they paid postal charges of $1,672,000—an average rate of 2 cents a piece.)

It seems to me that Mr. Wood's suggestion that the rate on books weighing less than 8 ounces be increased to 4 cents a pound is distinctly unfair, in that it acts to further discriminate against books in their efforts to compete with the text portion of magazines and newspapers. Magazines and newspapers—that is, the text portion of these media—are now and for a long time have been enjoying a special rate of 1½ cents a pound, whereas, at the present time, books, which are equally if not more important to the Nation as a means of dissemination of culture and information, are paying twice as much per pound and over five times as much per piece as are newspapers and magazines.

Your attention is directed to the fact that the average weight of books mailed under the third class is almost exactly the same as the average weight of magazines and newspapers mailed under the second class—approximately 5 ounces apiece.

It is important to remember here that the 1942 cost ascertainment report showing a deficit for books was based on the older rate of 1½ cents per pound, whereas the present rate is 8 cents per pound.

May I also quote here from the letter of J. W. Askew, Acting Comptroller of the Post Office Department, addressed to the Honorable Frank C. Walker, Postmaster General, on December 31, 1942, with respect to some of the methods used in determining costs:

"The collection of statistics and the segregation of revenues and expenses to the different classes of mail and services have proceeded in accordance with established methods. The results are factual and therefore do not account for such intangible expense considerations as relative priority, degrees of preferment, and economic value of the several classes."

As we understand the meaning of this paragraph, it is to the effect that third-class mail as well as other classes of mails of lesser importance are being charged with overhead, distribution costs, and various other indirect operating expenses on exactly the same basis as these intangible expenses are being charged to first-class mail. In other words, no credit is given to these lesser classes of mail; that is, those classes of mail which take up the otherwise idle time and space of employment and equipment, including buildings, for the fact that if these classes of mail were not in existence the entire intangible expense would have to be charged against first-class mail. Mail of the first-class constitutes more than 50 percent of the total transactions handled by the Post Office Department. The transmission of first-class mail may very well be considered as the main objective of the Post Office Department. That is the reason that it is the only class of mail for which it has the monopoly.

It is my opinion that all feeder classes of mail should not be charged with any item of expense, unless such item of expense originated for the sole benefit of the particular feeder class of mail.

I make these statements primarily as a means of indicating the utter complexity of the postal rate structure and in a further effort to emphasize my previously expressed opinion that the entire matter of postal rates, as well as be application of the 3-percent property transportation tax be left out of the present revenue bill and thereafter that the question of postal rates as a whole be transferred to the respective Senate and House Post Office and Post Roads Committee.

Yours very truly,

WILLIAM H. WISE & CO., INC.,
JOHN J. CRAWLEY, *President.*

Senator WALSH. I submit for the record at this time a letter from the Railroad Commission of the State of California, addressed to this committee, in connection with rates for utilities.

(The paper referred to is as follows:)

RAILROAD COMMISSION OF THE STATE OF CALIFORNIA,
San Francisco, Calif., November 30, 1943.

To the Honorable COMMITTEE ON FINANCE,
United States Senate, Washington, D. C.

GENTLEMEN: This commission exercises continuous supervision over rates of utilities subject to its jurisdiction, and at the present time has several investigations under way of gas, telephone, and electric companies looking toward reductions in rates and charges to the public.

However, we find that the current revenue law results in substantial inequalities. A recent detailed study of 12 major utilities in California by the staff of the commission indicates that the excess-profits tax would become applicable at rates of return varying from 7.03 percent down to 4.67 percent. For six of these utilities the excess-profits tax would become applicable at less than 6 percent return. These rates of return are measured on the historical cost rate base used for over 30 years by this commission for measuring earnings. In preparing the computations the most favorable methods were used under the present law.

The commission is calling this matter to your attention for such consideration as you may desire to give it in your present deliberations pertaining to the revenue act.

Very truly yours,

RAILROAD COMMISSION OF THE STATE OF CALIFORNIA,
By H. G. MATHEWSON, *Secretary.*

Senator WALSH. Mr. Jolly.

STATEMENT OF JOHN W. JOLLY, REPRESENTING THE MANUFACTURERS OF MEDICINAL AND PHARMACEUTICAL PRODUCTS

Mr. JOLLY. Mr. Chairman and members of the committee, my name is John W. Jolly, 2501 Washington Boulevard, Chicago, Ill. I am chairman of the special committee on alcohol problems of the proprietary association, speaking for the manufacturers of medicinal and pharmaceutical products. Many of these commodities, as well as certain items of food, require the use of distilled spirits in the form of ethyl alcohol.

We buy alcohol by the actual gallon which is 190 proof spirits. The cost today is about 55 cents per gallon. At the time of purchase we also advance in tax money $11.40 per actual gallon. In terms of a carload, the alcohol alone costs $2,148. The tax advanced amounts to $44,323. This is more than 20 times the cost of the alcohol.

Under the terms of the bill before you, we shall be compelled to advance in tax money at the time of purchase $17.10 per actual gallon, or $66,584 per carload, more than 31 times the cost of the alcohol.

Obviously, this is a rate of tax which should not be imposed on articles of necessity such as foods and medicines. A little over a year ago your committee afforded our industry a measure of tax relief through the medium of the draw-back. Today, after that draw-back, our net tax is $2.25 per proof gallon or $4.27½ per actual gallon on alcohol used in foods and medicines. This is approximately 8 times the cost of the alcohol. Under the terms of the House bill, we shall be required to pay, after draw-back, a net tax of $4 per proof gallon, or $7.60 per actual gallon, almost 14 times the cost of the alcohol.

Our industry has always believed that alcohol used in the production of foods and medicines has been subject to an inequitable tax. They are not articles of luxury and, therefore, are not properly subject to heavy excise taxes. However, our industry also feels that in these times it should do everything possible to obtain maximum revenues

for the Treasury Department. This maximum revenue is obtained from a net tax of $2.25 per proof gallon on alcohol used in the production of foods and medicines. Statistics of the Internal Revenue Bureau indicate that the Treasury Department received the maximum revenue at that figure. During the fiscal year 1941, when the net tax exceeded $2.25 per proof gallon, alcohol consumption for these purposes declined 26½ percent, and revenue therefrom declined $320,000.

The interest of Congress and of the Treasury as well as that of our industry can best be served by taxing nonbeverage alcohol at not more than $2.25 per proof gallon. Therefore, the foods and medicines industry urges this committee to amend the House bill and fix the rate of draw-back on nonbeverage alcohol so as to provide a net tax of not more than the present rate of $2.25 per proof gallon.

I might point this out: The maximum revenue that the Department received from this nonbeverage alcohol was at the time they had this effective rate of $2.25 per proof gallon. That is borne out by the 1942 figures. There are none available since then, because the figures have not been published, but we are thoroughly convinced that that figure of $2.25 does establish their maximum revenue, because, beyond that, other factors begin to intervene. In fact, when it was increased from $2.25 to $3 the consumption went down 26½ percent, and the revenue decreased $370,000.

We recommend, in other words, the retention of the present $2.25 net tax on the nonbeverage use.

Senator WALSH. We thank you.

(The following statement was submitted for the record:)

JOINT STATEMENT OF AMERICAN PHARMACEUTICAL ASSOCIATION AND NATIONAL ASSOCIATION OF RETAIL DRUGGISTS

THE TAX ON DISTILLED SPIRITS

Alcohol is an essential article in the preparation and preservation of many drugs and medicines required in the diagnosis, prevention, and treatment of diseases. These necessary drugs and medicines should be available to those who require them at the most reasonable cost possible.

Previously, the tax on alcohol was $2.25 per proof gallon. In the last revenue act the tax was increased to $6 per proof gallon with a provision for a draw-back of $3.75 per proof gallon on alcohol employed in the preparation of drugs and medicines upon payment of an occupational tax. The occupational tax and the extensive records required have made it possible for only a small percentage of the dispensing pharmacists of the country to avail themselves of the draw-back provision. The result has been that most of these pharmacists paid the full tax of $6 for the alcohol employed by them in the preparation, preservation, and dispensing of drugs and medicines including prescriptions.

In case the tax is now increased to $9 per proof gallon, the result will be a correspondingly greater expense.

The associations which are submitting this brief therefore respectfully recommend that in case the tax is increased to $9, the draw-back be set at $6.75 per proof gallon and that the draw-back be based on the use of the alcohol rather than on the sale of drugs and medicines in which it is used, in order that the records required of those who apply for the draw-back may be simplified.

The Secretary of the Treasury was recently reported to have expressed as his judgment that the Congress would not put a sales tax on food, medicines, and clothing. It is equally important that an additional tax should not be imposed on the alcohol required and used in the preparation, preservation, and dispensing of drugs and medicines.

Respectfully submitted.

AMERICAN PHARMACEUTICAL ASSOCIATION.
R. F. KELLY.
NATIONAL ASSOCIATION OF RETAIL DRUGGISTS.
GEORGE H. FEATES.

STATEMENT OF GEORGE H. BURNETT, TREASURER OF JOSEPH BURNETT CO., BOSTON, MASS.

Mr. BURNETT. My name is George H. Burnett, treasurer of Joseph Burnett Co., Boston, Mass. We have been engaged in the manufacture and sale of flavoring extracts for the past 98 years.

In addition to representing Joseph Burnett Co., I am also representing the Flavoring Extract Manufacturers Association, National Association of Manufacturers of Fruit and Flavoring Syrups, and National Manufacturers of Soda Water Flavors.

I am here to speak to you regarding a change in section 309 (B), draw-back on internal-revenue taxes on distilled spirits, of H. R. 3687. The proposed measure calls for a tax of $9 a proof gallon, or $17.10 per actual gallon on distilled spirits, which includes ethyl alcohol. If this ethyl alcohol is used in the manufacture or production of medicines, medicinal preparations, food products, flavors, or flavoring extracts unfit for intoxicating beverage purposes, a draw-back is provided at $5 a proof gallon, or $9.50 per actual gallon, making a net tax of $4 a proof gallon, or $7.60 per actual gallon, as compared with the present net tax of $2 25 a proof gallon or $4.27½ per actual gallon.

Practically all member companies of the foregoing associations are vitally interested in the present and proposed tax on distilled spirits, due to the fact that they use ethyl alcohol in the manufacture of aforesaid food products.

Every member company is aware of the difficulties attendant upon taxation generally and keenly alive to the need for increased Federal revenue. In the name of most of the member companies they would prefer to continue to use ethyl alcohol as a solvent or preservative instead of resorting to a substitute, thereby making a better product and producing revenue for the Government.

Under the regulations of the Alcohol Tax Unit in accordance with the provisions of the revenue bill of 1942, each manufacturer must pay an occupational tax of $25, $50, or $100 per annum to be eligible for the privilege of draw-back. When the alcohol is purchased the present internal revenue tax of $6 a proof gallon or $11.40 per actual gallon must be paid prior to withdrawal. Accurate records must be kept showing alcohol purchased, its use, and so forth. Finally, it must be proven to the Treasury Department that the finished product containing the alcohol has been sold or otherwise transferred for other than beverage purposes. Only then can a claim for draw-back be made, which claim is submitted at the end of each 3 months next succeeding the quarter for which the draw-back is claimed. The claim is filed with the local Collector of Internal Revenue, where a record is made of it. It is then turned over to the local office of the Alcohol Tax Unit and checked by the district supervisor who examines the books and records of the manufacturer, rechecked by the Alcohol Tax Unit in Washington, and rechecked again by the General Accounting Office. It is then turned over to the local collector of internal revenue for payment. With all these safeguards, no loss in revenue can be incurred by the Treasury Department by diversion of alcohol to intoxicating beverage purposes.

We have not had quite a year's experience in the filing of draw-back claims. We have no complaint with the cooperation received from the Bureau of Internal Revenue, for these draw-back claims were new to the industry and new to the Bureau. But the fact remains that 9 months to a year elapse before we receive our draw-back money. This means, then, that we pay our occupational tax of $100 per annum and approximately 55 cents for a gallon of alcohol, an internal-revenue tax of $11.40 on each actual gallon of alcohol, and then fabricate our product. After keeping all required records, selling the products and waiting for the end of each 3-month period, we are privileged to file our claim for draw-back, and then wait months for a refund check. But we anticipate and hope that as the draw-back system becomes more familiar to us and to the Bureau of Internal Revenue, unusual delays will be eliminated.

I want to interpolate there that we present these facts just to give you an idea of the seriousness of the thing. We have at the present time due us on draw-back claims and alcohol not yet subject to draw-back claims an amount equal to 27 percent of our total invested capital, and with the new tax that will go up to 40 percent of our total invested capital.

It is a very serious burden to bear.

Just a little over a year ago we paid a net tax of $4 a proof-gallon, or $7.60 per actual gallon, on ethyl alcohol purchased, at which time we pointed out to this committee the inequity in such a tax rate on a commodity becoming a part of an essential and necessary food or medicinal product. We pointed out also the fact which is a matter of importance today, that the Treasury Department derived its greatest revenue from nonbeverage alcohol when the tax was $2.25 a proof gallon or $4.27½ per actual gallon. That any increase over this net rate resulted in decreased revenues to the Treasury, caused either by the use of a substitute for ethyl alcohol whenever and wherever possible and the fact that many manufacturers were compelled to discontinue the production of certain alcoholic items. All these reasons caused the Senate to grant us the lower tax base, effective November 1, 1942.

What was true 1 years ago is true today and with greater emphasis. The action of this committee a year ago gave to that segment of the food and medical industry using pure ethyl alcohol an opportunity to add to the Federal income and at the same time pass along the saving to the consumer. Similar action is sought today, and we hope the committee will provide for sufficient amount of drawback so as to make the net tax on nonbeverage ethyl alcohol not more than $2.25 a proof gallon, or $4.27½ per gallon, the present net tax.

Your committee has heretofore distinguished between ethyl alcohol used for food, medicine, and flavoring manufactures; that is, essential and necessary uses, as compared with intoxicating beverage use; that is, luxury use. Unfortunately for the nonintoxicating beverage using industries, the Ways and Means Committee in considering excise taxes as a whole lost sight of our problem in the mass of detail to be considered. The House report states that a most productive source of revenue is increased excise taxes, and "by this method, it is possible to select those goods which are clearly luxuries and tax

them at a rate in accordance with the particular market situation." We respectfully submit that food products and medicines do not fall in that class designated as "clearly luxuries."

We are only now beginning to catch our breath after a painful struggle to operate under the recent tax rate of $4 a proof gallon, or $7.60 per actual gallon, on nonbeverage alcohol. The net rate of $2.25 a proof gallon, or $4.27½ per actual gallon, which we now pay has been the salvation of our business. Any increase in this net rate will prove detrimental to the Treasury and to the nonintoxicating beverage using industries alike. We hope, therefore, the committee will amend the House bill 3687 and increase the amount of drawback on nonbeverage alcohol so as to provide a net tax of not more than $2.25 a proof gallon, or $4.27½ per actual gallon, and continue in effect the current tax, or in other words that if the proposed tax of $9 be imposed that a drawback of $6.75 be authorized.

Senator WALSH. Senator Brooks has sent a letter to the chairman of the committee relative to this amendment, and I offer it for the record at this point.

(The letter referred to is as follows:)

UNITED STATES SENATE,
COMMITTEE ON APPROPRIATIONS,
Washington, D. C., December 3, 1943.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate Office Building, Washington 25, D. C.

DEAR SENATOR GEORGE: My attention has been called to a tentative suggestion to remove the 8-year bonding limit on liquor.

It is pointed out that to reduce the limit to 4 years would undoubtedly force a lot of liquor on the market at the present time and require the payment of a very heavy tax. If, however, this limit were removed, it would not be long until there would be practically no liquor for taxation, and the loss to the Treasury would be heavy. Further, it is charged that no limitation exists in England or Canada, and that their Scotch and other liquors would be marketed at the expense of our products, as all purchasers are anxious to have liquors that have been aged properly and that are as old as possible.

Illinois has a number of large distilleries, and would suffer in taxes to a considerable extent if the liquor business were reduced. Further, it is represented it would be necessary for the manufacturers to cash their War bonds or borrow large sums of money to meet the additional tax, so that the Department of the Treasury would not benefit to any appreciable extent.

I believe the situation is of sufficient interest to the country at large for the Finance Committee to give it careful consideration before adopting such a provision in the present revenue bill.

Yours very truly,

C. WAYLAND BROOKS.

STATEMENT OF EDWARD FILLMORE, NEW YORK CITY

Mr. FILLMORE. I represent the Associated Fur Coat and Trimming Manufacturers who manufacture and produce fully 85 percent of all the wearing apparel sold throughout the United States. Therefore you see we are affected by the increase in taxes.

Senator WALSH. How much time do you desire?

Mr. FILLMORE. Just about a minute, for this reason, because I understand that Senator Mead appeared before this committee yesterday. I read the testimony of Senator Mead as well as that of Mr. Brenck-

man, of the National Grange, and the arguments they have advanced are wholly in accord with our views.

We feel this tax is unfair and unjust; there is no justification for fur-wearing apparel to be penalized. We have been paying a tax off and on for 20-odd years. In the interim they have given us some relief, but in 1941 the tax was put back at 10 percent. We feel that 10 percent on fur-wearing apparel is ample.

Senator WALSH. What did the House recommend?

Mr. FILLMORE. Twenty-five percent. We cannot be compared to jewelry which is wholly a luxury, or toilet articles or things of that sort. We feel that somewhere this has been ill-considered. This is a small industry. There are no very wealthy men in the industry. It is comprised of small industries and a tax of this nature will be very burdensome, and it would not produce the revenue that the Ways and Means Committee thought it might produce. Twenty-five percent would be almost a prohibitive tax. The fur articles would not be attractive. The competitive angle should also be considered. We compete with cloth garments. Most of the articles are sold at less than $200. All of these garments are worn by the working classes. I think the theory of fur being a luxury has been discarded many years ago. It may be a luxury in the sable class, but it certainly cannot be considered a luxury in the class of garments that are worn daily as a protection against the elements by the working class, and therefore we feel we have been treated rather badly in suggesting this tax of 25 percent. We are perfectly willing to pay a tax of 10 percent, although it is hard to pay that, because we feel it is discrimination due to the fact that it is the only article of wearing apparel that has been taxed. Gentlemen's coats selling at $100 or $150 go free of taxes, yet a woman who pays $50 to $75 for a garment to keep her warm has got to pay a tax, and for that reason we think it is unfair.

Under the revenue law of 1941, Congress imposed a tax of 10 percent on articles made of fur, which now, by section 1650 of H. R. 3687, it seeks to increase by an additional 15 percent, making a total tax of 25 percent on the price to the consumer, and the manufacturers of fur wearing apparel join all individuals and all those other factors, in and out of the industry, who have heretofore requested the Senate Finance Committee to reject and eliminate the proposed increase, for the following reasons:

(a) That the tax on fur wearing apparel is highly discriminatory and unfair, because furs are the only articles of wearing apparel that have been singled out for excessive taxation, while all other articles of wearing apparel, made of every other material, go tax free.

(b) That fur wearing apparel is just as essential as any other wearing apparel, and even more so where climatic conditions demand the use of furs, which have a greater utilitarian value than apparel made of any other material. Therefore, imposing a prohibitive tax of 25 percent on fur wearing apparel is most unfair to those who require furs to protect them against the ravages of winter climates. In no sense of the word can furs, under such conditions, be considered a luxury, justifying the imposition of a tax penalty on the wearer.

(c) That the only possible theory which can be urged as a pretended justification for a tax on fur wearing apparel, while other wearing

apparel goes tax free, would be the exploded hypothesis that furs are a luxury. This premise has long since been discarded, especially in the United States, because statistics establish that 60 percent of all the furs used in the United States are in the lower price brackets, selling for less than $100 and from $100 up to $295, all of which are bought and consumed by the working class. Of the remaining 40 percent, not more than approximately 10 percent could be truly considered in the luxury class, while 30 percent is required by the middle class, not as a luxury, but as a distinct necessity. Therefore, a tax on fur articles would not be a tax on a luxury, but would constitute a discriminatory, penalizing tax, which Congress, in its fairness, should not countenance.

(d) That even the present tax of 10 percent, imposed in 1941, would have seriously affected and retarded the sale of fur wearing apparel had not the economic condition of the workers of our country been improved as a result of present world conditions. However, there can be no doubt that an added burden of 15 percent would have a disastrous effect up the fur industry, which supports approximately 500,000 farmers and trappers, whose income is greatly dependent upon that industry, along with the 75,000 firms and individuals engaged in or employed by those engaged in the fur industry.

(e) That if it is proposed to impose this additional tax of 15 percent on fur articles to obtain additional revenue, we are definitely of the opinion that the proposed increase will defeat its own purpose, as a tax of 25 percent would make a very big difference in the attractiveness of fur articles to the consumer, and would in many cases be sufficient to act as a deterrent to the purchase of a fur garment, no matter how badly it was needed.

As already indicated, most coats sell for, let us say, between $100 and $295. At 10 percent on a $295 coat the consumer would be obliged to pay a tax of $29.50; at 25 percent the tax for the same coat would be $73.75. To those buying a fur coat in this price range a tax of $74 is prohibitive. Such a tax would so intensify consumer resistance that the resultant reduction in the sale of fur wearing apparel would, we are convinced, yield a smaller aggregate revenue at the 25 percent rate than that which has heretofore been obtained at the 10 percent rate.

(f) That in no sense of the word can fur wearing apparel be classified with distinctly luxury articles, such as jewelry, toilet preparations, perfumes, and so forth. Fur wearing apparel, regardless of the kind and type of pelt from which it is made, whether the lowly rabbit or the precious sable, has a distinctly utilitarian value, by reason of its exceptional qualities for protecting the wearer, poor or rich, against the rigors of the elements. Yet no greater increase in the tax rate has been proposed for any of these distinctly luxury items than that which has been proposed for furs, and in fact the proposed increase in the tax rate on jewelry, the most distinctly luxury item of them all, is from 10 percent to 20 percent, or 5 percent less than the increase in the tax on furs.

(g) That even if there were a reasonable prospect of increased revenue, and we repeat our conviction that this is a fallacy, we feel, in

the light of all the reasons heretofore advanced, that Congress would not be justified in increasing the tax on furs from 10 percent to 25 percent.

The fur-manufacturing industry is a very small industry, composed of many small units. Due to the peculiar nature and inherent characteristics of the business, it is a very hazardous one, combining as it does all the risks of a pursuit dependent not only for the supply of its basic raw material, but also for the demand for its product, upon the whims and fancies of nature, and, in addition, in the matter of consumer demand, on all the whims and caprices of human fickleness and fancy.

Those engaged therein have accumulated no great wealth. They work very hard to eke out a modest livelihood. Naturally, they want to do all in their power to further the national endeavor and to bear their share of Government maintenance in this hour of unprecedented national expenditure. However, they believe that a tax of 10 percent on the retail output of such a small industry is about as much as can reasonably be expected, and that the imposition of a 25 percent tax would affect their businesses so seriously and detrimentally that they feel justified in praying that the Senate Finance Committee reject the proposal to increase the tax from 10 percent to 25 percent and allow the tax on furs to remain at the old rate of 10 percent.

If added revenue is needed, and the members of the fur manufacturing industry are just as mindful of this need as is every other thinking American, then the fur manufacturers respectfully urge upon the members of the Senate Finance Committee, as they have in the past, the adoption of a uniform sales tax, affecting all alike, and the abolition of all discriminatory excise taxes.

Senator WALSH. Thank you very much, Mr. Fillmore.

STATEMENT OF MARTIN H. MILLER, NATIONAL LEGISLATIVE REPRESENTATIVE, BROTHERHOOD OF RAILROAD TRAINMEN

Mr. MILLER. Mr. Chairman, may I call your attention to the proposed amendments on page 29 of the bill, which would place the railroad workers in the same category with the other workers relative to back pay attributable to prior years?

Senator WALSH. Very well.

Mr. MILLER. My name is Martin H. Miller and I am national legislative representative of the Brotherhood of Railroad Trainmen, with offices at 10 Independence Avenue SW., Washington, D. C. The international or grand lodge headquarters of the brotherhood are located in our building at Cleveland, Ohio. The Brotherhood of Railroad Trainmen is a labor organization whose membership consists of railroad conductors and brakemen, road passenger and freight, and yard service; train baggagemen; switchtenders; car retarder operators; yardmasters; and operators of highway busses.

The brotherhood, as an organization, and its members, as individuals, are deeply interested in the 1943 revenue bill, H. R. 3687. We are interested in tax legislation that will be formulated upon the ability of the taxpayer to meet the obligations imposed. Such principle of taxation should be adhered to at all times; it is most essential in time of war, if our Nation hopes to maintain a steady economic balance.

The members of the brotherhood recognize that the Nation's expenses, however great, must be met and that taxation affords the best possible media to meet the expenses of government.

The Brotherhood of Railroad Trainmen, by action of several conventions, has unanimously adopted resolutions opposing the idea of a sales tax. While the provisions of the bill now under consideration do not provide for a general sales tax, the House Ways and Means Committee, which had the bill under consideration, gave considerable attention to the idea of a general sales tax. There appears to still be some sentiment for that type of taxation.

The only real argument thus far advanced in behalf of a sales tax appears to be that of shifting the burden of taxation from those with the ability to pay their just proportion of taxes to those less able to bear any additional burdens. As a general rule, the proponents of a sales tax are usually the representatives of the high-income groups, who support that method of taxation in the hope that the great bulk of the tax burden will be shifted from them to the many millions in the low-income groups. I trust that the news reports advising that this committee will not give serious consideration to a general sales tax are correct.

The brotherhood is of opinion that section 110, back pay attributable to prior years, on page 29 of the bill, should be amended by adding subsections, as follows:

(d) Arising out of any awards or agreements under the provisions of the Railway Labor Act; or

(e) Arising out of any retroactive wage increase approved by the National Railway Labor Panel.

The aforementioned suggested amendments, covered in subsections (d) and (e), are for the purpose of making the section applicable to railroad employees who may receive back wages, which were earned in prior years and should rightfully be credited to such years, the same as the provision made to care for such back wages under the National Labor Relations Act, Fair Labor Standards Act, and the awards of the National War Labor Board. The operating employees of railroads have several thousand claims pending before the National Railroad Adjustment Board, Division I, many of which will take from 2 to 4 years, or longer, before being decided.

The brotherhood is opposed to that provision of the bill requiring returns of organizations exempt from taxation (p. 28). The brotherhood is one of the organizations now exempt from taxation and exempt from filing returns under present law. Our organization is a labor union, which, in addition to handling wage and working conditions, provides the members with optional insurance certificates. It also provides care for our members afflicted with tuberculosis and, jointly with two other transportation brotherhoods, maintains a home to care for our aged and infirm members.

Our members are regularly provided with reports of financial receipts and disbursements. The general committee and State legislative boards are required to furnish each lodge and local chairman or representative a quarterly statement of the receipts and disbursements of the funds, such disbursements including detailed statements. The general secretary and treasury furnishes each lodge, grand lodge officer, chairman of the general committee and State legislative board with a monthly statement of all receipts and the disbursements from the

funds. The Railroad Trainman, our official publication, issued monthly, contains itemized disbursements from the insurance fund and monthly statements are issued on the disbursements of the accident and health and hospital insurances. Quarterly statements are issued on the disbursements from the tuberculosis fund, giving the names of the members, amount expended, and where hospitalized or on home treatment. The general secretary and treasurer also furnishes each lodge with an annual statement covering the receipts for and disbursements from all funds.

Section 112 of the bill would require the brotherhood to file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe. If the brotherhood is required to comply with the foregoing provisions, it will be compelled to keep additional records, make up new and different reports of the items mentioned, and comply with any and all regulations which the Department of the Treasury may prescribe, which would add unnecessarily and unreasonably to the cost of the brotherhood's operations. It appears that the provisions contained in section 112 are a far-flung departure from what should constitute a revenue-raising bill, in that such provisions do not seek to raise any revenue whatsoever but are only an attempt to have a department of Government inquire into the business and affairs of groups not considered taxpayers under the law. Why do the provisions of the bill separate from the tax-exempt organizations the religious, educational, and charitable organizations?

The provisions of section 112 will not produce any revenue but, to the contrary, will add additional expenses to the Treasury Department in receiving and compiling the returns which are required to be filed by the tax-exempt organizations. The provisions of this section appear to be substantially the same as provisions of antilabor bills introduced in the Seventy-seventh and Seventy-eighth Congresses, with the only substantial difference being that in some of the bills the labor organizations were required to report under regulations prescribed by the Secretary of Labor and others under regulations prescribed by the Secretary of Commerce. It is true that the provisions of this section apply to the fraternal orders, fraternal beneficiary associations, funeral benefit societies, patriotic and business associations, as well as to labor unions. If the filing of returns, as provided in this section, applies to all organizations or units thereof, it would be such a gigantic task to receive and file such returns, without any study or consideration of them, that it would require the additional services of many hundreds, if not thousands, of Treasury Department employees. As aforementioned, we believe such a provision in a revenue bill, or otherwise, is an unnecessary and unreasonable requirement upon fraternal orders, fraternal beneficiary associations, patriotic organizations, and labor unions, and should be eliminated as a requirement in the revenue bill.

In conclusion permit me to say that it is unfortunate for the people and for your committee that the millions of citizens in the lowest income groups do not have and cannot have expert representatives to study, to plan, to devise, and to continually offer ideas of taxing methods favorable to them, that you and the other Members of Congress could have the value of the differences by comparison of equal submissions. The inability of those groups to be equally represented makes your task that much harder and oftentimes leads to the acceptance of the ideas of the groups best represented rather than a fair and equitable distribution of the tax burden based upon the ability of the taxpayer to meet the imposed obligations.

STATEMENT OF MYRON EVERTS, REPRESENTING THE JEWELRY INDUSTRY OF THE UNITED STATES

Mr. EVERTS. Mr. Chairman, this brief will confine itself largely to only three points:

First. It is a physical impossibility for this jewelry tax to get the money you want.

Second. The present tax rate will produce more revenue for the Government next year than the proposed rate.

Third. These being so, you do not want to pass a punitive tax bill that will only put thousands of jewelers out of business.

The revenue bill of 1943 estimates the retail jewelers' excise tax, now called a war tax, will produce $161,700,000, an increase of $72,500,000 over the $89,200,000, the estimated amount for 1943 (new rate 20 percent). This estimate of $89,200,000, we believe, is at least $10,000,000 too low.

That this statement is made without having any knowledge of the conditions now existing in the jewelry industry is very evident. Therefore we present the following in order that you may have the exact facts before you at this time.

In April 1941 it was indicated that Congress would impose an excise tax of 10 percent on jewelry, and that was finally passed and became operative on October 1, 1941.

Although the country at that time had not entered the active expansion of the war production program, so there was very little excess money in the hands of the workers, and there were unrestricted inventories in the stores of our members, and the 15,000 or more jewelers who were not members; nor was there any serious restrictions on sales of other so-called nonessential goods, the sales of jewelry wares began at once to show marked advances until September, when they reached a gain of about 300 percent. Please bear in mind this was during the summer. If a threatened tax of 10 percent will produce such a gain under those conditions, it does not take much imagination to visualize what a threat of 20 percent will do right now with the Christmas buying season just ahead and the largest reservoir of money ever known in the hands of people eager to own articles of adornment and furnishings for their homes they have always craved.

In considering this your attention is directed further to the following: Nearly all of those industries which competed for the consumer dollar with the jeweler have been greatly restricted or completely eliminated, with the result that the sale of taxable jewelry store wares in 1943 will reach about $1,000,000,000, or $100,000,000 in taxes.

However, that is not all of the story, and we request that you look at the picture as of today in relation to the future and its ability to produce revenue. Every business has its share of the restrictions due to the necessities of the war program and the jeweler has his full share. No silver-plated ware since April 1942, no American watches—these two items alone were the backbone of the smaller jewelers, 15,000 of them. Swiss watches are becoming very rare, except some very inferior qualities, all military-type watches have been taken for the Army and Navy. No more clocks, no fountain pens or pencils, no cigarette lighters, no lamps, no metal gift wares, no iridium or platinum to make fine jewelry, almost no men's wedding rings and greatly restricted quantity of women's wedding rings. Sterling silver restricted to 50 percent of 1941 or 1942 production and the O. P. A. regulations requiring a dealer to trade dollars as he must charge the same number of excess dollars and cents to the consumer that he is required to pay for domestic silver, the only silver now available, curtailing the retailer's margin to a point where he is handling sterling silver without profit.

Karat gold and gold-filled restricted to 50 percent of 1941, which was not a very active year in these articles, so that it is not possible to secure any substantial weight goods, such as signet rings for men, or men's wedding rings now in great demand for soldiers, and creating a serious black-market condition.

Thousands of articles made from moderate-priced, semiprecious, and synthetic stones, and cultured pearls, et cetera, all of which originated abroad, are no longer available except those now in the stores.

All of this adds up to this indisputable fact, that shelves and showcases in the stores are already becoming bare and there is not enough goods available to replenish them; the threat of additional tax will mean that after the coming Christmas gift-buying there will be very few jewelers who will have anything left to sell.

After the present Christmas buying season the smaller retailer jeweler will find himself with almost nothing to sell, and there are not less than 15,000 of them, because they depend almost entirely on American watches, electric and alarm clocks, silver-plated ware, wedding rings, cigarette lighters, and some inexpensive sterling silver and men's signet rings, all of which he will be unable to replace.

On the other hand, the larger jeweler, the bulk of the volume of whose sales was obtained from selling a large quantity of these same items plus moderately priced silver and gold jewelery, will have only his more costly jewelry set with precious stones, watches with jeweled cases, and fine sterling silver, remaining and available in very limited quantities to sell. A tax of 20 percent on these wares will create so much resistance the sales will show a definite drop. Consumers who purchase articles of this type will refuse to purchase when there is a high tax rate.

We believe Congress should at this time let it be known that they will not advance the present rate of excise tax on jewelry in order that the public will not absorb all the goods and destroy the possibility of securing revenue next year.

To secure $161,700,000 in excise taxes on jewelry in 1944 simply cannot be done because there just won't be any goods to sell unless a reasonable rate is made and publicized right now because, as stated,

there will not be sufficient goods on hand or available to produce a sufficient volume of sales to produce enough revenue even remotely approaching such an amount.

We find that Congress has been charged with the duty of "imposing taxes to produce revenue to meet the expense of the Federal Government." We contend that this does not grant to Congress the right to impose a tax on selected industries that are purely punitive in nature; therefore, we must assume the purpose of this revenue act is exclusively to secure revenue, hence the rate of such a tax must be one that will actually produce the most revenue.

So far as the jewelry industry is concerned, we believe the present rate of 10 percent will produce the maximum amount of return. As stated, a higher rate such as proposed in this law, unless immediately withdrawn, will do two things: (1) Force all the available stocks into the hands of the buying public; (2) close the great majority of the 24,000 retail jewelry stores, throwing at least 100,000 workers out of work, most of them being too old to secure a livelihood in other industries.

On page 26 of Report 871, Mr. Doughton states:

> As your committee felt that the rates of excise taxes contained in this bill were justified only in view of the wartime emergency, it was provided that the increases imposed shall terminate 6 months after the close of hostilities in the present war—

section 1650.

Now, gentlemen, especially in view of the fact that excise taxes were imposed on jewelry in the Revenue Act of 1941, we request that the entire excise or war tax shall be repealed in this law, not merely the additional amount, the same as is provided by section 1656, which eliminates the new excises provided in sections 1651, 1652, and 1653.

We understand that you are giving serious consideration to making all reductions possible in Goverment expenditures to avoid the necessity of raising the additional revenue requested by the Treasury. We commend this because we believe the rates of taxes now in use are as high as the average person and business can bear.

In 1917, 1918, 1932, and 1941, we advocated the imposition of an over-all tax on retail sales without any exceptions whatever as being the only economically sound method of securing revenue for emergency, the law when passed to provide for its repeal when the emergency ended, the rate to be determined by the amount of money required.

After the experience gained from the operation of these four tax bills, all enacted in times when an emergency faced our Federal Government requiring large sums of money, we are more firmly convinced than ever that this is the only method. It will produce the required revenue and no other plan has done so.

Mr. Chairman, in conclusion, I request permission for the two national retail associations to submit brief statements.

I submit a statement on behalf of the National Association of Credit Jewelers.

Senator WALSH. That may be made a part of the record.

(The statement referred to is as follows:)

STATEMENT TO THE SENATE FINANCE COMMITTEE ON BEHALF OF THE NATIONAL ASSOCIATION OF CREDIT JEWELERS, DECEMBER 8, 1943

This statement is presented on behalf of the National Association of Credit Jewelers which represents at least 80 percent of all installment jewelry business in the United States.

The following facts pertaining to further excise taxes on merchandise sold by retail jewelers are respectfully submitted for your consideration:

All goods sold by retail jewelers, and which already are subject to a 10-percent excise tax, are by no means luxury items. Medium-priced watches, clocks, wedding rings, silverware, alarm clocks, and various other items which are singled out for special luxury taxes are less luxury goods than many other untaxed items.

In considering the proposed 20-percent sales tax on jewelry-store merchandise, it is suggested that your committee bear in mind that the major portion of all sales made by retail jewelers is comprised of small units and that most of the sales are made to individuals in the medium and lower income brackets. For retail jewelers throughout the whole country, the unit of sale averages from $5 to $10. These moderate purchases from retail jewelers are not made by consumers who have too much money to spend—they are not made by individuals who comb the markets for luxuries and bid up for goods that are scarce and unusual, thus encouraging higher prices and inflation.

Most of the sales made by installment jewelers are for gift purposes and many of these modest gifts go to the men and women in military service and help to keep up their morale. These sales have played a substantial part in increasing jewelry sales during the last year.

To penalize those who buy gifts of jewelry-store merchandise for men and women in military service by imposing an excessive sales tax certainly would be both undesirable and unfair.

Facts, backed by the best figures available, indicate that a reasonable tax on jewelry sales, or no tax at all, will yield more Federal revenue from the jewelry industry than a tax so high that it will stop the public from buying jewelry-store merchandise, or cause those who will buy jewelry to try to avoid the tax.

Any excise tax imposed upon jewelry sales should be for the sole purpose of raising revenue. The question as to whether or not some may consider the jewelry business necessary or unnecessary to the winning of the war should not be allowed to influence a strictly revenue measure.

Your attention is directed to the probability that the war in Europe may come to an abrupt end. Under such circumstances, does it seem wise to levy at this time a tax so high that it can cause an entire industry to stagnate?

Does it seem sound to do that which will impair or destroy the livelihood of the men and women engaged in making and selling jewelry?

Does it pay to assume that the public's willingness and ability to buy merchandise of all kinds regardless of price will continue for a long enough period after the ending of the war in Europe to take the chance of taxing an industry to death at a time when all business will have to be encouraged to prevent a depression?

Furthermore, does it seem advisable to vote higher taxes on jewelry sales at a time when wartime restrictions on metals and other materials are decreasing retailers' stocks to a vanishing point—when merchandise shortages, if they continue and grow more acute, will force many jewelers out of business?

If retail jewelers' sales volume in 1944 is reduced by about 50 percent because of merchandise shortages caused mainly by curtailment of production, an excessive sales tax will not make the outlook for substantial revenue from the jewelry industry encouraging.

It is submitted for your consideration that the amount of revenue that can be and will be derived from any tax on retail jewelry sales in 1944 is so bound up with the fortunes of war in Europe—so dependent upon continuance of our present-day wartime pay rolls and an adequate supply of jewelry merchandise—that it should be obvious that this is not the time to impose a tax so high that it seems intended to depress jewelry sales while wartime spending is at its peak.

Many other sound reasons for not imposing further and higher taxes on jewelry sales have been stated by others, and in conclusion I respectfully ask that all of them receive your careful attention.

fact, several hundred jewelers have retired from business, because goods could not be had for resale. When it is understood that jewelers' stocks show an average turn-over of about once a year, this situation becomes plain.

To illustrate the present position of the average retail jeweler as to merchandise, the following facts may be clarifying:

1. Silver-plated ware has not been made for over a year and cannot again be made because of metal shortage. No more taxes will be collected on this item, because retailers' shelves are bare.

2. Sterling silver is now manufactured 50 percent of normal quantities. Reserve stocks are sold out, and the revenue from sterling silver cannot exceed a sum obtainable from one-half of the annual output—a definite shrinkage of tax return is sure.

3. American watches are no longer made, and almost all retailers' stocks are completely sold out. There can be no return from this source.

4. Gold is restricted by the War Production Board to one-half of the 1941 quantity. This must, of necessity, lower sales and a considerable loss of tax collections must result. This is especially true in the case of the small jeweler, who is already finding it hard to get even sufficient wedding rings to supply his trade.

5. Swiss watches continue to arrive in fair quantities but the Government is taking 20 percent of them. As a result, the retailers cannot secure normal needs and, having no American goods, his sales will be considerably lower than a year ago. Again reduced revenue.

6. Revenue from clocks—which are no longer made—will be practically nil.

7. Base metal-plated goods are out for the duration and stocks are practically gone. No more tax from this source.

Based on the above, and assuming that no immediate relief is in sight, it is our opinion that gross sales of jewelry will drop about 40 to 50 percent in the next year, unless some encouragement to buy his higher-priced items is given. This can be done by leaving the tax at its present level. Far more serious is the threat to small jewelers in rural areas where a 20-percent tax will put them out of business. There are fully 10,000 in this class, and their plight is really serious.

If the 20-percent tax is placed on jewelry, it will be collected almost entirely from the merchants in the larger cities, but because purchases in the higher-priced goods will be still further curtailed and greatly reduced quantities of other merchandise is available, the total will in our opinion drop to not more than 60 percent of the present total.

On the other hand, a continuance of the 10-percent levy will, we feel, do the following:

First, greatly increase the sale of precious stones and high-priced goods, on which considerable tax will be collected.

Second, keep thousands of small merchants in business and get through them a larger return on goods that will not otherwise be sold.

Third, raise more money as a whole than the larger impost will produce.

Fourth, prevent evasion of payment of taxes in the larger cities, where most of the tax is collected.

We would not object to the 20-percent tax if we felt it would serve the purpose for which it was written, but we are as certain of its result as we were when recommending a retail sales tax in 1941, and in which our convictions were justified. Selective excise taxes in excess of reasonable limits, not only will bring in less revenue but will, in this instance, cause irreparable hardship to an already severely harassed trade—or at least to that part of it which has benefited least from increased national income.

In the interest of the Government, of the trade which I have the honor to represent, and of the general economy, a continuance of the present 10-percent retail tax on jewelry is urged.

STATEMENT OF JOHN W. HOOPER, ON BEHALF OF BROOKLYN CHAMBER OF COMMERCE

Mr. HOOPER. Mr. Chairman, the Brooklyn Chamber of Commerce appreciates this opportunity to present certain observations on H. R. 3687, Revenue Act of 1943.

At the outset, may I emphasize that those of us in Brooklyn who are seriously concerned with the future of the business system are indeed gratified that H. R. 3687 does not reflect the grossly inequitable program of tax rates proposed by the Treasury allegedly for revenue and inflation-control purposes.

However, in the interest both of really controlling the threatened inflation at the source, and of enacting sound revenue legislation, we offer these criticisms of the proposed new revenue act together with specific suggestions for constructive revisions:

1. The proposed decrease of one percentage point in the excess-profits credit on invested capital in excess of $5,000,000 is another dangerous step toward destruction of the incentive system. The Ways and Means Committee has indicated that the purpose for the proposal, aside from revenue, is to offset the increasing excess-profits credit of invested capital companies which has resulted from undistributed profits being added each year to the base for such credit. The committee cites that such an avenue of increase in credit is not open to corporation taxpayers employing the pre-war earnings method of computing excess-profits credit. This chamber's opinion, based upon very close contact with the management of hundreds of Brooklyn industries, is that, by and large, taxpayers employing the pre-war earnings method of arriving at the excess-profits credit are companies still mainly engaged in their customary peacetime activities; they have not been obliged to suspend much, if any, of their peacetime work in order to participate in war production. On the other hand, companies that employ the invested-capital method are, in our experience, by and large engaged mainly in war work, having virtually ceased peacetime activities except for repair and maintenance services for the trade, and are concerns which have spent large sums to convert to war production. We are confirmed in the opinion that such invested capital companies, under the present law, are already laboring under inadequate recognition of the value of the capital at risk, because the excess-profits credits are diluted by the application of the 40-percent tax on normal income. The real net earnings under the present law

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and as proposed, in terms of percentages to invested capital, are as follows:

	Present law	Proposed law		Present law	Proposed law
	Percent	Percent		Percent	Percent
First $5,000,000	4.0	4.5	Next $90,000,000	2.0	2.0
Next $5,000,000	4.2	3.6	Over $200,000,000	2.0	2.4

When these rates of return are considered in conjunction with the taxes paid by individual shareholders on the dividends from the companies, the combined net return to the shareholder is reduced to an absurdity as an incentive for investment where risks are involved. Those in a position to know can state without equivocation that it is well-nigh impossible today to induce capital to go into a new venture. The return to the stockholder is hardly more than the yield of Government bonds and savings banks, yet without the security attending the investment in such institutions.

When it is realized that even the 90-percent excess-profits tax rate—and this bill proposes 95 percent—makes it unlikely that enough additional net income classed as excess profits will be realized to offset the burdensome 40 percent reduction of the excess profits credit on normal income, then the aforementioned net rates are even more disquieting by way of inadequacy of return.

Further, the Ways and Means Committee has stated that 31.4 percent of all dividends are received by stockholders earning net income from all sources aggregating under $5,000. Consider the consequences of this in the present system of taxing corporations which does not recognize the principle of ability to pay from the standpoint of its effect on the investor as compared with taxes levied on salaries and wages. Take, for example, the case of a married person, with two children, having net income from all sources of less than $5,000. He is taxed, under the present law, to the extent of only 15 percent of that net income. As a shareholder, however, he sustains a further tax of at least 40 percent on his share of the earnings of the corporation in which he has invested. Moreover, his share of earnings in an invested-capital company is subject to excess-profits taxes if the corporation has earnings in excess of the unrealistically low rates establishing the excess-profits credit. All of which quite obviously places a disproportionate burden on these comparatively small earning shareholders, who receive 31.4 percent of the dividends received by all shareholders.

The Mays and Means Committee further stated that—

> A shareholder in the lowest bracket will pay, under existing law, a tax, even after the post-war credit is taken into account, equivalent to a tax on comparable income from noninvestment sources of $50,000.

Could there be more convincing evidence that credits already allowed invested capital companies are already too small and should not be further reduced?

2. Some businessmen with whom we have been in contact do, and some do not, object to the increase to 95 percent in the excess-profits tax rate. But they do ask why business should be beset with the burdens of the Renegotiation Act when taxation reaches that level. If

there is to be a 95-percent rate, then in the name of everything that is practical and feasible and fair, renegotiation should be repealed, not revised. When the Renegotiation Act was enacted in April 1942, the excess-profits tax rates were graduated from 35 percent to 60 percent. Six months later, the rate of taxation on all excess profits was increased to a flat 90 percent. Now it is proposed to make the rate 95 percent. In this situation, can renegotiation for all industry, with all of its incentive to inefficiency, be justified merely on the grounds that a few companies have managed to work out a substantial net income despite the excess-profits tax rates?

3. The House has again given no heed to the widely expressed, obviously sound appeals for repeal of the capital stock and declared value excess-profits tax. As has been repeatedly pointed out at committee hearings, this tax feature involves the taxpayer in an annual Federal numbers game that should have no place in our revenue system. Surely, common sense and the urgency of doing everything practicable to simplify taxation today dictates its repeal in the writing of the 1943 act.

4. In view of the high rates of taxation on corporations, businesses should be permited to build up reasonable reserves against adverse developments following conclusion of the war. We submitted a concrete proposal to the House Ways and Means Committee for effectuating this and, accordingly, respectfully direct your attention to the last article on page 710 of the October 13 printed record of the hearings.

5. We also recommend amendment of H. R. 3687 to embody the provisions of H. R. 3712, introduced by Representative Wesley Disney, providing for revision of the amortization provisions of the Excess-Profits-Tax Act of 1940, under which a taxpayer could adopt a shorter period for amortization of special facilities if the use to which they were being put ended prior to either the 5-year period or the termination of hostilities. The cancelation of contracts and changes in types of war products have made manifest the need for the suggested change.

6. In this chamber's statement before the Ways and Means Committee, we submitted a number of other important recommendations which have not been reflected in H. R. 3687 and which we now urge you to consider. To avoid taking your time in repetitive discussion, we merely list the points here and refer you to our detailed statement on pages 709–712, inclusive, of the printed record of the House hearings of October 13:

(a) Provide for depreciation based on business judgment.

(b) Repeal duplication of income tax on dividends paid by one corporation to another.

(c) Repeal 2-percent penalty for filing consolidated returns.

(d) Continue avoidance of retroactive taxation.

(e) Admit 100 percent of long-term borrowed capital as true invested capital.

(f) Write into law definite termination dates for emergency taxation on individual and corporate incomes.

(g) Provide relief from surtax on normal incomes of corporations with preferred dividend obligations similar to the relief extended to utilities.

In connection with these changes, we take this opportunity to express strong approval of the reported prospect that, when new

legislation is written in 1944 embodying simplification of taxes, it will provide that dividends paid by corporations be allowed as a deduction for determination of taxable net income similar to interest paid.

7. We oppose the inclusion of sections 109 and 208 in the new revenue act which continue the change made in 1942 whereby fiscal-year corporations were placed on a calendar-year basis. The drastic increases in corporate income-tax rates enacted in 1942, as well as the war increased volume of business, may have warranted an earlier application of those rates to fiscal-year corporations than was permissible under the code, but the currently recommended change in rates does not, in our opinion, warrant a further breach in the practice previously followed of allowing fiscal-year companies to file on a fiscal-year basis. The decided effort made in the past 10 years to encourage companies to report their operations on a natural-year basis has influenced an increasing number of concerns to discontinue reporting on a calendar-year basis. To discourage that trend will further increase the burdens already placed on professional accountants and tax specialists on whom taxpayers so largely rely for the preparation of tax returns. One of the reasons why requests for extensions of time are so numerous each March is the sheer physical inability of the professional people to cover the ground for all the present calendar-year companies.

8. H. R. 3687 provides that certain nonprofit corporations file tax returns for information purposes. We are in agreement with the reasons advanced by the Ways and Means Committee for requiring such returns. However, as business people, we are apprehensive that, unless control of the publicity of such data is stipulated to a greater extent than is now set forth in I. R. C. section No. 55, one type of organization may find itself singularly subject to the glare of publicity while other bodies, because of such factors as political strength, remain wholly untouched in the privacy of their affairs.

9. We also wish to express our approval of the purposes behind section 115 of H. R. 3687 relating to the acquisition of companies whose activities are unrelated to the taxpayer for the purpose of reducing the impact of excess profits tax rates. However, we do wish to go on record as opposing the retroactive application of the section and suggest that if the section is enacted that it be effective with taxable years commencing with January 1, 1944. We feel that insofar as the past is concerned that in all fairness to the taxpayers affected the courts should be the avenue of remedy for the Treasury.

10. Most of the foregoing recommendations, if enacted into law, would reduce the additional revenues contemplated by H. R. 3687. To offset the effect of that loss and to help reduce the amount of public spending contributing to the inflation threat, we implore the Senate Finance Committee to employ every effort to achieve all possible economies in government. Prior to the adoption of the 1942 Revenue Act, Congress initiated an economy program but it has fallen far short, in our opinion, of what can and should be done. Emphasis on this subject is more essential today than ever before; it is literally a mandate from the American taxpayer. We commend the views expressed by Representative Wesley E. Disney in his statement included in the report of the Ways and Means Committee and deeply regret the failure of the House to follow his recommendations. We are confident that enactment of Mr. Disney's proposals would create a really effective con-

trol of spending because we are confident that every appropriation would then be viewed in the light of the revenue needed to finance it.

11. As a further means of offsetting revenue reductions contemplated in this series of recommendations and to control the inflationary threat arising from untaxed and uninvested excess purchasing power referred to by the Secretary of the Treasury as being in the hands of 80 percent of the people, we again urgently recommend the enactment of an emergency excise retail sales tax. If such a tax were established, the complications involved in the retention of the 3 percent minimum tax provision would be eliminated, the accentuation of discrimination against certain industries by the proposed increase in excise taxes would not be necessary and the additional load placed on taxpayers already carrying a disproportionate share of the tax burden could be alleviated by continuance of the present earning credit and application of personal exemptions vis-à-vis to separate returns for husband and wife.

The retail sales tax has been found to be an equitable revenue instrument in other countries. Those people in our country who are vitally awake to the weakened structure of the American business system cannot comprehend the refusal of the administration to recognize the fundamental equity of sales taxation in the present situation and, even more inconceivable, the retention of such a policy seemingly influenced largely by the threats of professional labor organizations to upset present efforts to stabilize selling prices should a retail sales tax be adopted.

In our opinion, the retail sales tax is the only way in which excess purchasing power can be tapped at its source and the purchasing power of the dollar maintained, at the same time preventing further abuses of the theory of assessing taxes according to ability to pay.

12. The proposal in H. R. 3687 substituting a minimum tax of 8 percent for the present Victory tax in principle is considered a definite step in the desired direction of simplification because recognition would be extended to the marital status of the taxpayer as to personal and dependency credits ordinarily allowed for income tax purposes. In addition, the integration of the minimum tax in the tables prescribed in H. R. 3687 for use by persons earning less than a gross income of $3,000 simplifies the computation problem for such a taxpayer.

13. Notwithstanding the simplification just mentioned, it is important for the committee to know that the prescribed withholding tables of H. R. 3687 make it obligatory on the taxpayer that takes the full marital exemption to also take the full credit for dependents. In the case where husband and wife are working and they file a joint return at the end of the year, the method referred to works a hardship from the standpoint of excessive withholding of tax on wages by the employer where the taxpayer is the spouse not claiming the full marital exemption. This restriction does not exist under the present law since the spouse contributing most toward the support of the dependents may claim the dependency credit. The text of H. R. 3687 does not prohibit this practice but the withholding tables referred to make no provision for it. If the contention here made is not clear, we will be glad to submit samples exemplifying the points in question.

If the right of use of the dependency credit by either spouse is to be provided for in the withholding tables as constructed in H. R. 3687, using the proposed weekly exemptions of $7 for each dependent, $10

for a single person, and $24 for a married person, then the tables must be expanded to twice their present size. However, if such unwieldy and impractical expansion of the withholding tables is to be avoided the situation cited highlights our previous contention that real simplicity could be achieved by the complete repeal of the Victory tax and without enacting the proposed minimum tax by substituting an emergency excise retail sales tax.

We thank you for this opportunity of appearing before you and expressing our views.

Senator WALSH. We thank you.

STATEMENT OF GEORGE J. BELDOCK, REPRESENTING THE ALLIED RABBIT INDUSTRIES BOARD OF TRADE, THE FUR DRESSERS AND FUR DYERS GUILDS, AND THE AMERICAN RABBIT DEALERS ASSOCIATION

Mr. BELDOCK. First, I apologize for not having a prepared brief. We didn't realize we would be kept here so late.

I am an attorney at law, and I represent the Allied Rabbit Industries Board of Trade, the Fur Dressers and Fur Dyers Guilds, the American Rabbit Dealers Association, and a number of other raw fur dealers and raw fur processor trade associations in New York City.

I wish to address you in opposition to the proposed 25 percent excise tax on furs at retail.

The House Ways and Means Committee in their report at page 25, speaking of excise taxes, say that by this method, referring to excise taxes, it is possible to select those goods which are clearly luxuries and tax them at a rate in accord with the particular market situation. So the first premise is that the article to be taxed under this statute is a luxury, as they say "clearly a luxury," and I am fully aware of the Government's program which dictates the consideration of our fiscal policies must be approached and developed with the realization that in these times of world conflict all luxuries—I repeat, all luxuries—must bear more than their normal tax burden, and I heartily subscribe to this sound policy, and those of our citizens who can afford and wish to enjoy the so-called luxury commodities, those commodities which we can readily dispense with in these practical times, should pay heavy taxes for the privilege of enjoying the luxuries.

It is my contention, Mr. Chairman and Senators, and it is my sincere conviction that the imposition of a 25-percent tax on furs, which, beyond question, is a severe and heavy tax on any consumer goods, should actually be confined to those goods which are clearly luxuries, and I am quoting the language of the House committee report. The tax should be imposed on a luxury, but not upon an article which in the main is a civilian essential article like an article of woman's apparel, which has a definite place in our civilian life, even in this war period.

In the attempt to speedily adopt the tax measure which this country is awaiting, and to the conclusion of which your committee is putting forth every effort, we should not lose sight of certain fundamental standards which are a part and parcel of our American way of life. We should inquire, in imposing an excise tax: Is the proposed excise tax fair and equitable? Is it free from discrimination? Is

the article to be taxed so heavily really and truly a luxury article? Is it an added comfort which most consumers could do without and should do without in these times of stress? In other words, is it one of our many peacetime frills which all of us should freely forego? Or, on the contrary, is it a utility product which serves a needed and useful purpose and is an important part of the civilian economy of this Nation?

We maintain and seek to impress upon you that the fur industry is definitely not a luxury industry and should not be so taxed.

The fur industry is one of the oldest trading ventures; it was founded on the use of one of our great natural resources, the fur-bearing animal.

The fur industry is part of our national economic structure, and in all of the brackets, from farmer, farmer-trapper, to producer and retailer, represents one of our Nation's most important commercial industries.

Mr. Chairman, when Senator Mead, of New York, was kind enough to appear before this committee yesterday, he referred to a letter that he had recently received from the Department of the Interior, in which it was stated that there are over 2,600,000 trapping licenses issued in 1942—2,600,000. In addition to those trapping licenses which were issued, there are uncounted hundreds of thousands of young trappers and owner-farm-trappers who are not required to be licensed and whom the Department of the Interior has no record of.

Mr. Chairman, every State of the Union is a producer of furs. Undoubtedly, many of the Senators on this committee have at some time or another had a part in the fur industry when they trapped a muskrat or caught a raccoon or an o'possum, which ultimately went into a fur garment.

Now, all these individuals, the traders in every branch of the fur industry depend entirely upon the consumer demand for fur garments. The proposed tax of 25 percent will reduce the income of the American farmer and the farmer-trapper and will place in jeopardy the capital investment of those identified with the fur trade for generations, and what is most important, this proposed tax will not produce the amount of revenue intended. I daresay that most people outside of the fur industry usually are under a misconception that all fur goods are of the type and kind that their favored Hollywood stars wear in the moving pictures. That is a fallacy that has long been exploded, although not widely nor effectively enough.

It is as fallacious as Hollywood's portrayal of every Westerner in a 10-gallon hat and high heeled boots. Actually, the fur industry supplies the mass of women consumers with warm, serviceable, and durable garments of necessary wearing apparel at a moderate price.

Mr. Chairman and gentlemen, furs are not a luxury. To illustrate my point, I call to your attention the following facts: This year this fur industry nationally would produce and sell about 1,800,000 to 2,000,000 fur coats. Of this total of unit production, as much as 82 percent is represented by fur garments in the utility class, sold at retail at prices ranging from $59 to $200. About 60 percent of all the fur coats sold annually, or over a million units, are in the class of less than $100 at retail prices.

In fact, the Office of Price Administration has publicly stated that rabbit and muskrat coats which comprise the bulk of these lower prices are considered by O. P. A. as "cost-of-living commodities."

Similarly, the War Production Board and the Small War Plants Corporation and the War Manpower Commission do not consider fur coats in the nonessential category, and the handling, the processing, manufacturing of fur garments was not considered by the War Manpower Commission as a non-deferable industry but on the contrary was considered necessary to our civilian economy.

How, then, can we reconcile the conclusion of the Treasury Department that furs are clearly luxuries. Perhaps, Mr. Chairman, if the committee of the Treasury Department who was working on the question of furs, excise tax on furs, had their meeting in a cold place in Duluth, Minn., in the month of January, rather than in the city of Washington, District of Columbia, in the month of July, they might have arrived at a different conclusion than they have in determining that fur is a luxury.

It appears to us that an industry which converts the bulk of its production into an article of wearing apparel which is of such utility to the women factory workers and the school teachers and the office workers and farmer housewives, in a price range of $200 and under, cannot be classified as a luxury industry.

Now, modern methods of fur farming, trapping, and particularly transportation and production have long ago taken the luxury out of furs. In most of the States of our country, due to climatic conditions, the fur coat is actually a necessity because it affords warmth and serviceable wear at a price generally within the reach of all. The fur coat is unique for another reason. It is a product of a natural resource and does not consume any critical materials or essential product or machinery and the equipment required in the war effort.

As a garment of apparel it is of greater warmth and longer usage than a cloth coat with which most fur coats directly compete. The fur coat does not, however, utilize mills or looms and machinery needed in the production of woolen materials so necessary for the armed forces.

I should like to stress the gross inequity and discriminatory features of the proposed tax on furs. The fur garment is the only article of apparel which is subjected to an excise tax. Women's cloth coats sold in comparable price ranges to fur coats are free from tax.

A woman who buys a $80 or $100 or $150 cloth coat pays no tax, while your secretary or my secretary who pays the same purchase price for a fur garment must pay an additional $20 or $25 or $37.50 as tax, if the proposed tax is adopted.

Is this equitable? Does it not result in undue discrimination?

The Treasury Department has recommended and still urges the tax bill which will produce over $10,000,000 in revenues.

The Treasury Department recommended to the House committee various rates of excise taxes among which they propose a 25-percent tax on furs, from 10 percent, and a 30 percent on jewelry, from 10 percent.

Now, what has resulted?

The House reduced the Treasury recommendation on total revenue by over 75 percent; the House reduced the recommended tax on

jewelry by 33⅓ percent. The fur tax remains at 25 percent, no reduction made by the House.

I realize that comparisons are generally poor arguments. However, if the House committee in its judgment found that a 20-percent tax on jewelry was fair and reasonable, how can anyone justify a 25-percent tax on an industry which produces a commodity of essential apparel which has such greater utility than items of jewelry?

I could continue and enumerate countless other luxury items, clearly luxury items, objects of art, and other articles of apparel, rugs, and expensive china and bric-a-brac on which there is no tax at all, although undoubtedly they are luxuries.

The tax on jewelry is 20 percent and the tax on furs, which we maintain never was and never will be a luxury item, is 25 percent. I submit it is unjust and inequitable to single out one industry that produces an article of apparel to carry this heavy excise tax burden.

This hardship, mind you, will be reflected upon the entire fur industry from the fur farmer to the trapper to the retailer, and there are in this country hundreds of thousands of fur farmers whose income depends in a great measure upon the return from the trapping of furs by themselves and their tenant farmers. This tax of 25 percent cannot produce the objective of increased revenue. The purpose of this bill as applied to furs, as they say in their report—the Treasury Department—was to raise the revenue from a $38,000,000 yield on furs at present at the 10-percent rate to an additional $55,000,000 yield.

Now, will it accomplish that purpose? We say it cannot do it. Well informed retailers throughout the country say that a 25-percent tax on furs will bring drastic reduction in sales volume, and I will take a moment to refer to a survey that was made by a large publication, daily publication, in New York City. Of 300 women who were asked: What is the effect of the 25-percent tax; what is your reaction? These women said that if the tax went into effect most of them would wait to buy the fur coat that they needed until next winter or next fall, to see whether the tax might be reduced. These women said they did not want to pay a tax at all, but of course they realized they must contribute to the war effort but a 25-percent tax seemed so much out of proportion that they did not feel that it was fair to tax them.

Senator JOHNSON. Do you think that poll is more reliable than the Gallup poll?

Mr. BELDOCK. I don't think Gallup has a poll on furs. I wish he would take one. He would prove my point.

Senator JOHNSON. He could take one, but so far as I am concerned, it wouldn't have much weight.

Mr. BELDOCK. I will pass the survey.

Senator WALSH. You may put it in the record.

Mr. BELDOCK. This is an important point, and I will pass over it briefly. We had a 10-percent tax put in effect in October 1941. The result of that tax was that for 4 or 5 months the fur market suffered a terrific slump, a very decided slump, and we only recovered from that slump because of the increased purchasing power through the war last year when employment increased and things started to boom and there was more money available.

Now, we say we absorbed the 10 percent tax in 1941 because the cost of living was more or less set in 1942, the wage scale was frozen to the levels of 1942 wage stabilization, and before the freezing of the wage level the consumer was able to spend more money and she bought a fur coat and she paid the tax, but today we are no longer in that comparable position because the wages are set, more or less.

Withholding taxes have siphoned off some of the excess purchasing power. Consequently there cannot be such an increase in the consumer's purchasing power to absorb this 25 percent tax.

What does the Treasury say about it; and the House? Well, the wholesaler, the producer, will absorb the increased tax at the low end. We say to you that that is impossible. This trade cannot absorb $55,000,000 which they estimate is the increase in yield by the additional 15 percent. The farmer trapper cannot absorb it; neither can the wholesaler or retailer. Admittedly the public cannot absorb it at the present time, and we say also to you gentlemen, and I am trying to cut this very short, that there is a so-called forgotten group, which started with the "forgotten man," and that is now the 15 million forgotten white-collar workers who, we are told, did not receive increases in wages comparable to the increase in cost of living. These are the consumers of our product, these 15 million white-collar workers. That is where most of our customers come from, because that is where $100 and $200 fur coats are sold.

Now, there must be a large shrinkage in volume, gentlemen. The revenue will not be returned, and so we say to you, leave the tax at 10 percent, encourage the public to spend money for this commodity. It is not a critical product, it is a natural product; it does not use up any war materials or war machinery. Encourage them, and in that way you will increase the yield and certainly by imposing a burdensome tax of this kind of 25 percent, which is entirely inequitable and out of line, you will discourage the sale of fur coats. You will not only hurt the merchants in the trade, you will hurt the farmer, you will hurt the consumer, and what is most important, the Government will not receive the revenue they hope to receive.

Senator JOHNSON. What do you recommend?

Mr. BELDOCK. We recommend that the tax on furs remain at 10 percent.

Senator JOHNSON. You wouldn't favor any increase?

Mr. BELDOCK. Yes; we feel that a 15-percent tax would be fair. Frankly, we feel if jewelry has a 20 percent tax it would be fair to impose a 15-percent tax on the fur trade if there must be an increase. But when you get to 25 percent you are getting in a direction that will not bring in revenue or do any good to the industry or to the public.

Senator WALSH. Thank you.

STATEMENT OF HAROLD RUSSEK, VICE PRESIDENT, RUSSEK'S FIFTH AVENUE CO., NEW YORK, N. Y.

Mr. RUSSEK. Mr. Chairman, in support of the summary attached with respect to the proposed increase in the tax on furs and fur-trimmed garments, I submit these facts and appeal for reconsideration by your committee of its action with respect to such tax increase.

The large majority of fur and fur-trimmed coats sold throughout the Nation retail under $200 and the greatest number of units of this

majority are sold below $100. It can therefore be construed that these items are no luxuries, but necessary wearing apparel. It would seem unfair to impose an excessive tax on wearing apparel merely because it is made of fur, or partly of fur, while other apparel is exempt from taxation.

Such an increase as proposed will likely incur the resentment of the women of the Nation, will be discriminatory in that no other wearing apparel is so taxed, and will tend to lower the morale of women who have been accustomed to fur and fur-trimmed articles of apparel by virtue of education during the past decade.

The present increased costs of raw materials and labor have already brought prices to levels where any increase beyond this point would undoubtedly work a hardship on the buying public and it is unlikely that the income and the spending power of the majority of people is adequate to meet such an increase.

The proposed increase must result in a loss of revenue to the Treasury Department, since experience of years has shown us that such a percentage of increase (15 percent) must lower consumption by 50 percent or more. Such an increase will also enlarge the unorthodox method of purchasing which had its beginning after the advent of the current 10-percent levy. I refer to the consumer who bought skins directly and who subsequently had a garment made by a tailor or tailor-furrier, thereby avoiding the tax altogether.

An increase in taxes in addition to the difficulties now prevailing because of the proposed O. P. A. regulations will tend to establish a black market in skins which will be detrimental to the legitimate merchant, undermining, and will result in the loss of tax revenue. Most small businessmen in the industry—the industry is mainly composed of small merchants—are very modestly capitalized and the loss of unit sales from the retailers' standpoint—the loss of large production from the manufacturers' standpoint—as a result of the drop in volume caused by the additional taxes will work an undue hardship, will probably result in many bankruptcies, and again in loss of tax revenue.

There are some thousands of farmers and trappers whose incomes are largely dependent upon the industry. There are some 3,000 manufacturers of furs. There are approximately 4,000 department stores handling furs, and about 5,000 retail furriers. In addition, there are many more people engaged in the dressing and dyeing and processing of furs. The possibility of unemployment, particularly in the city of New York, is great. The raw "catch" of furs—already diminished—will continue to lessen if these farmers and trappers cannot be gainfully employed—and in turn this will increase the unemployment danger in the other branches of the industry.

The fur industry, never well balanced, is in a particularly dangerous position at the present time due in a great measure to the fact that raw material is at a very high peak and that proposed O. P. A. regulations do not bid fair to an equitable arrangement. Due to the seasonal requirements of the industry large quantities of raw merchandise must be bought in the months of November and December at prevailing market prices. The proposed increased tax will, by cutting unit sales, cause drastic change of market values 60 to 90 days hence which in turn will make more chaotic the existing conditions

and will result in losses throughout the industry and thereby loss of tax revenue.

Such conditions as will then exist will leave the industry in a very unfertile condition during the post-war period and it will be unlikely that the industry can then absorb its rightful share of manpower now in the armed forces. The fur industry, though not a new one, has only of late begun to progress and lacks the strength and substantiality of a great many American industries. Nevertheless directly and indirectly it employes hundreds of thousands of people and should be permitted to strengthen itself reasonably so that it may become a stable and worthy industry in time to come. Substantial enough and progressive enough to support reasonably these hundreds of thousands dependent upon it.

Therefore—and in view of the aforementioned reasons—I respectfully suggest and urge that there be no increased tax on furs and fur-trimmed garments—that should a general sales tax be enacted that the existing tax be removed—otherwise the industry will be irreparably damaged and that the levy will have defeated its purpose.

(An excerpt from the Journal-American of November 27, 1943, submitted by Mr. Russek, is as follows:)

CONSUMER COMMENTS

[From the Journal-American]

NOVEMBER 27, 1943.

THE TAX ON FUR TRIM AND FUR COATS

Three hundred women were asked if the proposed 25-percent tax on furs and fur-trimmed coats went into effect what would be their reaction.

All the women pointed out that they resented the proposed tax because they felt that furs—fur-trimmed coats—were not luxury and that men's overcoats should be taxed if women's coats were taxed. They also pointed out that there were many things sold for the home that were far more luxury items than their coats, and they felt such a tax most unfair. They could see a fur tax on such luxury items as fur hats, muffs, scarfs, evening jackets, etc., but not on coats.

Many of the women said that if this tax went into effect in January and they had considered buying a coat, they would buy it before the tax went into effect, if they were given any notice of the tax.

The 300 women were asked—supposing they had a need for a coat this year, and the tax went in, would they buy the coat; most of them stated if the tax went into effect without advance notice they would not buy the coat this January or February, using what they had on hand, and would wait until next winter or fall to see if the tax might be less or removed by the time next winter when they really had need for the coat.

Other women stated they would rather invest in a good cloth coat, untrimmed, and then have fur from an old coat or a fur coat that they would cut up added to it.

Women said if there were a 25-percent tax that the store that sold really warm, well-interlined, untrimmed coats would sell many of them.

These women stated that it is not that they did not want to pay a tax, but 25 percent seemed so much, and that even if they purchased a $200 inexpensive fur coat it would cost them $250 with the tax. Or a fur-trimmed coat at $125 would cost nearly $160, and the women felt they could not afford this extra tax.

It was pointed out to the women that they did pay 10 percent and did not seem to mind it, and a number of women explained that they had trained themselves to think of the price of the coat plus the tax as one price, but the 10 percent did not compare with 25 percent and also that at the time that tax went into effect their income tax and cost of living was not as great.

STATEMENT OF CHARLES GOLD, REPRESENTING THE RETAIL FURRIERS EMERGENCY COMMITTEE

Mr. GOLD. Speaking for the Retail Furriers Emergency Committee, which was organized by the New York National Association of Retail Furriers in this country, who represent some 24 associations and 24 panels which we caused to be formed after the committee went into activity, may I say to you as follows:

I expressed and subscribed to all the views given here today on the question of the fur tax, except that I do believe that perhaps the 15-percent tax—I would like to do business and make a compromise on that basis. I do believe that the imposition of a 15-percent tax on the fur industry might be harmful to a great extent.

I should like to direct the attention of the chairman and the Senator to the fact that when the tax went into effect in 1941 we had such a bad slump for 3 months that prices dropped all the way down the line, at retail, jobbing, manufacturing, and fur farming and fur trapping levels. So much so, that the fur farmers found it necessary, a great many of them, to pelt out, which you know and I know means that they give up their business. They just cannot go on breeding animals at the cost of breeding them when the market had slumped off so badly as it had, and as Mr. Beldock pointed out, if it were not for the increased purchasing power which was then making itself felt, there would not have been this resumption of the upward movement in prices which again made it possible for all the various branches of the industry to get by, and some to make a fair margin of profit.

We fear other things in addition which might emanate from such a tax as this. The very fact that you put a 25-percent tax on furs is an indication to all prospective consumers that you consider the article to be in the luxury class. You stigmatize it; you create a psychological disadvantage when we, the retailers, we attempt to sell a garment to the consumer, and I cannot overemphasize the point made here by Mr. Beldock about the fact, or with reference to the fact that the large bulk of the furs sold are sold as utility garments.

A woman is much more intelligent, in our opinion, and we are all convinced of this fact, if she invests from one hundred to one hundred and fifty to two hundred dollars in buying a fur coat rather than in the purchase of a cloth coat, whether fur trimmed or without trimming. For these reasons the fur will outlast the cloth by years. In fact, it will outlast by probably once over. It will outlast it in style, because cloth coats are outmoded in a year and a half or 2 years times, the styles just keep changing.

Fur furnishes greater warmth and health protection. You cannot make a comparison, in my opinion, between cloth and fur, and yet the cloth goes untaxed and the fur is taxed. In fact, a fur-trimmed cloth coat, where the fur is a component part of lesser value than the cloth, is tax-free and there is the encouragement, gentlemen, to the cloth-coat manufacturers, to so construct their cloth coats, with fur on them, that they be tax free, and the competition which has been very great right along, especially during tax periods, will be even greater from the cloth-coat industry because all they need do is scale the cost of the fur down or the cost of the cloth up, and the cloth

garment sells tax-free while the fur coat of comparable price bracket sells with a 25-percent tax.

Just one more thing. We fear, too, the bootlegger which would be encouraged by the 25-percent tax. We look these things in the face. If you have it in the liquor industry, which is so carefully and well regulated throughout the country, where every ounce of liquor is supposed to be known and earmarked and yet it gets out of circulation into the hands of a few people who market surreptitiously, you will be encouraging the same sort of thing in this industry.

We ask you to give our arguments, which I know you will do, more careful consideration because we think the death knell of a great many merchants, manufacturers, fur farmers, and fur traders is in the 25-percent tax.

I submit below our reasons why there should not be this increase.

(The document referred to is as follows:)

REASON A. THERE WOULD NOT BE ANY APPRECIABLE INCREASE IN NET INCOME TO THE GOVERNMENT FROM A 25-PERCENT TAX

The Treasury Department estimated an increase of $54,800,000 would result from the proposed increase in tax.

It is the general opinion in the industry that there would be no such increase in revenue resulting from a 25-percent tax. On the contrary, it is the emphatic opinion of all those engaged in the industry that there would be a considerable let-down in business in the event of such an increase. It is likewise the opinion that such a tax would encourage bootlegging of furs on a large scale to the great loss of the Government. On such transactions, the volume of which should not be depreciated, the Government would collect neither the excise tax nor the income tax on the profits derived. The estimates of the reduction in volume which would result from such a tax range from 35 percent to 50 percent.

The fur industry fears strong consumer resistance would follow an increase in the tax.

Concededly the Congressional Ways and Means Committee anticipates that the retailer and/or the wholesaler will absorb part of the tax (see page 28 of Chairman Doughton's report). Undoubtedly a great number of merchants especially in nondefense areas would find it necessary to absorb a substantial portion of the tax. This would impair their net earnings and reduce their income tax.

REASON B. THOUSANDS OF SMALL BUSINESS ESTABLISHMENTS WOULD BE JEOPARDIZED

Though fur stores in defense areas experienced an upsurge in volume, few stores in other areas reported an appreciable business increase.

In the event of a tax increase storekeepers in nondefense areas would be forced to make price concessions or to absorb the tax to stimulate business. Reduced volume and mark-up would seriously undermine the capital structure of most of these small business firms.

REASON C. THE PROPOSED TAX WOULD BE INJURIOUS TO THE INTERESTS OF THE FUR TRAPPERS AND FUR FARMERS

Large-scale consumer resistance would undoubtedly result from a 25-percent tax. This would inevitably cause a severe deflation in all prices in all branches of the industry, including trapping and farming. Of this there can be no question. The common-place laws of economics would account for this. The historic experience of the industry proves it. In the past when consumer demand was low the storekeeper curtailed his purchases; the manufacturer in turn reduced his production and his skin purchases. Hence the trappers and fur farmers were compelled to reduce their prices.

As an example, about 2 years ago the demand for mink skins was very weak. The supply was plentiful. The farm-bred product was offered quite freely, but the prices obtained were quite low, so low, in fact, that farmers began to "pelt out" and terminate their breeding and fur-raising activities.

The fur farmers have large investments in their business. Whether they breed silver fox or mink they must contend with many obstacles. Whereas the average price obtained by them for their pelts is now higher, they nevertheless have considerable difficulty in making a fair and adequate profit on their ventures, due to the greatly increased cost of raising these animals. However, if, despite these increased costs, their selling prices were to be depressed as a result of consumer resistance generated by prohibitive excise taxes, they would find themselves in a worse predicament than they were in some 2 years ago.

Likewise the fur trapper must augment his income with moneys received for pelts. He, too, would be greatly prejudiced by depressed skin prices.

REASON D. MOST FUR GARMENTS SHOULD BE CONSIDERED AND TREATED AS ESSENTIAL WEARING APPAREL

Between 85 and 90 percent of all furs sold in this country are utility garments in every sense of the word. A rabbit, muskrat, racoon, skunk, or persian lamb coat selling at prices ranging up to $195 and which gives from 4 to 8 years of wear are good, sound investments in warmth, health protection, and wear. Such garments are essential wearing apparel in most parts of the country and constitute approximately 90 percent of all fur sales.

A purchaser of a fur garment such as any of those named above makes a much sounder investment than a purchaser of a cloth coat. The styles in cloth coats change rapidly. Cloth coats deteriorate much faster. They lack the warmth and comfort which are furnished by a fur garment. For these reasons a cloth coat is a less sound investment than furs.

The large bulk of fur garments are purchased by women of average and less-than-average incomes. The best proof of this is found in the tremendous volume of installment and lay-away transactions which occur annually. Furthermore the general experience of the fur retailer clearly establishes that fact.

From all of the foregoing it must appear that the large bulk of fur garments is purchased as essential articles of clothing. Their durability and warmth are especially important under the prevalent conditions. One of the most important of these conditions is women's all-out participation in the war effort in all seasons and climates.

A 25 percent tax would seriously affect those who need fur coats most.

REASON E. CLOTH COATS ARE GIVEN AN ESPECIALLY FAVORABLE COMPETITIVE ADVANTAGE OVER FUR COATS UNDER THE PROPOSED FUR TAX

Under the present law and under the contemplated proposal, cloth coats without fur trimmings are tax free. Likewise cloth coats with fur trimming are tax free, if the fur is not the component material of chief value.

A substantial increase in tax would encourage and stimulate the cloth coat manufacturers to construct more of their coats so as to make the cloth skeleton of greater value than the fur trimming thus making them tax free. This plan has been used to a considerable extent under the current tax. Cloth coats should not be given such a great trading and competitive advantage over fur coats.

It is the general sentiment of the fur trade that a tax on fur coats, while cloth coats are left untaxed, is discrimination against furs in favor of cloth. This should not be permitted.

Consideration should be given to the storekeepers, manufacturers, fur farmers, and trappers and all of their respective employees who, regardless of all other considerations earn their livelihood in the fur industry. Anything which retards the fur business and considerably reduces its volume must necessarily affect all of these people, their financial investments and/or standards of living. Very few of these people are able to withstand a serious financial setback.

The very enactment of an increased tax to start January 1, 1944, would be a disastrous blow to thousands of storekeepers who presently have large inventories bought at the current prices. Drastic price reductions would be required to stimulate business all at great sacrifice to these merchants.

We sincerely urge that there be no increase in the fur tax.

Respectfully submitted.

RETAIL FURRIERS EMERGENCY COMMITTEE,
By: CHARLES GOLD, Esq.,
Office and P. O. address 11 West Forty-second Street, New York 18, New York.

STATEMENT OF MITCHELL B. CARROLL, REPRESENTING THE NATIONAL FOREIGN TRADE COUNCIL

Mr. CARROLL. I am submitting a brief for the record, Mr. Chairman, and I wish to point out that the declared intention of Congress in regard to the excess-profits tax in several particulars has not been carried out. That is due more or less to a drafting oversight.

Senator WALSH. Have you talked this over with the Treasury and Mr. Stam?

Mr. CARROLL. Yes, I have; and I would be glad if you would get their report.

Senator WALSH. We will comply with your suggestion.

(The brief submitted is as follows:)

The basic amendments to the excess-profits-tax provisions in the Revenue Act of 1942 inadvertently resulted in restrictions on the credit for foreign taxes allowed in section 131, Internal Revenue Code.

These unintended restrictions can be removed by some minor changes in the language of section 131, as regards the normal tax and surtax, and of section 729 (c) and (d) as regards the excess-profits tax.

These restrictions are twofold:

Restriction No. I.—This inequitable reduction in the foreign tax credit occurs primarily in the case of domestic corporations which take their excess-profits credit on an invested-capital basis and whose foreign income consists of dividends from foreign subsidiaries. Such corporations receive no credit against excess-profits tax because foreign dividends are not subject thereto, but they suffer a severe reduction in the credit allowable against normal tax and surtax because the denominator of the limiting fractions in section 131 (b) is padded by excess-profits net income not subject to the normal tax and surtax. Domestic corporations which take excess-profits credit on an income basis may, under certain circumstances, defined under section 711 and particularly if they come within the purview of section 721, have their credit similarly reduced.

Restriction No. II.—Domestic corporations which take their excess-profits credit on an income basis and derive dividends from foreign subsidiaries are being denied the credit allowable against excess-profits tax because of language in a limiting clause in section 131 (f). This subsection was intended to provide substantially the same relief from double taxation for a domestic corporation with a foreign subsidiary as one with a foreign branch. It was introduced as a separate section in the Revenue Act of 1921 and was subject to its own limitation so as to prevent the allowance for foreign tax deemed to have been paid from reducing the domestic tax on domestic income, but this special limitation is now unnecessary because subsequent amendments subject the entire section to the limiting clauses in section 131 (b). The present language in section 131 (f) makes the credit allowable only against normal tax and surtax even though, under section 729 (c), any excess of foreign tax over the credit allowable under section 131 against normal tax and surtax is to be allowed against the excess-profits tax subject to the limitations in section 729 (d).

EXPLANATION OF UNINTENDED LIMITATIONS

I. *Restriction No. I.*—The restriction on the foreign-tax credit referred to above as Restriction No. I exists despite a precise attempt to provide an accurate limiting fraction. As is stated in the Senate Finance Committee report concerning the revenue bill of 1942. "to preserve the appropriate ratio between the numerator and denominator of the limiting fraction under section 131 (b) it is necessary that adjusted net income be not reduced by the amount of the adjusted excess profits net income for the purposes of that section." Hence, the law places in the denominator of the limiting fractions, in subsection (b) (1) and (2) "the sum of the normal-tax net income and the amount of the credit for adjusted excess profits net income provided in section 26 (e)."

However, the law leaves the same the language in the numerator that previously existed, i. e., under subsection (b) (1), the net income from sources in the for-

eign country, the tax of which is being claimed as a credit, and under subsection (b) (2), the entire net income from sources without the United States.

In order to provide a proper ratio for purposes of the credit allowable against the excess-profits tax, section 729 (d) as framed in the Revenue Act of 1942, places in the denominator of the fractions limiting the credit against excess-profits tax the entire excess-profits net income, whereas in the numerator of the first fraction in subsection (d) (1) there is placed the excess-profits net income from sources in the foreign country to which was paid the tax to be credited, and in the numerator of the second fraction in subsection (d) (2) there is placed the entire excess-profits net income from sources without the United States.

It is to be noted that the denominator of the limiting fractions for both normal tax and excess-profits tax is essentially the same, viz:

1. For the normal tax, normal tax net income plus the credit for adjusted excess-profits net income in section 26 (e);

2. For the excess-profits tax, the excess-profits net income, which is normal tax net income as adjusted and without deduction of the credit allowed in section 26 (e).

As the income in the numerator of the fraction limiting the credit allowed against the excess-profits tax is of the same character as that in the denominator, i. e., excess-profits net income, a proper ratio is preserved. This is true even though the excess-profits tax is imposed on adjusted excess-profits tax net income, because the foreign income is presumably diffused evenly throughout the net income of the corporation whether included in the adjusted excess-profits net income upon which excess-profits tax is imposed or the amount deducted from excess-profits net income as excess-profits credit allowed under section 712, the amount of unused excess-profits credit adjustment computed under section 710 (e) and the specific exemption of, generally speaking, $5,000.

The amounts of taxable income in the numerator and the denominator have been proportionately increased by including such deductible items and the value of the fraction is unchanged.

For example, if the said deductions equal one-third of the excess-profits net income, and if the ratio of excess-profits net income from sources in the foreign country to entire excess-profits net income—

$$\frac{\$3M}{\$6M} \text{ or } \frac{1}{2},$$

the fraction would be the same if both the numerator and denominator were reduced by one-third.

$$\frac{\$3M-1M}{\$6M-2M}=\frac{2M}{4M}=\frac{1}{2}$$

Moreover, the correctness of the terms of the fraction is not impaired if the domestic corporation derives dividends from abroad (such as dividends from a foreign subsidiary) and computes its excess-profits credit on an invested capital basis because such dividends are excluded from excess-profits net income under section 711 (a) (2) (A) and do not bear excess-profits tax; hence, there is no occasion to credit the foreign tax against excess-profits tax to prevent double taxation. No credit is allowed because such dividends are not included in the numerator nor in the denominator of the limiting fraction and, when they constitute the only kind of foreign income, the limiting fraction is 0.

On the contrary, the situation is quite different from the viewpoint of the foreign tax credit against the normal tax and surtax. For example, in the case of a domestic corporation whose foreign income consists exclusively of dividends from a Canadian subsidiary, and which computes its excess-profits credit on an invested capital basis, such dividends constitute the numerator and are included in full in the normal tax net income in the denominator of the limiting fraction in section 131 (b). They are included in full in normal tax net income because they are excluded from excess profits net income as the result of the adjustment in section 711 (a) (2) (A). Hence, to prevent double taxation of such foreign dividends, the Canadian tax should be offset against the United States normal tax and surtax which are imposed thereon. The proper ratio of the limiting fraction in section 131 (b) is obviously the dividends over the normal tax net income in which they are included. The addition to the normal tax net income of adjusted excess-profits net income which has not borne normal tax obviously pads the denominator of the fraction and reduces the resulting percentage and thereby the allowable credit.

For example:

1. Canadian dividends	$2M
2. Domestic income	4M
3. Net income	6M
4. Dividend adjustment (sec. 711 (a) (2) (A))	2M
5. Excess-profits net income	4M
6. Excess-profits credit on invested capital basis	2M
7. Adjusted excess profits net income	2M
8. Normal tax net income (item 3–item 7)	4M

Limiting fraction under section 131 (b) (1):

$$\text{as provided in law } \frac{\$2M}{4M+2M}=\frac{1}{3}$$

$$\text{as proposed above } \frac{\$2M}{4M}=\frac{1}{2}$$

Hence, as the result of including in the denominator income not subject to normal tax the allowable tax credit has been reduced from 50 percent of the total United States tax accruing to 33⅓ percent, and the tax burden is correspondingly increased.

The inequity of this mathematical reduction is evident if it is assumed, as in the above example, that, in the years prior to the introduction of the excess-profits tax, the Canadian dividends equaled the domestic income and that, since the introduction of the excess-profits tax, the amount of Canadian dividends has remained the same, whereas the domestic income has doubled. In other words, assuming the excess-profits credit on an invested-capital basis is approximately equal to the pre-war earnings, the ratio of Canadian income to entire normal net income is still one-half. The amount of Canadian income is not influenced in any degree by the doubling of domestic net income due to war activities, Federal Government expenditures, and consequent profits here. Nevertheless, even though taxes have increased sharply in Canada, the allowable credit against normal tax and surtax is reduced as the result of a mathematical misconception.

Let us replace the above symbols by figures and see the extent to which the credit is reduced by the law as it now stands as compared with what the result would be if the Internal Revenue Code were amended so as to include in the denominator of the limiting fraction only normal tax net income.

Example showing inequitable operation of section 131 (b) of the 1942 Internal Revenue Code

	1942 law	As proposed
Domestic income	$1, 00,000	$1,000,000
Foreign income excludible from excess-profits taxation pursuant to sec. 711 (foreign tax paid, $400,000)	1,000,000	1,000,000
Net income and adjusted net income	2,000,000	2,000,000
Income excludible under sec. 711	1,000,000	1,000,000
Excess-profits net income	1,000,000	1,000,000
Excess-profits credit	500,000	500,000
Adjusted excess-profits net income	500,000	500,000
Excess-profits tax—90 percent	450,000	450,000
Foreign tax credit		
Excess-profits tax payable	450,000	450,000
Net income	2,000,000	2,000,000
Less: Credit for adjusted excess-profits net income	500,000	500,000
Normal-tax net income	1,500,000	1,500,000
Normal tax—40 percent	600,000	600,000
Credit for foreign taxes [1]	300,000	400,000
Normal income tax due	300,000	200,000

[1] Foreign tax credit equals normal tax (times) $\frac{1,000,000}{2,000,000}$ $\frac{1,000,000}{1,500,000}$

NOTE.—In other words, the corporation's tax burden has been increased from $200,000 to $300,000, or by 50 percent merely because of the improper language of sec. 131 (b) and (7).

It is, of course, desirable to have the same formula apply in the case of a domestic corporation which computes it excess-profits credit on an income basis, but in this case foreign dividends are included proportionately in adjusted excess-profits net income. If the present language of section 131 (b) (1) and (2) were amended so as to omit from the denominator of the limiting fractions the credit for adjusted excess-profits net income allowed under section 26 (e), it would be necessary also to exclude from the numerator the part of the foreign income which is contained therein and which bears only excess-profits tax.

This can be done by placing in the numerator of the limiting fraction only normal-tax net income, as it contains only the proportion of foreign income that is *not* included in adjusted excess-profits net income.

If income is derived from several foreign countries, there would, of course, have to be an apportionment to the various countries of the part of the foreign income which is included in adjusted excess-profits net income, and the respective amounts so apportioned would be deducted from the net income from each country in arriving at the amount to be placed in the numerator of the limiting fraction under section 131 (b) (1). A similar adjustment would have to be made in the numerator under subsection 131 (b) (2). However, these are simple computations that can be described in the regulations and need not be provided for in the law itself.

The fractions limiting the credit against normal tax in section 131 (b) (1) and (2) would then be theoretically and mathematically correct; both the numerator and denominator would contain only income subject to the normal tax. The taxpayer would receive the full appropriate credit for the foreign tax on foreign income that is included in normal-tax net income.

Strictly speaking, income not subject to the excess-profits tax should be removed from the numerator and denominator of the limiting fractions in section 729 (d), through replacing the term "excess-profits net income" by "adjusted excess-profits net income."

Sections 131 (b) and 729 (d) so amended would read as follows:

"SEC. 131 (b) * * *

"(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, in the case of a taxpayer other than a corporation, or which the taxpayer's *normal-tax* net income from sources within such country bears to *its entire normal-tax net income* in the case of a corporation, 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, in the case of a taxpayer other than a corporation, or which the taxpayer's *normal-tax net income* from sources without the United States bears to *its entire normal-tax net income* in the case of a corporation, for the same taxable year.

"SEC. 729 (d) * * *

"(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 *adjusted* excess-profits net income from sources within such country bears to its entire *adjusted* excess-profits 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 *adjusted* excess-profits net income from sources without the United States bears to its entire *adjusted* excess-profits net income for the same taxable year."

These amendments should apply to all taxable years under the Revenue Act of 1942, i. e., those beginning after December 31, 1941.

II. *Restriction No. II.*—The foregoing amendment is not sufficient to prevent the loss of the credit against excess-profits tax for the excess of the foreign tax over the credit allowed against normal tax and surtax to which a domestic corporation is entitled if it computes its excess-profits credit on an income basis and derives dividends from a foreign subsidiary company.

Let us take, for example, a domestic corporation which derives dividends from a Canadian subsidiary. Under section 131 (f) the domestic parent corporation is assimilated to a domestic corporation with a direct branch in Canada to the extent that the parent is deemed to have paid the same proportion of taxes

paid in Canada by the subsidiary on its income as the dividends which the subsidiary distributes to its parent bear to its accumulated profits.

However, the amount of this deemed tax payment that is allowable as a credit is limited in subsection (f) itself by the ratio of dividends to the normal tax net income of the parent corporation. This has the effect of not allowing the excess of the deemed foreign tax payment over the credit against normal tax and surtax to be applied against the excess-profits tax. A serious curtailment of the intended abatement results, which means an equally serious increase in tax burden, inasmuch as the Canadian effective rate of tax may be about 80 percent, while the credit against normal tax and surtax cannot exceed 40 percent.

Thus, a domestic corporation which operates through the medium of a subsidiary in Canada is placed at a serious disadvantage compared to domestic corporations operating through the medium of a branch, whose credit for foreign taxes is not subject to the limitations of section 131 (f).

When the provision in section 131 (f) was originally introduced in the Revenue Act of 1921 as subsection 238 (e), it was a separate relief provision and had a separate limitation. This provision was incorporated in the revised credit provisions in section 131 of the 1928 act as subsection (f) and continued to have the same separate limitation but, at the same time, the general limitations under subsection (b) were made applicable to the amount of credit taken under the entire section, including the indirect credit under subsection (f) as well as the direct credit under subsection (a).

Hence, the simplest solution would be to omit the now unnecessary limitation in subsection (f) by deleting the following clause:

"*Provided*, That the amount of tax deemed to have been paid by such domestic corporation under this subsection shall in no case exceed the same proportion of the tax against which credit is taken which the amount of such dividends bears to the amount of the normal-tax net income of the domestic corporation in which such dividends are included."

There should be no doubt that the term "tax paid" as used in section 131 (b) and section 729 (c) covers the tax deemed to have been paid under subsection (f) of section 131. If there is any doubt, it could be removed by inserting after the words "tax paid" the parenthetical clause "(which term includes tax deemed to have been paid)."

As this inadvertent nullification of relief intended, ever since the introduction of the excess-profits tax in the Second Revenue Act of 1940, "to place our American corporations on an equal competitive basis with foreign corporations located abroad" (Ways and Means Committee report) the proposed amendments should be made applicable to taxable years under and since said act, i. e., those beginning after December 31, 1939.

NOVEMBER 30, 1943.

SUMMARY OF PROPOSED AMENDMENTS TO SECTION 131, I. R. C.

PROPOSAL I

A taxpayer which computes its excess-profits credit under the invested capital credit excludes foreign dividends from both the numerator and the denominator of the credit under section 729 (d) and therefore gets no credit for tax thereon against excess-profits tax. For the purpose of the credit against normal tax and surtax, the foreign dividends are included in both the numerator and denominator of the limiting fractions under section 131 (b) (1) and (2), but the denominator is padded by the amount of the credit for adjusted excess-profits net income provided in section 26 (e) which contains no such foreign income.

Hence, to arrive at the appropriate limitation for normal tax and surtax purposes, under section 131 (b) (1) and (2), the amount of said credit under section 26 (e) should not be added in the denominator of the limiting fraction.

Moreover, it is desirable to include only the normal tax net income in the numerator of the limiting fractions in order to exclude from the numerator the part of the net income subject only to excess-profits tax. This is appropriate in order to make the language in section 131 (b) (1) properly applicable also in the case of taxpayers which compute the excess-profits credit on an income basis (and particularly those which come under sections 711 and 721) the clause

describing the numerator and the denominator of the limiting fraction in section 131 (b) (1) should be amended to read:

"or which the taxpayer's normal tax net income from sources within such country bears to its entire normal tax net income from all sources, in the case of a corporation, for the same taxable year."

Similar changes will have to be made in section 131 (b) (2).

These amendments should be applicable to taxable years under the Revenue Act of 1942; i. e., those beginning after December 31, 1941.

PROPOSAL II

A taxpayer who takes excess-profits credit on an income basis is denied credit against excess-profits tax in respect of tax deemed to have been paid under section 131 (f).

Proposed amendments:

1. Eliminate the clause beginning "*Provided*, That * * *" in section 131 (f), because it is adequately covered by the limitation in section 131 (b);

2. In section 729 (c) after the phrase "the tax paid" insert the parenthetical clause "(which term includes tax deemed to have been paid)" as follows:

"(c) Foreign Taxes Paid.—In the application of section 131 for the purposes of this subchapter the tax paid (*which term includes tax deemed to have been paid*) or accrued to any country shall be deemed to be the amount of such tax reduced by the amount of the credit allowed with respect to such tax against the tax imposed by chapter 1." [New language in italics.]

3. In section 729 (d) insert the word "adjusted" before "excess profits net income," as follows:

"SEC. 729 (d) * * *.

"(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 *adjusted* excess profits net income from sources within such country bears to its entire *adjusted* excess profits 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 *adjusted* excess profits net income from sources without the United States bears to its entire *adjusted* excess profits net income for the same taxable year.

These amendments should, of course, be made applicable as far back as the first year in which the excess-profits tax was imposed by the Second Revenue Act of 1940, i. e., taxable years beginning after December 31, 1939.

PROPOSAL III

Amendment to section 727 (g).

A number of taxpayers had been enjoying the limited exemption from excess-profits tax under section 727 (g) of the Internal Revenue Code, which was introduced by the Second Revenue Act of 1940, until the amendment to the introductory clause of this provision in the Revenue Act of 1942 deprived a corporation of this relief if it happened to be a member of an affiliated group of corporations filing consolidated returns under section 141, Internal Revenue Code.

We have not since been able to ascertain that there was any particular intent to remove the exemption from excess-profits tax granted to corporations engaged almost exclusively in foreign commerce and therefore not deriving excess profits from the increase in activities in the United States due to the war effort. We have been informed that the only reason for removing the exemption in the case of filing a consolidated return was because it was considered, from an administrative viewpoint, that corporations should have the same basis for normal tax and excess-profits tax in the event they elected to consolidate.

We note that the exemption under section 731, Internal Revenue Code, from excess-profits tax in the case of profits from mining strategic materials is carried through even in the case where a consolidated return is filed. Paragraph (c) of section 33.30, regulations 110, reads as follows:

"* * * If the affiliated group for any taxable year includes a corporation a portion of the income of which is, pursuant to section 731, exempt from tax by

reason of such corporation having engaged in the mining of strategic metals, the tax liability of the group shall be an amount which bears the same ratio to the tax computed on the consolidated adjusted excess profits net income as the portion of the consolidated adjusted excess profits net income not exempt from tax bears to the entire consolidated adjusted excess profits net income. The portion of the consolidated adjusted excess profits net income not exempt from tax shall be determined in the same manner as if the consolidated adjusted excess profits net income were the adjusted excess profits net income of a separate corporation."

We respectfully urge the adoption of an amendment along similar lines to maintain the exemption for corporations engaged almost exclusively in foreign trade within the narrow limitations of section 727 (g). This might be accomplished by placing the letter (a) before the present paragraph of section 731, Internal Revenue Code, and by transferring subsection (g) from section 727 to section 731 as subsection (b) and amending it slightly to read as follows:

"(b) No tax shall be imposed by this chapter in the case of any domestic corporation satisfying the following conditions:"

"(1) If 95 per centum or more of the gross income of such domestic corporation for the three-year period immediately preceding the close of the taxable year (or for such part of such period during which the corporation was in existence) was derived from sources other than sources within the United States; and

"(2) If 50 per centum or more of the gross income for such period or such part thereof was derived from the active conduct of a trade or business.

"If such a corporation is a member of an affiliated group of corporations filing consolidated returns under section 141, the tax on the portion of the consolidated adjusted excess profits net income remaining after the exclusion of such income shall be an amount which bears the same ratio to the tax computed without regard to this subsection as such remaining portion bears to the entire adjusted excess profits net income."

Senator WALSH. The committee will recess until tomorrow morning at 10 o'clock.

(Whereupon, a recess was taken until 10 a. m., Saturday, December 4, 1943.)

REVENUE ACT OF 1943

SATURDAY, DECEMBER 4, 1943

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

The committee met, pursuant to adjournment, at 10 a. m., in room 312, Senate Office Building, Senator David I. Walsh (acting chairman) presiding.

Present: Senators Walsh, Gerry, Guffey, Johnson, Lucas, Davis, Danaher, Taft, Butler, and Millikin.

Senator WALSH. The committee will come to order.

If any of the witnesses who are scheduled wish to communicate with the Chair they may do so by sending a note to the secretary who will call it to my attention, and I will give you the consideration you may desire.

Those who were not called yesterday will be called after the first subject assigned to us this morning is disposed of. Special assignment has been given to those who represent religious and charitable organizations and who are interested in the contributions under the withholding tax. Will those who are scheduled to appear on this subject stand?

Now, it is simply just impossible for the committee to hear you at length. We would like to have you consolidate your statements as much as possible and limit yourselves each to 3 minutes or 5 minutes, or have someone represent you for 15 minutes and the others just address the committee for 2 or 3 minutes. Is that possible, or do you all want to be heard at length?

Mr. CURTIS. Mr. Chairman, we will comply with that.

Would you like to make an over-all time requirement?

Senator WALSH. Would 30 minutes be too much or too little? Can you confine yourself to 30 or 35 minutes?

Mr. CURTIS. About 45.

Senator WALSH. We will give you 45 minutes.

Who will have charge of the time and speakers?

Mr. CURTIS. I will.

Senator WALSH. Congressman Curtis, we will charge you with that responsibility.

Are you going to address the committee yourself?

Mr. CURTIS. Briefly.

Senator MILLIKIN. Mr. Chairman, I assume everyone will be permitted to file briefs in extenso if they wish.

Senator WALSH. Yes. Although you may be limited in time in addressing the committee, there is no limit to whatever material you may want to submit in the record.

Congressman Curtis.

STATEMENT OF HON. CARL T. CURTIS, UNITED STATES REPRESENTATIVE FROM THE STATE OF NEBRASKA

Mr. CURTIS. Mr. Chairman and Senators, perhaps I have some undue advantage here. I am the timekeeper and I am the first speaker, but, I will be as brief as I can.

The problem we are concerned about this morning has to do with the proposition, of many years' standing, that a certain portion of a man's income, up to 15 percent, if he gives it to religious and charitable institutions is exempt from income tax. Within the last year we have changed the method of collecting taxes for millions of American people. I am referring to those people whose only income is their wages or their salary. They file a statement of their family situation and their employer takes out the taxes before the pay check ever comes to them. Suppose they want to give something to their church or their college, to the American Red Cross, or to the many institutions of service and mercy, they must go ahead and pay taxes on income that is exempt and file a claim at the end of the year for a refund or credit. Unless some legislation is enacted so that as they go along, as the taxes are taken out of their wages, you can take into account what their anticipated contributions to charity are, the United States Government is going to have a tremendous problem on its hands. There will be millions and millions of applications. It will run into millions of dollars and it may take a large additional appropriation to take care of it.

Senator WALSH. Are you speaking of a change made in the law by the House?

Mr. CURTIS. I am not speaking of the bill that is before you, I am referring to the withholding tax generally.

Senator WALSH. Yes.

Mr. CURTIS. That is one side of the picture. Unless something is done endless complications will arise for the Treasury of the United States.

Now, let us take the other side of the picture. What is happening in the way of contributions to churches and charities at the present time? In the last 5 years the tax-gathers have gone forth and taken money. Where they used to take $5,000,000,000, they are taking $43,000,000,000. People go on eating; we have to go on wearing clothes; we have to have our homes lighted; we have to have the other necessities of life. It is these fine institutions that depend upon free-will offerings that have suffered more and will suffer more from the heavy tax program of our Government than any other institution.

Now, to meet this situation a bill was presented over on the House side. It gained considerable interest and backing. Quite a number of the members of the Ways and Means Committee favor it. One member of that committee, Mr. Gearhart, will be here this morning and will speak for it.

We are not here in behalf of any particular bill. We have a suggestion, if that can be changed, improved upon in any way or approached from a different angle, we do not care.

Senator WALSH. Have you an amendment drafted?

Mr. CURTIS. Yes; we have one that was presented in the House as a bill. That is H. R. 3472 and H. R. 3473. They are identical bills.

Senator WALSH. It may be printed in the record.

(H. R. 3473 is as follows:)

[H. R. 3473, 78th Cong., 1st sess.]

A BILL To permit the amount of charitable contributions made or to be made to be taken into account in computing the tax required to be deducted and withheld on wages

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 1622 (h) of the Internal Revenue Code (relating to collection of income tax at source on wages) is amended by inserting at the end thereof the following:

"Any employee may include in his withholding exemption certificate a statement of the amount of contributions he has made or will make in the calendar year which are allowable as deductions under section 23 (o) in computing net income. If such a statement is so included, the amount so stated shall be prorated to pay-roll periods beginning with that with respect to which the certificate first takes effect and ending with the last pay-roll period which ends in the calendar year, and for the purposes of subsection (b) (1) (A) the family status withholding exemption for each such pay-roll period shall be increased by the portion of such amount so prorated to such period. If the employer exercises his election under subsection (c) (1) (relating to wage bracket withholding) the tax to be deducted and withheld for any such pay-roll period shall be that determined without regard to this sentence decreased by 17 per centum of the amount so prorated to such period, except that in no event shall the amount to be withheld and deducted be less than that prescribed as the minimum amount to be withheld and deducted in cases in which the number of dependents is in excess of the largest number shown on the applicable table."

SEC. 2. The amendment made by this Act shall take effect January 1, 1944.

Senator WALSH. So it is your wish that this committee add the substance of this bill to this tax bill?

Mr. CURTIS. Yes. But we have no pride of authorship. If you can improve upon the method, we want you to do it.

Senator WALSH. I understand.

Mr. CURTIS. We say in substance this: At the time the employee files his annual exemption certificate stating he is married, that he has so many dependents, and so on, he should also state his anticipated contributions for the next year. Suppose an employee receives $200 a month, when he files his exemption certificate he tells them that he is going to give $25 a month to charity and religion. His employer then, instead of figuring his withholding tax on the basis of $200 each month, will figure it on the basis of $175. That is how simple it is.

This matter has been taken up with the International Business Machines Co., and they say it can be handled where the pay roll is handled by the machine. This meets the Treasury's objection.

Senator MILLIKIN. Mr. Chairman, may I ask the witness a question, please?

Senator WALSH. Sure.

Senator MILLIKIN. If you are going to get to it, I will not interrupt you now. Have you calculated what is involved financially in your plan?

Mr. CURTIS. As regards to whom?

Senator MILLIKIN. To the Treasury.

Mr. CURTIS. The Treasury cannot lose anything that belongs to them.

Because it is the basic law of the land that 15 percent of a man's income, if he give it to religion and charity, is exempt from taxation. I think it will mean a temporary loss to the Treasury, but in the long pull it will mean a gain, because if these millions and millions of people have to pay taxes on exempt income and then at the end of the year file a claim for a refund, it will be a tremendous bookkeeping job, a tremendous bill to pay that will be an unknown amount.

Senator DAVIS. In other words, he is going to say that he gives $25 a month out of his pay to his church, and he names his church, and then the employer will deduct that from his pay envelope and send it to the church?

Mr. CURTIS. No, it is no charge-off, it merely reduces the amount of taxes that the employer pays for him. He gets the money and makes his own contribution. That is his responsibility. We do not load any such burden on the employer. It merely reduces the amount of the taxes that his employer pays for him.

Senator WALSH. The other process is to get that back in the way of a drawback.

Mr. CURTIS. Yes.

Senator WALSH. Which is a tedious and long drawn-out and complicated process.

Mr. CURTIS. Yes, and it is something that is a dangerous blow to every orphanage, every hospital, every church, every college that is depending upon these free-will offerings, because they are the people that are going to suffer by reason of our enlarged tax program.

Earlier in the week, Father Flanagan, of Boys Town in Omaha, submitted a statement in regard to this. He could not wait for this hearing. I hope an appropriate unanimous consent order might be entered so his testimony could appear with these other witnesses in your printed hearing at this place.

Senator WALSH. That may be done.

Mr. CURTIS. Mr. Chairman, I am not going to take any more of your time myself. Mr. Gearhart will be our next witness.

Senator WALSH. Representative Gearhart.

STATEMENT OF HON. BERTRAND W. GEARHART, UNITED STATES REPRESENTATIVE FROM THE STATE OF CALIFORNIA

Senator WALSH. We are glad to see you on this side of the Capitol.

Mr. GEARHART. Thank you.

Senator WALSH. We used to be enlightened by you on the House side. I hope you give us a little more enlightenment than this bill does.

Mr. GEARHART. The time, of course, is short. There are many men here from various parts of the country and I will, of course, make my remarks as brief as I possibly can.

I think the issue is very simple and can be very easily understood. It is just a question of whether we want to do it or not. We have a gross income from which the employer is required to deduct, or subtract rather, the family exemption, the exemption for children, draw a line and subtract, and that is all; and then the employer is required to withhold on that 20 percent. That is the withholding tax we have

imposed upon the people. If you pass this bill and adopt this principle stated in the two bills that Mr. Curtis and I have introduced, the employer will have to ask just one more question, and that is, "What do you intend to give to your church or charity or your educational institution?", and then subtract that and then apply the 20 percent rule.

Now, to quote and to paraphrase, and I think that is often illustrative and helpful, "patriotism is the last refuge of the scoundrel." Likewise, "unsurmountable administrative difficulties" is the last cry of the Treasury. They have opposed this on that ground, that insurmountable administrative difficulties will be encountered. Senators, I think the insurmountable difficulties that they have in mind are going to result from a failure to enact the statute rather than from putting it into the revenue law, because, if the provision is adopted, it just means one little additional subtraction from the gross income before they apply the 20 percent tax, whereas if they go ahead and tax that exempt income during the year the Treasury is going to have to pass upon a tremendous number of claims for refund at the end of the year. It ought to be apparent to everyone that passing upon claims for refunds at the end of the year is a far more difficult problem than merely asking the question, "What do you intend to give to your church and charity?" and then subtract it, and then figure 20 per cent upon that.

Senator WALSH. How would the Government know that the intention to give to charity is carried out?

Mr. GEARHART. That question is very pertinent: Supposing the man says, "I am going to donate so much to my church or charity," and the 20 percent deduction is based upon that as a truth, and later on the man does not make that donation, then he is required at the end of the year, March 15 following, to make his adjustment, and then under oath he will have to say whether he did or not, and if he falsifies his return he will take his place in Leavenworth where other persons who deviate from the strict line or letter of the law in preparing their returns are committed.

Senator WALSH. That would put upon the Government the responsibility of seeing that every promise to make a charitable contribution was carried out. I want to find out what process the Government would have to go through in order to do this unusual thing.

Mr. GEARHART. It does not place any greater responsibility upon the Government than it must bear in respect to every other obligation that is imposed upon the taxpayer by law.

Senator WALSH. That is true.

Mr. GEARHART. If he does not live up to the line or letter of the law, it is up to the Treasury to catch him and report him to the Attorney General and send him through the judicial process. I think without question, Mr. Chairman and gentlemen, that the administrative difficulties that are going to be encountered as the result of a failure to adopt this proposed section are many times greater than those that will be encountered if you do include the section in the bill.

Senator MILLIKIN. Mr. Chairman.

Senator WALSH. Senator Millikin.

Senator MILLIKIN. You stated, Congressman, that the taxpayer would make his return at the end of the year and would then reveal whether he had or had not performed his intention. Would he be required to specify to whom he had made his charitable contributions?

Mr. GEARHART. The return will have to be the same kind of adjusting return that you have to make on every other item that figures in the net return.

Senator MILLIKIN. He would not just say that he gave to unspecified charities a certain sum of money; he would have to specify to whom he gave the money?

Mr. GEARHART. I always have in my return; I always specify what I give to charity and to whom I gave it, in my return. I think it is required.

Senator MILLIKIN. That is subject to check by the Treasury, as is any other declaration on the return?

Mr. GEARHART. Yes. Now, the important thing, Senators, is to decrease as much as we can, through the adoption of good policies, these claims for refunds and these claims for readjustments on the following March 15, because everyone has got to be touched by human hands, everyone has got to be studied by human brains. If you allow this man to make a deduction in the first place, then at the end of the year he will say, "Well, I probably paid a little too much, but it is not worth while asking an adjustment upon," and he will go his way. If he thinks his Government is taxing him on something that is exempt, that man is most certain to go down and put in a claim for a refund, and it will impose upon the Government this great burden of checking millions of returns, whereas otherwise they might be cut down to a very, very much smaller number.

Senator WALSH. That is rather rudimentary.

Mr. GEARHART. Yes. . .

Senator WALSH. You take your own case, Congressman. You want to give $50 to $100 for charitable or religious purposes, what is the present process and what is the process you propose?

Mr. GEARHART. Well, now, the present process is nothing would be done until the following March 15 when he files the adjusted return and claims that deduction. If he has made a contribution of as much as 15 percent, certainly there would be money due him and the Government would have to send him a check, and he will probably get it 8 or 10 years later.

Senator WALSH. To get back the money that is held back by the pay clerk in the House or Senate, you indicate so much is for charity and you must take an affirmative position next March in asking for that deduction?

Mr. GEARHART. That is right. It imposes a tremendous burden on our people.

Senator WALSH. After you adopt this, the pay clerk in the House or Senate will allow that credit as a credit to you and not draw back in taxes the amount you give to charities and religious purposes?

Mr. GEARHART. If I understand your question correctly, the deductions for charitable donations will have their place in equal dignity with the deductions you are entitled to for family and for children.

Senator WALSH. I understand that.

Mr. GEARHART. I want to conclude, unless the Senators want me to pursue it further, because I am thinking of the gentlemen that are behind me.

I want to say this about the withholding tax. All of us know it is the most unpopular thing we have ever imposed upon the people. Employers everywhere write me that their best employees leave them to seek employment in industries that are not subject to withholding deductions. Out our way we have a lot of agricultural industries that pay in wages as much as the urban industries, and they are not subject to withholdings at all.

There are many deductions besides those we have discussed. We have a deduction for War bonds: that takes another 10 percent out; we have deductions for union dues, and that takes out something else. Then, we have the Social Security, and that takes still more out. You have some other voluntary deductions which are local in their nature but which the employer, because of his public-spiritd nature is cooperating with. So, the man has deduction after deduction and the pay check, when it reaches him, is a mere fraction of what it was originally. What is the effect on the public mind? The effect is this: He economizes, and he economizes where he should not economize. He does not give to his church and to his charities and to his favorite educational institutions, praiseworthy institutions, which are good for the country and which have made America what it is. We cannot contemplate an America without churches and charitable institutions and educational institutions. Ie we do not do something to help these great institutions which have made America what it is, they are going to be financially starved. Donations are going to fall off and fall off until, perhaps, America will be in the end a very different kind of America than the one we have always had and we have enjoyed living in.

Senator WALSH. Mr. Representative, I think the committee understands your position.

Mr. GEARHART. Thank you very much, Senators. I wish we had more time to devote to this subject.

Senator WALSH. I wish we could do it today.

Mr. CURTIS. Our next witness, Mr. Chairman, is Mr. William F. Montavon, director of the legal department, National Catholic Welfare Conference. He has with him Msgr. George Johnson, the secretary general of the National Catholic Educational Association. The two of them will be heard jointly.

STATEMENT OF WILLIAM F. MONTAVON, DIRECTOR OF THE LEGAL DEPARTMENT, NATIONAL CATHOLIC WELFARE CONFERENCE

Mr. MONTAVON. Mr. Chairman and gentlemen, I am directed by the chairman of the administrative board of the National Catholic Welfare Conference to bring to the attention of your committee an important matter in relation to the revenue bill now pending before your committee. The specific purpose of this communication is to seek a remedy for a hardship which bears heavily upon individuals who by their free will offerings contribute to religious, educational, and charitable enterprises and indirectly is detrimental to organiza-

tions and institutions which depend wholly, or in great measure, on free-will offerings and contributions for funds with which to carry on their activities in the field of religion, education and charity. The National Catholic Welfare Conference in this matter serves as the agent of the Catholic bishops of the United States, under whose jurisdiction upward of 10,000 parishes and missions, more than 1,000 charitable hospitals, sanitariums, and homes for the needy, a large number of orphanages, colleges, and other educational establishments, and the National Conference of Catholic Charities with diversified activities in the field of charity and social service are dependent. Without exception, these institutions and organizations receive their support in great measure from the free-will offerings of millions of contributors, most of whom are in the low-wage brackets.

The situation to which I refer arises out of the fact that the Current Tax Payment Act of 1943 which imposes a 20 percent withholding tax makes no provision for an employer to make deduction for gifts to a religious, educational, or charitable organization in computing the income of the employee subject to the withholding tax. The Current Tax Payment Act does make allowance for the deduction of an amount on the basis of family status to which the taxpayer certifies.

The difficulty to which I refer would be remedied if, for the purpose of the withholding tax, at the time the employee certifies his family status to his employer, he were permitted to certify also the amount which, during the tax year, he will give to religious, educational, and charitable purposes and if the employer deducted the sum of the two amounts certified by the employee in computing the income subject to withholding tax. Failing to provide such a remedy as herein suggested would lay upon a person dependent upon wages for his income the unnecessary but onerous burden of filing with his tax return at the end of the tax year a petition for a refund of the amount collected as income tax on his gifts to religious, educational, and charitable purposes during the tax year.

I respectfully suggest, therefore, to the Committee on Finance, as a remedy for this situation, that the revenue bill now pending before your committee be amended to include a provision amending the Internal Revenue Code to make possible the deduction for charitable gifts as herein outlined.

Senator WALSH. I suppose the law has not been in operation sufficiently long for you to be able to state whether or not you have appreciated that there has been a deduction in the amount of contributions.

Mr. MONTAVON. I have only conversational reports, Mr. Chairman, to that effect from ecclesiastical authorities, I have no definite statistics. They all feel there has been some falling off, and the danger they fear is that there will be a greater falling off.

Senator WALSH. As time goes on.

Mr. MONTAVON. Yes, sir.

Senator WALSH. Is there nothing else.

Mr. MONTAVON. There is nothing else.

Senator WALSH. Dr. Johnson.

STATEMENT OF THE RT. REV. MSGR. GEORGE JOHNSON, SECRETARY GENERAL, THE NATIONAL CATHOLIC EDUCATIONAL ASSOCIATION

Dr. JOHNSON. I am appearing before your committee at the direction of the executive board of the National Catholic Educational Association to request your consideration for a provision in the Current Tax Payment Act of 1943 that would permit an employee to certify the amount which he will give to religious, educational, and charitable purposes during the year in order that this amount may be deducted bp the employer in computing the amount of income subject to withholding tax.

The National Catholic Educational Association is an organization made up of the following departments: A department of colleges and universities, a department of seminaries, a department of secondary schools, a department of elementary schools, and a department of superintendents. The executive board is composed of representatives from these various departments.

There are in the country 25 Catholic universities, 168 Catholic colleges, 2,105 secondary schools, and 7,944 elementary schools. All told these schools enroll, according to the biennial census of the department of education of the National Catholic Welfare Conference, 2,584,461 students. They employ 97,464 teachers. This represents a very large educational undertaking which is supported for the main part through voluntary contributions on the part of the Catholic people of the United States.

Catholic elementary and secondary schools derive their support from people in very moderate circumstances. Because they believe in the necessity of a religious education for their children, they are making the financial sacrifice that is necessary to provide Catholic schools. Incidentally by assuming the burden of educating their own children, they are saving the Government millions of dollars every year. Under the circumstances, it would seem that some way should be found according to which they can get credit for their contributions at the time that the employer computes the amount of their income that is subject to withholding tax.

Senator WALSH. Not all secondary schools are free. In some there is a tuition.

Dr. JOHNSON. In some there is a tuition.

Senator WALSH. I assume where there is a tuition, they must pay for their boys and girls.

Dr. JOHNSON. A great majority, about 70 percent of our schools, are either parish high schools or diocese high schools. The tuitions are very nominal indeed. That would be 70 percent of the schools.

Senator WALSH. All right, Father Rooney.

STATEMENT OF FATHER EDWARD B. ROONEY, JESUIT EDUCATIONAL ASSOCIATION

Father ROONEY. Mr. Chairman and Senators, I wish to second what Mr. Montavon and Monsignor Johnson have already said, since I am a member of the organizations which they represent.

The Congressmen have given a sufficient explanation of the measure they are advocating here today. I wish to add just one point. It is this:

It is common knowledge in educational circles today that all privately conducted colleges and universities are now faced with a very difficult problem, and will be faced with it more as time goes on, from the fact that the day of very large donations to educational institutions seems to have passed. Colleges and universities are very conscious of this, with the result that they are making a strenuous effort to foster a movement among their alumni, a long-range plan calling for a multiplicity of small donations over a long period of time.

Such a measure as we are proposing here this morning would, it seems to me, help along that movement because it would impress upon people first of all their own ability and the convenience of giving small amounts over a long period of time. Secondly, the very fact that they have to indicate at the beginning of the year how much they intend to give, and the fact that they have to check on this three or four times a year, would be an incentive to individuals to give the amount they promised for educational and charitable purposes.

It is my opinion, therefore, that such a measure as is proposed here would find favor among educators. At practically all educational meetings today we hear mention of the difficulty of supporting privately controlled educational institutions. These educators are aware that they will have to depend on a large number of small donations over a long period of time. Such a measure as we advocate will facilitate this kind of gifts.

For these reasons I, as an educator, wish to second what Mr. Montavon, Monsignor Johnson, and the Congressmen have already said.

I thank you.

Senator WALSH. Representative Curtis, who is your next witness?

Mr. CURTIS. Dr. Alva Vest King.

STATEMENT OF DR. ALVA VEST KING, UNITED STEWARDSHIP COUNCIL AND THE GENERAL COUNCIL, PRESBYTERIAN CHURCH

Dr. KING. Mr. Chairman, first I want to thank the members of the committee and the chairman for this courtesy and past courtesies, for I hold in my files letters, very gracious letters, from members of this committee to whom I had written before, and for their kindness and their consideration.

I am representing this morning the United Stewardship Council, as well as Presbyterian Church. The United Stewardship Council is an organization of between 25,000,00 and 26,000,000 Protestants who are interested particularly in the cultivation of giving in support of the churches and institutions.

The present revenue law and the proposed revenue bill, H. R. 3687, in the withholding sections make no allowance for contributions to church and charities. The following suggestions are offered for consideration:

First. The basic tax law has observed the historic principle of separation of church and state. Contributions up to 15 percent of the net income are not subject to tax. The withholding section of

the present and proposed revenue legislation nullifies this principle by taxing that part of the income which the individual reserves for contributions.

Second. The tax tables were set up to meet a mechanical method of deducting the withholding tax from pay rolls. Consequently a law of averages had to be established which works great hardship on some and credits others for contributions which are not made. This again nullifies the democratic principle of allowing freedom to the individual.

Third. All philanthropic institutions are facing the fact of a dwindling number of the larger givers. Church benevolence boards, colleges, hospitals, and other philanthropic organizations were formerly supported out of the surplus of a comparatively few large givers. For example, the benevolence income of the Presbyterian Church, U. S. A., in the year 1929 was derived as follows:

	Nonliving		Living		Total
	Amount	Percent	Amount	Percent	
1929	$3,258,480	28	$8,400,377	72	$11,658,857
1942	1,812,028	27	4,854,329	73	6,666,357

One reason for this decline may be seen in the following facts regarding sources of income.

	Dividends and interest	Wages and salaries
1929	$13,100,000,000	$52,500,000,000
1942	9,900,000,000	100,700,000,000

Legacies and income from invested funds largely represented the generosity of these who derived their living from dividends and interest. This source has been greatly reduced while wages and salaries have doubled during the decade. Yet it is this large group of salaried workers and wage earners who are affected by the withholding tax. They are deprived of the privilege of setting aside a tax-exempt portion of their income. Because of the tax pressure on this group, contributions have failed to keep pace with the rising national income. If philanthropic institutions are to maintain their programs in a world that needs them more now than ever, there must be some way of securing larger support from the people who have the major portion of the income.

Senator TAFT. Just question there. I have reports from the community chest in Cleveland that last month they raised 50 percent more than they have ever raised, and the same applies to contributions to the war chest.

Dr. KING. That is true. I think contributions are coming up.

Senator TAFT. Largely from small givers.

Dr. KING. And yet the record which we have here, and the charts, have not shown that as to our churches and charities so far.

Senator MILLIKIN. Perhaps the distinction is in the difference between systematic giving and giving in spurts.

Dr. KING. Yes.

Senator TAFT. It seems to me on the whole high tax rate on the intermediate incomes and heavy credits tend to increase contributions.

Dr. KING. We hope it will work out that way.

Senator TAFT. You can give much more cheaply. In other words, you can give twice as much without any more tax, without any more net loss to yourself.

Dr. KING. We hope it will work out that way. The point I am making, however, Senator, is if the philanthropic institutions are to maintain their program in a world which needs them more than ever right now, there must be some way securing this larger support from the people who have the money, that is, among wage and salaried workers.

Senator WALSH. Your problem is those who have other income from stocks, securities, and investments can make their claim for charitable deductions when they make their returns, and that ends it.

Dr. KING. That is right, Senator.

Senator WALSH. But where a working man makes his claim for a deduction for charitable purposes, he has to go to the Treasury the following March and ask for a refund!

Dr. KING. That is correct. He has his withheld while the other man does not.

Senator TAFT. That would only be true if he were exactly on a 20-percent basis.

Dr. KING. Yes.

Fourth. There are millions of salaried workers and wage earners whose withholding tax is not computed by machines. They should be given consideration.

Fifth. If churches, colleges, and other charities are worth conserving and supporting it is important that we avoid destroying their financial foundations.

Sixth. In our judgment the proposed amendment, H. R. 3473, would correct those difficulties.

(1) It conserves the principle of exempting contributions from taxation.

(2) It allows the individual freedom to designate an amount of his own choice for contributions.

(3) It would become an important educational means of developing voluntary generosity among millions of wage earners who should know their responsibility to the free institutions which have contributed to our democracy.

(4) The employee's voluntary declaration to his employer would be an annual reminder of his responsibility and amount to a pledge. If the promise of intent to contribute was not kept, the taxpayer would be under obligation to pay the balance of his income tax at the end of the year.

(The tables submitted by Dr. King are as follows:)

A 25-year comparison of individual returns with net income, including returns of estates and trust—This survey shows deductions taken and contributions in dollars and percent

[All figures in thousands of dollars]

Year	Net taxable income reported	Total deductions reported	Percent of total deductions to net income	Total contributions	Percent of total contributions to net income	Deductions exclusive of contributions	Percent of deductions exclusive of contributions to net income
1918	6, 298, 578	2, 051, 324	32.5	[1] 137, 559	[1] 2.2	[1] 1, 913, 765	[1] 30.3
1917	11, 191, 246	885, 763	7.91	245, 080	2.0	640, 683	5.91
1918	15, 924, 639	1, 821, 122	11.4	[1] 350, 342	[1] 2.2	[1] 1, 470, 780	[1] 9.2
1919	19, 839, 491	2, 573, 194	12.9	[1] 435, 608	[1] 2.2	[1] 2, 141, 586	[1] 10.7
1920	25, 735, 629	3, 954, 641	12.4	357, 290	1.6	2, 567, 351	10.8
1921	19, 577, 213	2, 751, 569	18.6	[1] 522, 074	[1] 2.7	[1] 2, 229, 495	[1] 13.9
1922	21, 336, 713	3, 835, 696	16.5	625, 218	2.0	3, 110, 478	14.6
1923	24, 777, 466	4, 476, 127	17.9	534, 797	2.1	3, 933, 330	13.8
1924	25, 656, 153	3, 972, 943	15.2	533, 168	2.1	3, 399, 675	13.1
1925	21, 894, 576	3, 377, 456	15.4	441, 500	2.0	2, 935, 908	13.4
1926	21, 958, 506	3, 458, 930	15.8	454, 206	2.2	3, 004, 725	13.6
1927	22, 845, 091	3, 663, 470	16.2	507, 705	2.25	3, 155, 765	13.95
1928	24, 727, 114	4, 681, 170	18.9	541, 351	2.18	4, 139, 819	16.72
1929	23, 775, 606	6, 971, 404	29.7	649, 109	2.27	6, 431, 295	27.43
1930	16, 579, 183	6, 944, 646	41.8	434, 401	2.56	6, 510, 245	39.24
1931	11, 668, 018	6, 900, 083	59.1	353, 929	3.03	6, 546, 154	56.07
1932	10, 174, 987	5, 048, 685	49.6	316, 660	3.11	4, 732, 025	46.49
1933	9, 867, 307	4, 282, 335	43.0	281, 918	2.85	3, 970, 420	41.15
1934	12, 383, 943	3, 053, 072	24.6	279, 816	2.25	2, 773, 256	22.38
1935	14, 528, 450	3, 076, 699	21.1	310, 143	2.13	2, 766, 556	18.97
1936	19, 240, 110	3, 193, 324	16.5	388, 691	2.02	2, 793, 733	14.48
1937	20, 930, 056	3, 774, 437	18.2	444, 929	2.12	3, 329, 508	16.06
1938	18, 543, 218	3, 831, 001	20.6	413, 979	2.23	3, 417, 022	18.37
1939	22, 907, 544	3, 711, 704	16.2	498, 910	2.18	3, 212, 884	14.02
1940	[2] 35, 730, 644	[2] 4, 357, 910	[1] 12.3	[1] 731, 277	[1] 2.04	[2] 3, 656, 633	[2] 10.26
26 year total	475, 810, 900	96, 317, 097		10, 542, 956		85, 774, 741	
Average			20.24		2.26		17.98

[1] Estimated; no report given.
[2] Preliminary figure.
Source: Bureau of Internal Revenue.

NOTE.—Statistics based on taxpayer's returns as filed—includes those classes of individuals and fiduciaries who, under the revenue laws of the respective years were required to file returns.

PER CAPITA GIFTS, UNITED STEWARDSHIP COUNCIL STATISTICS, ISSUED FOR 1943

Religious body	Budget benevolence		Denominational benevolence		Total benevolence		Congregational expenses		All purposes	
A	B		C		D		E		F	
1. Baptist, Northern	(6)	$2.24	(10)	$2.38	(14)	$2.86	(13)	$13.58	(15)	$16.44
2. Baptist, Southern	(9)	1.89	(13)	1.89	(18)	1.89	(18)	8.32	(18)	10.21
3. Brethern, Church of	(10)	1.67	(8)	4.74	(6)	6.34	(17)	9.41	(16)	14.63
4. Brethern, United	(12)	1.58	(9)	2.85	(12)	3.15	(15)	13.30	(14)	16.45
5. Congregational Christian	(13)	1.58	(14)	1.82	(16)	2.36	(12)	14.21	(10)	16.57
6. Disciples of Christ	(13)	1.23	(15)	1.64	(19)	1.79	(19)	8.09	(19)	9.88
7. Episcopal, Protestant	(4)	3.44	(5)	4.08	(10)	4.08	(6)	18.65	(5)	22.73
8. Evangelical Church	(6)	2.34	(3)	6.39	(4)	6.63	(5)	16.39	(7)	23.02
9. Evangelical and Reformed	(12)	1.58	(11)	2.34	(15)	2.60	(11)	14.27	(12)	16.87
10. Friends, Ohio (Damascus)					(1)	12.79	(2)	33.10	(1)	45.90
11. Lutheran, American					(11)	3.27	(10)	14.70	(11	18.07
12. Lutheran, Augustana					(8)	4.21	(9)	15.47	(9)	19.68
13. Lutheran, United					(13)	2.97	(13)	13.58	(13)	16.55
14. Methodist Church	(11)	1.59	(12)	2.18	(17)	2.18	(16)	11.90	(17)	14.08
15. Nazarene, Church of	(2)	2.05	(4)	4.95	(7)	4.97	(1)	36.86	(2)	41.83
16. Presbyterian, United	(2)	5.67	(2)	6.70	(2)	8.83	(3)	19.36	(4)	27.69
17. Presbyterian, United States (South)	(1)	6.31	(1)	6.71	(3)	6.93	(7)	18.04	(5)	24.97
18. Presbyterian, United States of America (North)	(5)	2.97	(7)	4.21	(8)	4.21	(4)	20.48	(6)	24.69
19. Reformed in America	(3)	4.28	(6)	4.56	(5)	6.44	(3)	22.45	(3)	27.89
Average United States, 1943		2.11		2.63		2.75		12.90		19.70
Average United States, 1942		1.83		2.46		2.49		12.22		14.70
20. Baptist, Ontario and Quebec			(1)	4.13	(7)	4.13	(1)	16.22	(1)	20.39
21. Baptist, western Canada	(1)	3.34	(2)	3.34	(3)	3.34	(3)	13.42	(4)	16.76
22. Presbyterian, Canada	(3)	2.72	(4)	3.25	(4)	3.25	(7)	14.44	(7)	17.69
23. United Church of Canada	(7)	3.01	(7)	3.96	(1)	4.22	(4)	13.41	(3)	17.63
Average Canada, 1943		2.79		3.73		4.03		13.74		17.77
Average Canada, 1942		2.83		3.60		4.12		13.36		17.28
General average 1943		2.24		2.74		2.80		12.94		15.81
General average 1942		1.76		2.45		2.53		12.25		14.80

Source: These statistics are furnished by national officers of religious bodies, members of the United Stewardship Council. Budget benevolence includes contributions to the missionary budgets of the reporting bodies. Denominational benevolence includes gifts to any benevolence in the denomination whether or not it is included in the national denominational budget. The totals for each benevolence column and for congregational expenses is larger than for the preceding year. Compiled for the United Stewardship Council, Harry S. Myers, secretary, Hillsdale, Mich., October 1943.

TOTAL GIFTS

Religious body	Budget benevolence	Denominational benevolence	Other benevolence	Total benevolence	Congregational expenses	All purposes	Membership excluding infants	Reports for year ending—
A	G	H	I	J	K	L	M	N
1. Baptist, Northern	$3,494,432	$3,704,868	$757,371	$4,462,239	$21,133,953	$25,596,192	[1] 1,556,112	Apr. 30, 1942
2. Baptist, Southern	9,681,772	9,681,772		9,681,772	42,505,890	52,247,662	[1] 5,112,191	Dec. 31, 1942
3. Brethren, Church of	285,093	807,315	80,000	887,315	1,400,000	2,487,315	170,000	Feb. 28, 1943
4. Brethren, United	607,705	1,095,005	113,050	1,208,054	5,092,000	6,300,154	382,800	Dec. 31, 1942
5. Congregational Christian	1,707,060	1,953,677	553,908	2,557,585	15,316,072	17,873,657	[1] 1,077,346	Do.
6. Disciples of Christ	2,215,237	2,735,087	150,000	2,885,087	13,490,375	16,365,462	1,664,943	June 30, 1942
7. Episcopal, Protestant	5,059,159	6,005,669		6,005,669	27,400,705	33,406,374	1,968,672	Dec. 31, 1942
8. Evangelical Church	546,878	1,556,746	57,697	1,614,443	3,991,386	5,605,829	243,475	Do.
9. Evangelical and Reformed	1,057,163	1,493,716	240,607	1,734,321	9,508,482	11,242,803	665,920	Do.
10. Friends, Ohio (Damascus)		57,785		57,785	149,551	207,337	4,517	June 30, 1943
11. Lutheran, American		1,376,713		1,376,713	6,003,611	7,380,324	408,299	Dec. 31, 1942
12. Lutheran, Augustana		1,136,942		1,136,942	4,170,674	5,307,616	308,316	Do.
13. Lutheran, United		3,687,541		3,687,541	16,874,059	20,561,600	1,242,238	Do.
14. Methodist Church	10,584,159	14,823,686		14,823,686	79,041,364	93,867,050	6,640,424	Do.
15. Nazarene, Church of	372,240	898,470	2,783	901,253	6,661,834	7,563,087	181,239	Do.
16. Presbyterian, United	1,086,842	1,293,347	312,658	1,606,005	3,706,496	5,302,501	191,369	Mar. 31, 1943
17. Presbyterian, United States (South)	3,497,817	3,717,949	121,518	3,839,467	9,994,289	13,833,756	553,797	Do.
18. Presbyterian, United States of America (North)	5,714,732	8,003,669		8,003,669	39,349,048	47,442,717	1,920,744	Do.
19. Reformed in America	713,797	761,830	142,585	904,405	3,731,116	4,635,521	165,173	Apr. 30, 1943
Total United States 1943	46,624,086	64,533,777	2,572,094	66,098,076	309,789,905	376,046,958	24,012,658	
Total United States 1942	41,213,009	57,707,572	1,940,751	59,648,323	292,885,184	352,353,511	23,975,057	
20. Baptist, Ontario and Quebec		228,307		228,307	[2] 802,697	1,120,494	55,000	Apr. 30, 1943
21. Baptist, western Canada	56,515	56,515		56,515	227,037	283,553	16,909	Do.
22. Presbyterian, Canada	471,566	561,856		561,856	2,475,139	3,036,995	172,744	Jan. 31, 1943
23. United Church of Canada	2,164,197	2,742,586	290,000	3,032,586	9,630,731	12,663,317	717,019	Dec. 31, 1942
Total Canada, 1943	2,692,278	3,589,354	290,000	3,879,366	13,215,004	17,094,359	961,672	
Total Canada, 1942	2,684,304	3,415,711	452,565	3,898,276	12,460,194	16,357,470	946,700	
Grand total, 1943	49,316,364	68,123,131	2,862,094	69,977,432	323,004,909	394,041,317	24,973,730	
Grand total, 1942	43,897,311	61,113,283	2,423,316	63,546,599	305,354,378	368,910,981	24,921,757	

[1] Total membership.
[2] From last year's report.

Mr. CURTIS. Our next witness will be Mr. Moore Gates, representing the interests of the Presbyterian Church in the United States of America.

STATEMENT OF MOORE GATES, REPRESENTING THE INTERESTS OF THE PRESBYTERIAN CHURCH IN THE UNITED STATES OF AMERICA

Senator WALSH. Your name, please.

Mr. GATES. Moore Gates. I represent the Presbyterian Church interests. I have a letter here also from the Federal Council of the Churches of Christ in America, and another letter from the Presbyterian Church in the United States of America, which I will ask to have inserted in the record.

Senator WALSH. That may be done.

(The letters referred to are as follows:)

THE FEDERAL COUNCIL OF THE CHURCHES OF CHRIST IN AMERICA,
New York, N. Y., December 1, 1943.

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee, Washington, D. C.

MY DEAR SENATOR: In connection with your current hearings, I should like to report that we have evidence of increasing concern on the part of the churches over tax procedures which make it difficult and complicated for the people to continue appropriate and necessary financial support of the churches and other religious, charitable, and voluntary enterprises.

Some provision whereby anticipated contributions to churches and charities could be recognized as deductible in computing tax withholdings on wages would be helpful. Existing procedures impose a hardship upon the individual to maintain at an adequate level his contributions to his church when he does not receive credit in tax computation until the end of the year.

Every development which makes it more difficult to maintain the institutions of religion on a high level of efficiency is an impairment to our national life and a threat to the continued strength of voluntary private institutions.

I hope that your committee will find appropriate and practicable measures whereby the present difficult situation may be remedied.

Yours very truly,

ROSWELL P. BARNES.

THE GENERAL COUNCIL OF THE GENERAL ASSEMBLY,
THE PRESBYTERIAN CHURCH IN THE UNITED STATES OF AMERICA,
New York, December 1, 1943.

Senator WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SIR: Mr. Moore Gates, the bearer of this letter, is assistant treasurer of the board of national missions of the Presbyterian Church in the United States of America.

Mr. Gates has been asked to represent the interests of the Presbyterian Church in the United States of America in the name of all the organizations of our church in the hearing granted by your committee on the matter of permitting the amount of charitable contributions made or to be made to be taken into account in computing the tax required to be deducted and withheld on wages.

Very truly yours,

D. ALLAN LOOKE,
Secretary of Finance.

Mr. GATES. I take it for granted that church representatives are amongst friends in appearing before this distinguished committee of Senators. I believe we may safely presuppose your active support of our spiritual home front. I hope we may equally take for granted that

you all believe in the continued maintenance of support for our churches by individual free citizens—not by any State subsidies. This is a keystone in our American tradition of freedom; and the tax credits for individual gifts to churches and philanthropies, in our basic income-tax laws, are fundamental to preservation of the ability of our citizens to support their churches—always, under all conditions. In order to save time, I shall confine my remarks to a few basic factors.

The existing law which established collection of income taxes by a method of withholding by employers has certain very serious consequences to churches and philanthropies. We do not oppose pay-as-you-go taxation. But we believe that the tax forms in use and the administrative formulas used carry serious dangers to the continued maintenance of the ability of private citizens to support their churches and charities.

In the interest of simplicity, the Treasury worked out certain average allowances in the tax tables used, and in the simplified Form 1040–A for incomes of $3,000 or less. This use of average allowance for tax credits means that everyone gets some allowance whether they give to their church, the Red Cross, the community war fund, and so forth, or not. As we interpret the historic tax philosophy of our predecessors, tax credits were made specific, in order to encourage freedom of religion, and other basic social ideals amongst a free people. Any average allowance to all—regardless of whether an individual fulfills his spiritual or social responsibility as a private citizen—tends to undermine the fundamentals of encouragement by our Government of private enterprise in support of religion, philanthropy, and social, or community improvement. The tax credits are for specific contributions by those who assume spiritual and social responsibility. An average allowance to all is destructive of the national premiums placed upon individual intiatives in the field of spiritual and social values.

Again, in the interest of simplicity, none of the simplified forms used by the Treasury—Form 1040–A, the estimate of income at September 15, the employee's certificate to his employer, or the forms formerly used for Victory tax—carry any statement of the allowable tax credits in the basic income-tax law, except the bare personal exemptions and dependents. This means that our Government fails to inform some twenty or thirty million new taxpayers about the encouragement for religion and philanthropy embodied in our basic income-tax laws. Ignorance is always a primary danger to freedom and democracy. This is a serious handicap to our churches in their efforts to preach moral and social responsibility in brotherly love in the spirit of Christ.

The present technique of withholding taxes at the source of wages and salaries works out to tax "tax credits" in advance on large incomes—subject to a refund at the end of the taxable year—and to destroy the tax incentives for spiritual and social responsibility of those with small incomes, by average blanket allowances to all. Do we no longer value the small gifts from the masses of our people? Is there no premium for support of religion from those in modest circumstances? Amidst the pressures of war, we have installed technical methods, devised in the name of simplicity, which endanger the continued maintenance of our churches and our philanthropies, and leave millions of new taxpayers in ignorance of allowable tax credits.

America has always combined keen practical good sense, with a deep-seated faith in Almighty God. This combination of hard-headed practicability and idealism has always astonished foreign people. Spiritual faith must be passed on from generation to generation. Never have the needs for church work been greater. In the war-industry areas the children of working fathers and mothers will grow up in ignorance and depravity, unless our churches and social agencies care for them. The armed services plead for more chaplains, and the areas around our military camps plead for better conditions for soldiers on leave. Juvenile-delinquency statistics indicate the type of long-range guns, shooting 20 years into the future, aimed at the spiritual core of our national life. Red Cross requirements increase by leaps and bounds. Our national war fund is struggling for its goal. This Nation under God needs a mobilization of all its people to revive the spiritual faith of our fathers. Strange as it may seem, there is a constant requirement that we implement the cold ideas of taxes and tax methods, with the spirit of individual enterprise in religion, education, and philanthropy. We dare not fail to inform each new tax generation of the tax credits for support of church and charity. No amount of simplicity can ever justify methods which handicap support for churches and philanthropies by private citizens. No simple theory of average allowances can justify taking away from great masses of our people the premiums for social and spiritual participating responsibility.

The needs are critical. It is already late, because these destructive methods are already acting as slow poison to hinder the flow of support for the organizations of our spiritual home front. You have able technicians. Say to them, "We must work out withholding tax methods which will not create forces of attrition to hinder church and charity." See to it that all our taxpayers are fully informed about tax credits. Gentlemen, these are major issues. The lifeblood of a people flows through taxes. It is given gladly in the cause of freedom. But let us be careful about the way that blood is drafted, that we may not choke our spiritual heritage in the process by any careless or overhurried methods. We all believe in simple methods. We have not yet exhausted American ingenuity about ways and means. Simplicity of method must never be allowed to serve as an excuse for injury to the requirements of our spiritual home front.

Senator TAFT. The answer is, of course, is that everybody that ever asked for a contribution that I know always points out the fact that you are going to get the credit. If you cannot impress that on the people, you are not going to get the money. In any campaign for money that is always one of the big talking points. You always tell them about it.

Mr. GATES. It is very hard to reach these new taxpayers and explain that. I tried it with fellows who never paid a tax before. They knew nothing about this tax exemption. I asked one fellow that worked for me, "Are you giving to the Red Cross?" He said, "Yes." I asked him, "Are you getting a tax exemption for that?" Well, he did not know.

Senator TAFT. You know that on the 15th of March. It is right on the return.

Mr. GATES. They use the 1040–A Form and there is not a word in that form about it. They have got to go and get the long forms, and

then they have got to get the instructions, and the fellows who were there were allowed one set of instructions for 14 forms. They were short of them. The short, simplified form carries not a word about it.

Senator TAFT. I should think they ought to include it on the 1040–A Form.

Mr. GATES. They could tell them all about those things on the employees certificate. There are between twenty and twenty-five million new taxpayers who will not know a thing about it from the Government. It all depends on the churches and the philanthropic institutions to tell them about it. We think that is dangerous in our tax situation.

Senator MILLIKIN. I think the strong point is that the little fellow has to go through the refund procedure to get the credit for his taxes.

Mr. GATES. He has to go to an awful lot of trouble.

Senator TAFT. I do not undersand that he has to go through that procedure. He has to file a form in which in not one case out a hundred is he going to be exempt. My understanding is if he did not go for the refund the check would come automatically once he has filed his permanent return.

Mr. GATES. If he uses the 1040–A Form there is a sliding scale of wages that the Treasury has included. Supposing I am a cynical fellow and I haven't given to anybody, I still get that allowance whether I have eraned it or not, whether I have supported a charitable institution, a church, an educational institution, the Red Cross, the war fund, or not, I would still get that. So the premium we always put on the fellows who support the spiritual home front is gone for those small incomes.

Senator TAFT. It seems to me your objection is even sounder to the average form of simplified return and table of payments than it is to the preliminary certificate.

Mr. GATES. I think it is very insidious the way in which these averages, under the guise of simplicity, have been worked out. It hurts us, the church people, very much.

To answer the question of the chairman a little earlier.

Our gifts were heavy in the Board of National Missions. We have a budget of $3,000,000 for our missions from Alaska to Puerto Rico, the schools, hospitals, and war work, and in these war industry areas our gifts were heavy through September of the previous year. In October they dropped like that [indicating]. You see, it is too early to get average figures, but I just throw that into the record for what it is worth.

Mr. CURTIS. We will next put on Dr. Gould Wickey.

STATEMENT OF DR. GOULD WICKERY, GENERAL SECRETARY, NATIONAL CONFERENCE OF CHURCH-RELATED COLLEGES; AND GENERAL SECRETARY OF COUNCIL OF CHURCH BOARDS OF EDUCATION

Dr. WICKEY. My name is Gould Wickey. I am general secretary of the National Conference of Church-Related Colleges and also of the Council of Church Boards of Education.

As general secretary of the National Conference of Church-Related Colleges, I represent some 780 Catholic and Protestant colleges. As

general secretary of the Council of Church Boards of Education, I represent 22 of the major denominations in the United States with a membership of more than 25,000,000 persons.

These organizations recognize the necessity for legislation which will "permit the amount of charitable contributions made or to be made to be taken into account in computing the amount of tax to be deducted and withheld on wages."

The Tax Payment Act of 1943 allows the deduction of family exemptions but forgot, not purposely of course, to allow deduction of the amounts given to charitable organizations and institutions, up to 15 percent. And yet previous tax legislation definitely makes provision for such deduction. Consequently, our Government now levies and collects a 20 percent tax on a well-established tax-exempt portion of one's wages. That is not honest. That is not just.

The church related colleges are dependent for the support, up to 80 percent in most cases, upon the income received from the tuition of students and the gifts and grants of the churches and church people. Since October 1941 the civilian enrollment in these colleges has dropped about 55 percent. When the Government not only increases taxes but also taxes charitable gifts, the American people are seriously crippled financially, and thereby and to that extent prohibited from making the charitable contributions which they sincerely desire to make.

Education is essential to the national welfare. Our President has repeatedly emphasized the thought that during these critical times we must redouble our efforts "to make our colleges and universities render ever more efficient service in support of our cherished democratic institutions."

An editorial in the October 29, 1942, issue of the New York Times puts it this way:

> It is evident that the country cannot neglect the role of the colleges and universities in the total war program. Little would be gained, either for this or the coming generation, if the liberal arts colleges were destroyed. It is difficult to imagine any greater victory for Hitler than the closing of our colleges and universities.

The church-related colleges of America are fighting to serve their country and their God. With the tragic reduction in income from tuition and the churches, it is a question as to how long some of them can continue. We plead not for the preservation of mere institutions; we plead for the conservation of those values and principles without which America cannot endure.

For the sake of those colleges and universities which awaken American youth to life's true values, for the sake of the millions of American laborers and wage earners who wish to assist their beloved sons and daughters to obtain an education for freedom, I humbly ask you to enact legislation which will prevent an unjust taxation of charitable gifts and religious contributions.

Senator WALSH. Thank you.

Representative Curtis, who is next?

Mr. CURTIS. Mr. Chairman, we are drawing to a close. One of the witnesses who was representing the Seventh-day Adventist denomination could not be here today, and I would like to ask leave to submit a written statement from them.

Senator WALSH. That may go into the record.

Mr. CURTIS. And a telegram received from the Presbyterian Church of the United States of America.

Senator WALSH. That may go into the record.

Mr. CURTIS. And two letters from the Right Reverend Henry W. Hobson, bishop of the diocese of southern Ohio.

The CHAIRMAN. That may go into the record.

(The matter referred to is as follows:)

GENERAL CONFERENCE OF SEVENTH-DAY ADVENTISTS,
Takoma Park, Washington, D. C., December 3, 1943.

Hon. WALTER F. GEORGE,
Chairman of the Senate Finance Committee,
United States Congress, Washington, D. C.

DEAR SIR: I am writing you this morning as a representative of the treasury department of the General Conference of Seventh-day Adventists. As you are perhaps well aware, the Seventh-day Adventist Church is a church of ardent missionary endeavor, both at home and abroad. The very principles upon which our church is founded require this.

Although as churches go, the Seventh-day Adventist Church is comparatively young, having been officially in existence for only 80 years, it has already been able to establish its activities quite firmly in many countries.

Seventh-day Adventists, as individuals, have long been known as liberal givers to religious and philanthropic organizations. While it would be impossible, of course, to give an exact statement as to just what percentage of their income they do use for these purposes, I think I am safe in stating that for the church as a whole it would probably come well up to the 15 percent permitted by law to be deducted before paying income tax, and would possibly even reach 20 percent. Our church practices the tithing system, which calls for the contribution of 10 percent of net increase for the support of the ministry, and in addition to this many other offerings are given. While Seventh-day Adventists are quite liberal in their support of religious and philanthropic activities this does not mean that they are a body of wealthy individuals. On the contrary, the preponderant majority of our members come from the middle class, and those who could be considered wealthy would be few indeed.

We appreciate very much the fact that the Government of the United States has recognized that an individual should be permitted to assign up to 15 percent of his income for religious and philanthropic purposes, said amount to be deductible before the computation of income tax is made. We believe this to be a safe and sound principle, and we believe that it contributes not only to the spiritual stability of an individual and community but also to their civic stability. One who has not contributed to the support of an organization or institution generally does not have as deep interest in that organization as those who have. We feel that our efforts serve definitely to the upbuilding and preservation of the morale of the Nation, both in peace and in war. We believe that the Government has been wise in recognizing this principle, and feel that it has been proved sound in times past.

When the present withholding tax system was adopted, it would seem that there may have been some oversight in that provision was not made whereby the individual could take the advantage of this 15 percent deduction weekly, biweekly, or monthly as the case might be. There are certain cases, such as those of farmers, professional men, and clergymen who are not subject to withholding tax but who are required to file their estimate of income quarterly, and they are allowed to take into consideration this deduction when they pay the quarterly installment of their income tax, which they are really paying in lieu of the withholding tax. It would seem, therefore, that those who are subject to withholding tax should be entitled to this same privilege of deduction, for there could scarcely be any reason why the person who pays his income tax quarterly should be permitted this privilege while it is denied to the other individual who is required to pay more frequently.

As mentioned before, Seventh-day Adventists are not rich. Their contributions constitute to them a real sacrifice, as they do not give merely of their abundance, but oftentimes deny themselves what many people consider necessities, in order to be able to make their contributions. This being the case, it then becomes even more difficult for them to maintain their contributions when the withholding tax plan has not taken into account this exemption in calculating the amount to be deducted from their pay roll periodic[illegible]y.

We feel that as a result of the outworking of this plan our income will be materially reduced and consequently our efforts for the advancement of religion, education, and social betterment will be hampered.

Our request as contained in the official action adopted by the general conference committee in autumn council, under date of November 2, when this matter was under consideration in the House of Representatives, is as follows:

"Whereas from the earliest beginnings of Christianity, people have been taught to cherish the spirit of liberality, both in sustaining the cause of God and in supplying the wants of the needy; and,

"Whereas the Holy Scriptures admonish the believers to bring into the churches the tithes and offerings; and,

"Whereas the God-fearing founders of these great United States were so thoroughly convinced that there should be absolute separation of church and state that they provided in the early colonial constitutions that no tax money should be used for the support of the church and later incorporated their beliefs in the first article of the Bill of Rights; and,

"Whereas freedom of religious worship has been maintained in this country through the private support of the churches by their members; and,

"Whereas heavy demands of a national wartime budget have already seriously curtailed offerings to religious institutions; and

"Whereas under the present pay-as-you-go tax program insufficient consideration is given in each pay-roll period to deductions for tithes and offerings of millions of church members who follow the principles of Christian stewardship: Therefore be it

"*Resolved*, That the autumn council of the General Conference of Seventh-day Adventists representing its churches and religious institutions, petition the Ways and Means Committee of the United States House of Representatives to incorporate into pending tax legislation now under its consideration the principles of H. R. 3472 and H. R. 3473.

Respectfully yours,

JAMES F. CUMMINS,
Assistant Treasurer.

[Telegram]

PHILADELPHIA, PA., *December 2, 1943.*

HON. CARL T. CURTIS,
United States Senate, Washington, D. C.:

As representatives of stewardship and Christian education for the Presbyterian Church in the United States of America we commend and support you in presenting bills H. R. 3472 and 3473 that our faithful tithing church people may be allowed to deduct church and charitable contributions hereafter in computing tax withholdings on their wages we must do all in our power to undergird and sustain freedom of worship and from fear by an adequate support in these times of religious, educational, and philanthropic institutions. Best wishes from former Fresno Minister Stein.

LUTHER E. STEIN,
Secretary of Church Relations.
JAMES A. McDILL,
Director of Stewardship Education.

DIOCESE OF SOUTHERN OHIO,
OFFICE OF THE BISHOP,
Cincinnati, Ohio, November 30, 1943.

SECRETARY HENRY MORGENTHAU, Jr.,
Treasury Department, Washington, D. C.

MY DEAR MR. SECRETARY: On behalf of the church in this diocese of southern Ohio, and also as a member of a number of organizations of charitable and religious nature, I write you urging that you make it possible for the Treasury Department to consider further some amendment in the present tax law which will permit a charitable contribution to be taken into account in computing the tax required to be deducted and withheld by employers.

This matter came before the Ways and Means Committee of the House of Representatives in the form of H. R. 3472 or H. R. 3473. I've read the objections to these bills as presented by a statement of the Treasury Department, and

cannot feel that the proposal has been given adequate consideration. I do not believe the proposal would involve the many difficulties which the statement of the Treasury Department envisions. Granted that there are difficulties involved, I feel it much better to try to meet these difficulties squarely than to run the risk of doing grave harm to some of the most important organizations in the life of our Nation.

The present withholding provisions of the Internal Revenue Code are a very serious threat to all educational, charitable, and religious organizations depending upon gifts for their support. The spiritual life and morale of our Nation would be greatly lowered if, in this day of crisis, there should be any serious decrease in the support necessary to keep our churches, colleges, and social agencies strong. The present tax law certainly will have this effect. The result may be slow in coming, but like a deadly poison, the influence of the tax law will affect in a dangerous way our whole social body.

Once money is withheld under the present tax law, it is going to be almost impossible in most cases to get individuals who might otherwise make donations to charitable and religious organizations to go through the process of such adjustments as may be necessary to provide for charitable gifts.

Some amendment designed to overcome the serious deficiency in the present tax law is imperative. Unless this is done there is bound to be a growing opposition to our tax laws on the part of many of our leading citizens, and I am sure it is not in the best interests of our Nation or of the Treasury to have such a situation develop.

Thanking you for what I know will be a careful consideration of this matter on your part, I am

Sincerely yours,

Rt. Rev. HENRY W. HOBSON.

DIOCESE OF SOUTHERN OHIO,
OFFICE OF THE BISHOP,
Cincinnati, Ohio, November 30, 1943.

Hon. WALTER F. GEORGE,
United States Senate, Washington, D. C.

MY DEAR SENATOR: On behalf of the members of the church of this Diocese of southern Ohio, and also as a member of a number of organizations of charitable and religious nature, I write you urging favorable consideration of some amendment of the present tax law in line with the proposals as made in H. R. 3472 or 3473, which were before the Committee on Ways and Means of the House of Representatives. I have read the objections to these bills as presented by the Treasury Department, and cannot feel that the proposal has been given adequate consideration.

The present withholding provisions of the Internal Revenue Code are a very serious threat to all educational, charitable, and religious organizations depending upon gifts for their support. The spiritual life and morale of our Nation would be greatly lowered if, in this day of crisis, there should be any serious decrease in the support necessary to keep our churches, colleges, and social agencies strong. The present tax law certainly will have this effect. The results may be slow in coming, but like a deadly poison, the influence of the tax law will affect in a dangerous way our whole social body.

Once money is withheld under the present law, it is going to be almost impossible in most cases to get individuals, who might othewise make donations to charitable and religious organizations, to go through the process of such adjustments as may be necessary to provide for charitable gifts.

Some amendment designed to overcome the serious deficiency in the present tax is imperative.

Thanking you for what I know will be a careful consideration of this matter on your part, I am

Sincerely yours,

Rt. Rev. HENRY W. HOBSON.

Mr. CURTIS. Our next witness, Mr. Chairman, is Mr. E. Raymond Wilson, representing the American Friends Service Committee, to substitute for Mr. Clarence Pickett.

Senator WALSH. Come forward, please.

STATEMENT OF E. RAYMOND WILSON, AMERICAN FRIENDS SERVICE COMMITTEE

Mr. WILSON. The American Friends Service Committee is only one of the many organizations that are dealing with relief and humanitarian activities both at home and abroad. We are facing the extremely difficult period of reconstruction after the war, when the health of our society is going to depend on the virility and strength of many of these charitable, educational, and religious organizations appearing here this morning. We had hoped some way might be found to facilitate and solve the problem that has been discussed here this morning.

Senator MILLIKIN. Mr. Chairman, may I ask has anyone put any statistics into the record as to what the average contribution for charity and educational purposes by the people that are contemplated by these representatives here?

Senator WALSH. No, nobody has. Representative Curtis, what is the average contribution made by these people who are affected by this draw-back provision?

Mr. CURTIS. I can answer your question directly, and I will not take more than 1 minute to throw light on it. What these tables do is allow a flat rate—I believe it is 10 percent—for all deductions, which includes interest and taxes, as well as contributions, and the figures show that in reality they do not allow anything for contributions, because the people who support our churches, colleges, and institutions of service and mercy pay State taxes, and many of them pay interest. The table submitted by Dr. King will show that the deductions allowed in the tables are not sufficient to allow anything for church and charitable institutions.

Senator MILLIKIN. I am not contesting that, Congressman. My point is, What has been the average of contributions, by people affected by the amendment that you propose, to education and charities?

Senator WALSH. I suppose that varies with the various churches.

Mr. GATES. It runs anywhere in different organizations from $15 to $30 per capita. It varies in different denominations. That is, the average of those memberships who do not come at all and those who come often.

Senator MILLIKIN. My end point, of course, is if any correction of the statute is to be made it ought to have some relation to reality.

Mr. GATES. Apparently the figures used in the averages do not have much relation to reality. They work hardships particularly in the low-income and lower wage brackets. They cover managers, whose salaries are taken out, and so forth, who are very large givers to charity, the management group as well as the wage-earning group.

Senator MILLIKEN. In other words, if you could imagine such a thing as an average wage earner—I realize the difficulties—what does he give in the course of a year to education and charity?

Mr. GATES. It varies tremendously.

Mr. CURTIS. Here is a chart which shows the downward trend per capita of contributions and the upward trend of the national income [indicating]. However, that does not answer your question, because this per capita giving takes into account millions of people who do not give anything.

Senator TAFT. The Treasury figures show the total given for taxes, interest, and contributions was approximately 10 percent by every-

body. I do not know whether they have the figures dividing it between contributions, taxes, and interest and a few other deductions. I do not suppose contributions average over 3 or 4 percent.

Mr. CURTIS. I have a table on that, and I shall be glad to submit it. It is the first one submitted by Dr. Alva Vest King.

Senator WALSH. Your claim is if all these taxpayers drop their credit claim there would be no loss to the Treasury. The Treasury's gain is in the failure of these small taxpayers to put their claim in for a credit; is that right?

Mr. CURTIS. Yes; but plus the reduction in contributions.

Mr. Chairman, I wish to submit a table here which will show the total deductions compared with net income for those years 1916 to 1940, inclusive, and also show the total deductions exclusive of contributions and the percentage of deductions exclusive of contributions compared to the net income for those years, and with the exception of 2 years it runs above 10 percent. In fact, in 1 year here it reaches 46 percent.

Senator TAFT. Do you include all grades of income?

Mr. CURTIS. No; these are the people who are filing income-tax returns.

Senator TAFT. I mean the percent of contributions of people of $3,000 earnings and less is much less than those with higher income.

Mr. CURTIS. I do not see how the Treasury could have arrived at figures like that.

Senator TAFT. Yes; they have those figures.

Mr. CURTIS. Because there are millions of people who do not file income taxes.

Senator TAFT. What they gave us last year when this simplified form was approved was a table showing people with a $3,000 income and under to whom it applied, and it showed they deducted on an average of 10 percent for all purposes.

Mr. CURTIS. That was their contention.

Senator TAFT. I think that was their figure. The figure may have been a couple of years old.

Mr. CURTIS. We have, as petitioners for this bill, the Seventh-day Adventist, and the entire membership in their church pay a tithe of 10 percent.

Senator TAFT. I know; but that does not prove anything about the taxpayers as a whole. That does not weaken your point. Your point is it is not fair to average it. That is the point.

Mr. CURTIS. I further contend that the average is not adequate.

Senator TAFT. I do not think you can prove that.

Mr. CURTIS. The average that the Treasury struck is not the real average? All individuals do not give alike to religion and charity, therefore they shouldn't get the same tax refund.

Mr. GATES. May I add a word to Senator Taft's remark?

Senator WALSH. Certainly.

Mr. GATES. These new taxpayers, 20 or 30 million of them, we notice a very great deepening of spiritual interest in there, it comes back from the boys at the front, and through work in the chapels, and so forth, we are getting a great many more small contributions, and that needs Government encouragement.

Senator TAFT. I agree with that; but you cannot take the percentage of what the members give and then create an average for all the taxpayers of the United States.

Mr. GATES. We do not know the average of that group. They never paid taxes before. We have no accurate figures on that group, but we should encourage them and build them up, because we must have a great many more small gifts rather than rely on the big givers under the present circumstances of social economy.

Senator MILLIKIN. Might I ask one more question, Mr. Chairman?

Senator WALSH. Certainly.

Senator MILLIKIN. Congressman, will you tell us how much in deductions you are recommending that the employer be allowed to make to cover this purpose?

Senator WALSH. All that the law permits, I suppose.

Mr. CURTIS. Whatever amount he is going to give, not to exceed 15 percent of his income.

Senator TAFT. Are you allowing that in addition to the present deduction? Are you proposing to let them take the 10 percent which is supposedly represented in the present deduction table, and then add 15 percent to that?

Mr. CURTIS. Not to increase the 15 percent over-all limit at all, no.

Senator TAFT. There is no 15 percent over-all limit for deductions; there is only a 15 percent limit for contributions. You are suggesting in addition to the 10 percent that is allowed to everybody on these benefits for deductions in general, that you go to 15 percent on specific charitable contributions?

Mr. CURTIS. Yes, but I am making no pretense to raise the general total of 15 percent as to the amount that can be deducted by reason of contributions.

Senator TAFT. What occurred to me was if you are going to allow a specific deduction for contributions, I think you are going to have to reduce the 10 percent to 5 percent or something and raise all the table for the people who do not contribute.

Mr. CURTIS. I am not prepared to answer that in detail.

Senator LUCAS. Has this matter been presented to the Ways and Means Committee?

Mr. CURTIS. Yes, and there was considerable support for it, but not quite enough to get it reported out and placed on the bill. It must be borne in mind by the Senator that this whole proposition is quite new, because the withholding tax has been in force just a little while, and it has taken time to get the reaction of the people and to build our case. It was not presented in as great detail before the Ways and Means Committee as it was presented here. A number of the Ways and Means Committee members favor it, and one of them was here, Mr. Gearhart, and he testified for it.

Senator WALSH. Are there any other witnesses?

Mr. CURTIS. I think not. We have some charts here that Dr. Vickery of the Golden Rule Foundation has made up, but you have been generous about the time and we do not like to impose on you. Dr. Vickery, do you want to add anything further?

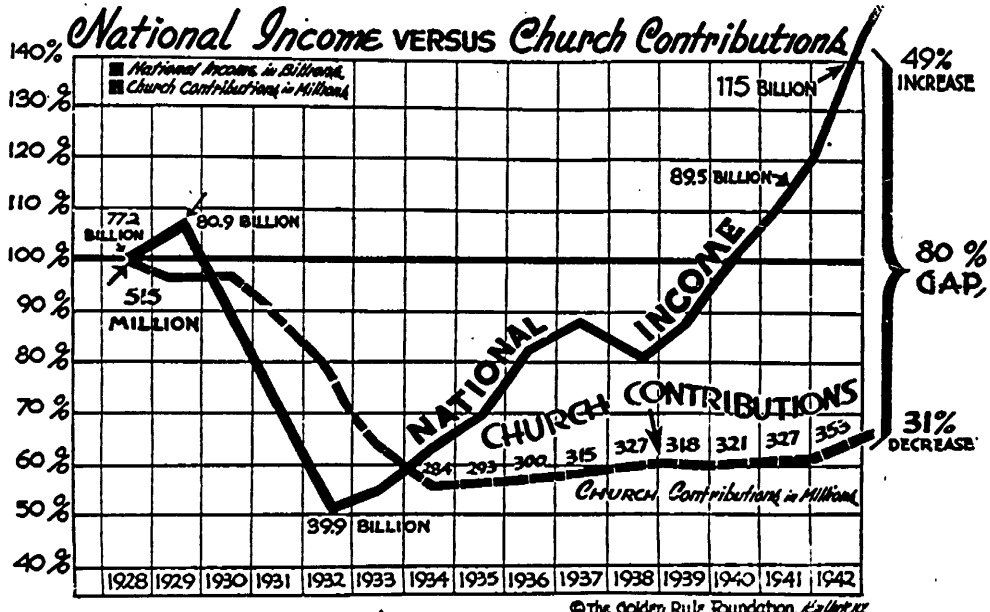
Dr. VICKERY. Merely to make a statement of what those charts are, what they show.

Senator WALSH. Would you like to have the charts put in the record, as far as they can be put it?

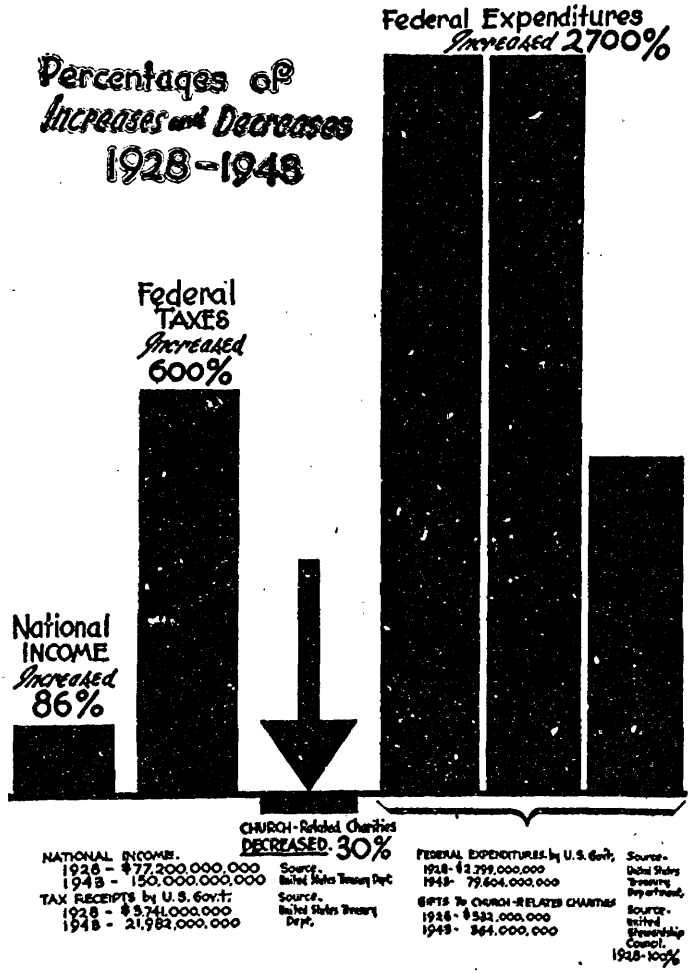
Dr. VICKERY. I hope you can put them in.

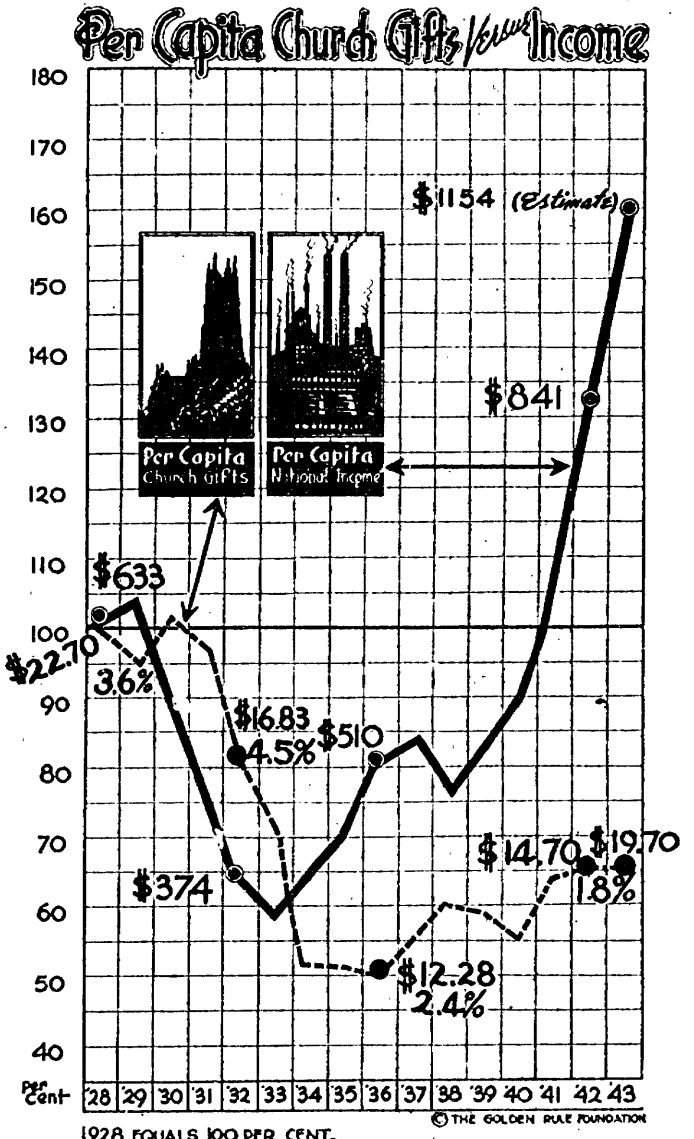
Senator WALSH. That may be done.

(The charts referred to are as follows:)



Help bring Gifts in line with Income.


Federal Expenditures
Increased 2700%
Percentages of
Increases and Decreases
1928-1948
Federal
TAXES
Increased
600%
National
INCOME
Increased
86%
CHURCH-Related Charities
DECREASED 30%
NATIONAL INCOME:
1928 - $77,200,000,000
1948 - 150,000,000,000
Source: United States Treasury Dept.
TAX RECEIPTS by U.S. Gov't:
1928 - $3,241,000,000
1948 - 21,982,000,000
Source: United States Treasury Dept.
FEDERAL EXPENDITURES by U.S. Gov't:
1928 - $2,799,000,000
1948 - 79,604,000,000
Source: United States Treasury Department.
GIFTS To CHURCH-RELATED CHARITIES
1926 - $521,000,000
1948 - 364,000,000
Source: United Stewardship Council.
1928-100%



1928 EQUALS 100 PER CENT.

SOURCES: Per Capita Gifts. UNITED STEWARDSHIP COUNCIL
Per Capita Income. NATIONAL INDUSTRIAL CONFERENCE BOARD

98381—44——50

Mr. CURTIS. I think that is all, Mr. Chairman.

Senator WALSH. Thank you, Representative Curtis.

Mr. CURTIS. I certainly thank you, Mr. Chairman and Senators. You have been very fine to us.

Senator WALSH. The hearing on this subject is closed.

Mr. Barrett.

STATEMENT OF RICHARD F. BARRETT, REPRESENTING THE COLORADO FUEL & IRON CORPORATION AND STUDEBAKER CORPORATION

Senator WALSH. Mr. Barrett, your name is Richard F. Barrett?

Mr. BARRETT. Yes, sir.

Senator WALSH. You are representing the Colorado Fuel and Iron Corporation and the Studebaker Corporation?

Mr. BARRETT. Yes, sir, Mr. Chairman.

Senator WALSH. What phase of this bill do you want to be heard on?

Mr. BARRETT. We would like to make a very brief oral statement that may take 2 or 3 minutes.

Senator WALSH. Very well, sir.

Mr. BARRETT. In behalf of a bill which has been introduced by Senator Johnson with respect to receiverships and bankruptcy reorganizations under the National Bankruptcy Act.

Senator WALSH. Very well.

Mr. BARRETT. I have a statement which gives the detail of our suggestions and arguments in behalf of this amendment, and with your permission I would like to file it with the committee.

Senator WALSH. That may be done.

Mr. BARRETT. Briefly, the proposed amendment has the effect of eliminating a penalty which exists under present laws and is imposed upon insolvent corporations which go through receivership or bankruptcy proceedings under the National Bankruptcy Act.

The penalty to which I refer is that many of these corporations lose a substantial portion of the tax basis of the property by virtue of the reorganization proceedings, and the tax basis, of course, is employed with respect to invested capital and tax liability in general. Even if there is not a definite loss of a substantial portion of this basis, there is, in many cases, a great uncertainty and confusion as to exactly what the tax basis after the bankruptcy proceedings is.

Now, this committee in 1942 recognized the merit of our contention, which I have just outlined, and provided that this penalty should be removed in the case of railroad corporations and street railway corporations by passing certain provisions in the 1942 law which permitted the tax basis to carry through the bankruptcy proceedings and remain undiminished, which is in accordance with the realities of the bankruptcy proceedings because the business remains the same.

The sections to which I refer are sections 112 (b) (9), 113 (a) (20), and 113 (a) (21) of the present Internal Revenue Code. Now, our amendment is very simple. It merely makes a very limited change in the terminology of two of those sections in order to broaden their scope to apply to corporations generally which go through bankruptcy proceedings. We claim that the proposed amendment would

be a timely and appropriate inclusion in the revenue bill that is now under your consideration. It is not an administrative measure but rather one of substantive tax law.

Senator WALSH. Have you taken the matter up with the Treasury?

Mr. BARRETT. We have discussed it with them, and their inclination is to delay this until next year's bill.

Senator WALSH. Administration bill?

Mr. BARRETT. Yes, sir; however, it would add no new sections to the code, it just slightly changes the two that now exist, and it adds no new principle of tax law.

Senator LUCAS. How would this affect your company?

Mr. BARRETT. It would permit us to use the invested capital basis and the taxable cost basis of the old company whose assets were transferred to the new company which I represent under 77-B proceedings.

Senator WALSH. Are there many corporations affected by this?

Mr. BARRETT. There are a great many affected by it.

Senator WALSH. What you want to do is to have a law to apply generally to all corporations rather than to a limited number as under the present law.

Mr. BARRETT. That is correct, Senator Walsh.

I would like to close by saying our statement quotes from your comments in your report on last year's bill, which very clearly points out the great uncertainty that exists without the passage of such an amendment. This uncertainty is creating an extremely undesirable situation with respect to current business planning and post-war planning for many important corporations which would like to make plans for expansion and post-war activities now. Their tax liability is a matter of speculation and mystery both to the Government and to them.

One reason we would like to have this included in the present bill is that it would immediately stop the perpetuation of that very undesirable situation which grows increasingly worse as every day goes by.

Thank you very much.

Senator WALSH. You are welcome.

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

BRIEF ON BEHALF OF PROPOSED AMENDMENT WITH RESPECT TO RECEIVERSHIPS AND REORGANIZATIONS UNDER THE NATIONAL BANKRUPTCY ACT

The amendment proposed by Senator Johnson of Colorado permits corporations passing through receiverships or reorganizations under the National Bankruptcy Act to receive the property of the old company at the same taxable basis as was attributable to the property in the hands of the old company prior to the receivership or reorganization. For purposes of computing invested capital, depreciation, and gain or loss on their sale, the taxable cost of the assets of the business remains undiminished by the receivership or bankruptcy reorganization.

The amendment recognizes the fact that in every realistic and practical sense the same business is operated before and after reorganization and that the continuity of the enterprise is uninterrupted. This is in fact the primary objective of section 77, section 77B, and chapter X of the Bankruptcy Act, to prevent the disruption of business enterprises by making available an efficient means of debt and equity adjustments. Accordingly the amendment under consideration proposes to harmonize the taxable and practical statuses of such transactions, by giving to the new company substantially the same position under the tax laws as that held by the old company prior to reorganization.

The principle involved in the amendment recommended is not new, and has already received the committee's approval with respect to a limited number of

receiverships and bankruptcy reorganizations. These railroad and street railway corporations were by the Revenue Act of 1942 afforded the same relief that is now suggested as desirable for all corporations. In its report, at page 43, the committee commented on the new provisions which it recommended in this connection, as follows:

"NONRECOGNITION OF LOSS IN CERTAIN RAILROAD REORGANIZATIONS

"In recent years, many railroad corporations have been required to go into receivership or into bankruptcy. To continue their operations, it is necessary to reorganize such companies. The question as to whether or not reorganizations of this type constitute tax-free reorganizations for income-tax purposes has caused considerable concern. Recent decisions of the Supreme Court have not clarified this situation. If the reorganization is affected in such a manner as to constitute a tax-free reorganization, the basis of the property in the hands of the reorganized company is the same as its basis in the hands of the old corporation. Thus for the purposes of computing the invested capital of the reorganized corporation under the excess-profits tax the basis of the property paid in to the old corporation for stock would not be diminished. If, however, the reorganization is not tax-free, the invested capital of the reorganized corporation is reduced.

"As a result of this situation, many railroad corporations will simply remain in receivership or bankruptcy for extended periods of time. It is felt desirable regardless of whether such reorganizations are taxable or tax-free in the income-tax sense to permit the basis of the property to go over undiminished to the reorganized corporation.

"The committee bill provides, therefore, that in the case of such reorganizations in taxable years beginning after December 31, 1939, the basis of the property of the old corporations shall not be reduced if the transfer of the property is in pursuance of an order of a court having jurisdiction of such corporation in a receivership proceeding or in a proceeding under section 77 of the National Bankruptcy Act.

"In the case of street, suburban, or interurban electric railway companies which are common carriers in interstate commerce a similar provision is made with respect to property transferred after December 31, 1934."

The amendments in question were enacted by the 1942 act as sections 112 (b) (9), 113 (a) (20), and 113 (a) (21) of the Internal Revenue Code.

As is indicated by the foregoing excerpt from the committee report on the revenue bill of 1942, the consideration given to the problem was stimulated by the inequitable and unrealistic situations developing in many bankruptcy reorganizations as a result of the technical provisions of the tax law with respect to taxable and tax-free reorganizations. The question of when a reorganization is taxable and when tax-free is most complex and the outcome in this respect in the case of many corporate reorganizations, notably those under the Bankruptcy Act, was dictated by technicalities of form and practical factors over which the corporation had no control. A series of decisions of the Supreme Court handed down in 1942 aggravated the uncertainties of the situation and added emphasis to the technical distinctions between corporate reorganizations substantially identical from every practical standpoint (*Helvering* v. *Limestone Co.*, 315 U. S. 179, *Helvering* v. *Southwest Corp.*, 315 U. S. 194, *Helvering* v. *Cement Investors*, 316 U. S. 527). These decisions were referred to in the committee's report quoted above.

An example of the problems and confusion referred to is afforded by the situations involved in the Supreme Court decision of *Helvering* v. *Cement Investors* (316 U. S. 257). This case involved the reorganization under section 77B of the National Bankruptcy Act, as amended, of the Colorado Fuel & Iron Co. in the year 1936. The assets of the old company were transferred pursuant to order of the court to the new Colorado Fuel & Iron Corporation. Securities of the new company were issued to the security holders of the old company. It was decided by the Supreme Court that no gain or loss was recognized with respect to the exchanges of securities by the security holders. The effect of the reorganization upon the taxable situation of the new company was not determined, however, and this question is still subject to complete uncertainty. It is possible that the new company holds the assets of the old company at any one of six or more bases of cost, ranging from the basis at which they were held by the old company to a basis of cost determined by the numerous and varying costs at which the security holders acquired the securities of the old company. The purpose of section 77B of the Bankruptcy Act was to assist less fortunate corporations, but from a taxable point of view, this purpose in the case of the Colorado Fuel &

Iron Corporation is defeated by the uncertainties prevailing with respect to the basis of cost of its assets and its invested capital as described above. From every business and practical point of view, there has been an uninterrupted continuity of the business enterprise and, apart from technical considerations, it is evident that the taxable basis of the old company should carry on through without change into the hands of the new company.

The situation cited is a common one, duplicated many times throughout the country. Its effect is to impose upon numerous corporations a heavy burden and to deter normal operations and planning. These companies are unable in many instances to determine important questions related to taxes and to make intelligent decisions with respect to such questions as elections to file separate or consolidated returns and other matters necessitating definite commitments which are irrevocable under the tax laws. Determination of general corporate business policy is frequently made confusing, but probably the most important effect of the uncertainty is its deterrent influence on post-war planning. Plans for post-war expansion and investment will be necessarily delayed until a definite knowledge of the exact basis for determining present and future tax liability is available.

One of the principal virtues of the proposed amendment would be to eliminate a penalty which is imposed under existing law upon many corporations which are least well situated to sustain such penalty. A reorganization of a prosperous corporation, in a position to control the form of the reorganization, can be made a tax-free reorganization and the taxable basis of the old corporation secured by the new corporation, if such is found advantageous. However, insolvent corporations undergoing bankruptcy proceedings frequently find themselves, for reasons entirely beyond their control, forced to accept a new and radically diminished taxable basis for the assets received at the termination of the bankruptcy proceedings. There is no evident economic ground for any such distinction and, indeed, if distinction is to be drawn tax-wise, economic considerations would seem to dictate precisely the opposite result. The financially stronger enterprise gets the better tax result, because of its ability to dictate the technical form of the transaction, and yet it is the weaker company that has the greater need of such result. The amendment under consideration will cure this inequity in exactly the same manner that the inequity was eliminated with respect to railroad and street railway corporations by the amendment to the 1942 act, referred to previously.

The proposed amendment will be a timely and appropriate inclusion in the Revenue Act of 1943, now under consideration by the committee. It is not an administrative provision but one relating to substantive tax law. The amendment (a copy of which is attached to this statement) is framed in the form of a revision of sections 112 (b) (9) and 113 (a) (21) existing in the present law. The result which is sought will be thereby secured merely by a very limited change in the terminology of these two existing sections of the Internal Revenue Code. The sections in questions are those which extend to railroad and street railway corporations the relief now proposed for corporations generally, undergoing receivership or bankruptcy proceedings. Accordingly, the physical content of the present tax law is not increased and no new principle or theory of substantive or administrative law will be enacted. The enactment of the amendment at this time will prevent the perpetuation of many seriously confused and uncertain business and tax situations to the advantage of both the Government and the taxpayer and will unquestionably provide a stimulus to both current and post-war planning of many corporate businesses.

RICHARD F. BARRETT
(On behalf of the Colorado Fuel & Iron Corporation).

DECEMBER 4, 1943.

[H. R. 3687, 78th Cong., 1st sess.]

AMENDMENT Intended to be proposed by Mr. JOHNSON of Colorado to the bill (H. R. 3687) to provide revenue, and for other purposes, viz: At the proper place insert the following:

(a) NONRECOGNITION OF LOSS IN CERTAIN REORGANIZATIONS.—Section 112 (b) (9) (relating to nonrecognition of loss on certain reorganizations) is amended to read as follows:

(9) LOSS NOT RECOGNIZED ON CERTAIN REORGANIZATIONS.—No loss shall be recognized if property of a corporation is transferred, after December 31,

1934, in pursuance of an order of the court having jurisdiction of such corporation—

(A) in a receivership proceeding, or

(B) in a proceeding under section 77, section 77B, or chapter X of the National Bankruptcy Act, as amended, to another corporation organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding. The term "reorganization", as used in this paragraph, shall not be limited by the definition of such term in subsection (g).

(b) BASIS OF PROPERTY ACQUIRED BY CERTAIN CORPORATIONS.—Section 113 (a) (21) (relating to the basis of property acquired by certain corporations) is amended to read as follows:

(21) PROPERTY ACQUIRED BY CERTAIN CORPORATIONS.—If the property of a corporation was acquired, after December 31, 1934, in pursuance of an order of the court having jurisdiction of such corporation—

(A) in a receivership proceeding, or

(B) in a proceeding under section 77B or chapter X of the National Bankruptcy Act, as amended, and the acquiring corporation is a corporation organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, then, notwithstanding the provisions of section 270 of chapter X of the National Bankruptcy Act, as amended, the basis shall be the same as it would be in the hands of the corporation whose property was so acquired, notwithstanding that the transaction may fall within another provision of section 113 (a). The term "reorganization", as used in this paragraph, shall not be limited by the definition of such term in section 112 (g).

(c) TAXABLE YEARS TO WHICH AMENDMENT APPLICABLE.—The amendment made by this section shall be applicable to taxable years beginning after December 31, 1939.

Senator WALSH. Russell Smith.

STATEMENT OF RUSSELL SMITH, LEGISLATIVE SECRETARY, NATIONAL FARMERS UNION

Senator WALSH. Your name is Russell Smith?

Mr. SMITH. Yes, sir. I represent the National Farmers Union, Mr. Chairman.

Senator WALSH. What phase of the bill would you like to discuss?

Mr. SMITH. The provisions requiring the filing of income tax returns by cooperatives and nonprofit associations.

Senator WALSH. You may proceed.

Mr. SMITH. Mr. Chairman, the pending tax bill contains a provision, inserted by the House Ways and Means Committee without hearing or public discussion, that strikes at the heart of the cooperative movement in the United States. This is the provision requiring such cooperative, nonprofit associations to file income-tax returns.

The provision can serve no purpose except to obtain information upon which taxes later would be based. Tax exemption of farmer cooperatives is not a privilege, but bare justice.

Senator WALSH. There is no tax levied in the bill, but there is a requirement for a return.

Mr. SMITH. That is right. We are sure that only a very small minority of Members of Congress favor taxation of farmer cooperatives. The historic position of Congress always has been one of fair play for and encouragement of farmer cooperatives, and taxation of cooperatives is antithetic to that position. It amounts to double taxation.

If the Government at any time thinks that a cooperative is violating the spirit or intent of the law, the Bureau of Internal Revenue already is armed with power to investigate. The intent, not only of the revenue laws but of numerous other statutes enacted by Congress over a long period, is clearly sympathetic to farm cooperatives. If there have been any instances where the Government feels that cooperative operations have not been properly carried on, it can reach those cooperatives without any enactment by Congress that strikes at all cooperatives.

It is unnecessary for me to ask you or the committee to go into the history of legislative enactments encouraging farmer cooperatives extending as far back as the nineties. The Capper-Volstead Act of 1922 making it clear that antitrust statutes are not aimed at cooperatives has been followed by numerous other enactments since. You are familiar with these.

The Congress is now confronted with a proposal to reverse this long-standing policy. If the tax bill is adopted with such a provision as this still included, then it will be difficult for Congress later to decline to levy a tax on cooperative associations. The way will have been paved. For the first time, then, Congress will have gone on record as being against the use by farmers of their most effective means of survival in a free-enterprise system. We know you will agree that this will be a disastrous step backward.

There is no question that this provision is the forerunner of an attempt to tax cooperatives. Indeed, the Ways and Means Committee clearly has said the information to be gathered would be used for taxing: Moreover, it has coincided with an open campaign outside of Congress for taxation of cooperatives.

Mr. Chairman, I would like to call your attention to this language in the House Committee report.

Senator WALSH. Yes, sir.

Mr. SMITH. Since you pointed out that this was an informative provision, but in the language of the report occurs these words:

> These returns, under the bill, are required to be made for the taxable years beginning after December 31, 1942, and all subsequent years, and it is the intent of your committee to make a thorough study of the information contained in such returns with the view to closing this existing loophole and requiring the payment of tax, and the protection of legitimate companies against this unfair competitive situation.

Moreover, it has coincided with an open campaign outside of Congress for taxation of cooperatives.

As documentation for that statement, I call to your attention the following quotation from Business Week of September 25:

> First organized as the League for Protection of Private Enterprise, the new bloc is incorporating as the "Central coordinating Group, Inc." with headquarters in Chicago's Continental Bank Building. The organization hopes eventually to represent not only grain, lumber, oil, and coal interests, but also feed companies, retail clothiers, produce and commission houses, dairy groups, furniture and hardware companies, real estate agents, meat dealers, and livestock associations. Most other trade groups which founders of the organization hope to interest in membership are holding out until the Central Coordinating Group can show a more definite program than it has so far in two or three closed meetings.
>
> *Would tax dividends.*—No. 1 aim of the new lobby is to "equalize tax laws between co-ops private enterprise." Opponents attribute the spectacular growth of co-ops (B. W.—Apr. 17, 1943, p. 72) to the fact that patronage divi-

dends, or rebates, are tax-exempt. Cooperatives admit that this is just about their biggest economic advantage, and they like to remind private entrepreneurs that they are free to follow co-ops' policy of turning profits back to consumers, which is essentially what the patronage dividend is—a division of profits in which co-op members share on the basis of their purchase of goods and services from the co-ops.

Inroads in gas and oil.—The oil industry, likewise is becoming increasingly restive as co-ops make deeper and deeper inroads not only into gas and oil retailing, but more particularly into wholesale and producer operations. The National Cooperative Refinery Association's purchase last summer of the big Globe Oil & Refining Co. of Kansas for about $5,000,000 (B. W.—July 24, 1943, p. 92) brought to five the number of refineries owned by the National Cooperatives Refinery Association and to eight the number of cooperatively owned refineries in the United States.

Lumber, coal invaded.—The lumber and coal trades find reason for joining the ranks of co-op foes in the fact that co-ops have bought four lumber mills in the past 2 years and, more recently, the biggest coal yard in Indianapolis, Ind.

Yardstick of success.—The central coordinating group will measure its success in terms of how well its case can be presented to this session of Congress in order that it may eventually (1) induce Washington to slap taxes on co-op dividends and (2) get private enterprise a share of the Government business now going to co-ops. Ultimately, Central Coordinating Group can be expected to gun for such legislative protection as that afforded by the Robinson-Patman law, which specifically exempts co-op dividends from its general ban on rebates and all other forms of price discrimination. Central Coordinating Group members hope to have ex-Representative John W. Boehne, Jr., of Indiana, represent them in Washington.

Co-op leaders are accepting modestly estimates of the newly organized opposition that cooperative organizations in some instances sell goods as much as 30 percent below retail levels.

Thus, there is no doubt whatever that this provision is the first long step toward a concerted effort to wreck the cooperative movement in the United States, one of the principal bulwarks of a balanced free-enterprise system for all. This has been demonstrated repeatedly in other countries, notably in Sweden, where private business has prospered in an economy in which cooperatives figure larger than elsewhere.

The complete unfairness of such taxation is easily demonstrable, Taxation of the income of cooperative associations is double taxation, for members of cooperatives of course pay income taxes on their own incomes. Since the cooperative income is only a part of each member's income, the tax obviously is inequitable.

On this point please note the following telegram from Mr. James G. Patton, president of the National Farmers Union, which went to Chairman Doughton of the House Way and Means Committee but could not be made a part of the record of hearings of that committee because the provision was not discussed during the hearings:

Although the bill as reported does not call for tax payments by cooperatives, the requirement for filing of returns is the first step desired enemies of cooperatives who have announced determination to bring cooperatives under taxation, despite the fact that individual members of cooperatives receiving patronage dividends pay income taxes. Taxation of cooperatives in addition to their individual members would amount to double taxation. The National Farmers Union urges amendment of the bill to strike out the provision requiring cooperatives to file income-tax reports.

I thank you.

Senator WALSH. I suppose this section was incorporated in the bill on the recommendation of the Treasury?

Mr. SMITH. No, sir; it was not.

Senator WALSH. Who put it in the bill?

Mr. SMITH. The committee itself; Mr. Stam, I understand, recommended it.

Senator WALSH. What is the Treasury's position on it?

Mr. SMITH. The Treasury does not approve of it, I understand informally. It was not asked about formally, during the course of the hearing.

Senator DAVIS. How many cooperatives are there in the United States?

Mr. SMITH. There are about 8,300 marketing cooperatives and a little over 2,000 purchasing cooperatives.

Senator DAVIS. How much have they invested in it?

Mr. SMITH. I could not tell you that, Senator.

They do an annual business of around two and one-half billion now.

Senator DAVIS. Two and one-half billion?

Mr. SMITH. Yes, sir.

Senator WALSH. Very well, sir.

(The following statement was submitted for the record:)

STATEMENT OF THE NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION BY ITS EXECUTIVE MANAGER, CLYDE T. ELLIS

GENTLEMEN: The National Rural Electric Cooperative Association is the National Association of the rural electric cooperatives and Rural Electrification Administration financed public power and public-utility districts of America. There are 741 of these organizations in operation in 45 States. Five hundred and sixty-two of them belong to the association and these 562 have a total membership of 657,827 farmers. Five hundred and thirty-six of our 562 members are cooperatives, and they, primarily, are the ones for whom we appear, but, of course, we are interested in the welfare of all electric co-ops.

The rural electric cooperatives are nonprofit organizations incorporated under the laws of their respective States for the exclusive purpose of serving their members with electricity at cost. They have all received 100-percent loans from the Government through the Rural Electrification Administration for the construction of their systems, and their systems and revenues are mortgaged to secure these loans.

The revenues of the cooperatives consist of payments made for electric energy delivered by the co-ops to their consumers. The rates are established with a view to meeting operating costs and expenses, the cost of energy delivered to the consumers and debt service. These rates are determined by the co-ops, and the determination is guided by the amount needed for these purposes. The element of profit does not enter into the rate determination; in fact rates are adjusted from time to time with a view to maintaining the nonprofit character of their operations.

Membership in the cooperatives is entirely voluntary. Each member, whether his membership is evidenced by certificate or share of stock, is restricted to one such membership certificate or share of stock, and each member has one vote on a par with that of all other members in conducting the affairs of the cooperative.

The business of a cooperative is conducted by nonsalaried officials and directors who select and employ such personnel as is required for the day-to-day conduct of the cooperative enterprise. In most instances the personnel of each cooperative is very small and the very nature of the operation requires the utmost economy in the conduct of its affairs. The simplicity and economy of operation have been a very important factor in making it possible for more than 1,000,000 American farmers, who had gone far too long without electricity, to secure for themselves power at rates they can afford to pay. Any additional burden imposed on electric cooperatives will work a hardship not only on the farms that have electricity, but such burden, plus the threat of further taxes, will affect the feasibility studies on the unelectrified areas, will tend to slow down the program and thus affect the more than 3,500,000 farmers who still do not have electricity.

The savings effected through the cooperative participation of the members, officials, and directors in the enterprise, and the principle of economy followed in the employment of paid personnel, have been reflected in low rates which are of immediate and direct benefit to the members, many of whom could not afford

to have electricity except for these economies. Any additional burden, whatever its source, is reflected in the rates charged for energy delivered to the consumer members. Conversely, any savings effected through economy and efficiency are reflected in the rates charged the consumer members and are consequently enjoyed by them.

The nonprofit nature of these cooperatives has long been recognized by the Congress in section 101 (10) of the Internal Revenue Code exempting these cooperatives from income taxation, provided 85 percent or more of their income is received from members. Under the present regulations the right of electric cooperatives to the exemption is based upon application of the individual cooperative for such exemption. This application furnishes the information upon which the Commissioner of Internal Revenue can determine whether the applicant is or is not a mutual or cooperative enterprise, and whether 85 percent of its income is derived from its members. The applicant must also submit other information under the existing regulations to evidence its right to the exemption. Once the exemption is granted, its continuance is based on the condition that the applicant continue to remain eligible under the law. Substantially all of the electric cooperatives have applied for exemption and have been determined to be exempt under section 101 (10). It is with those cooperatives which are exempt under the law that this statement is concerned.

H. R. 3687, now before your committee, contains a provision which would impose immediately a new and additional requirement upon these cooperatives; that of filing a return calling for more information than is now required by the Commissioner of Internal Revenue for the purpose of making a determination of exemption under the law—and requiring this information each year.

On behalf of the electric cooperatives, we should like to submit to your committee that the application of the proposed section 112 would impose a new burden on them, costly both in time and money, at a time when they are making every effort to effect economies in time and money and to maintain efficient service to their members without rates increases. The cooperatives, like all other enterprises, are already facing a serious manpower shortage. Most of them are operating with reduced personnel and are striving to continue to operate along the same standards of efficiency and economy which they have attained and to which, with justification they point with pride. We are confident that this committee will hesitate to take any steps which would interfere with, or lessen the efficiency of the co-ops to continue the very great contribution which they are making to the war program in terms of increased production of food and other farm commodities.

We should also like to point out and stress that the added burden imposed upon the cooperatives would not of itself yield any additional revenue to the Federal Government. In fact, it would entail needless expense to the Government in collecting and examining annually those proposed returns.

If the purpose of this provision is to secure information for the guidance of the Congress in determining whether the cooperatives are sources of potential tax revenue, then we submit that this objective is now capable of being attained under the existing provision of the Internal Revenue Code, at least with respect to the electric cooperatives, and would not be necessary for this purpose.

Furthermore, under the law today, the Bureau of Internal Revenue has the means of fully determining whether the cooperatives are required to pay the present income tax

Frankly, we are apprehensive that the proposed amendment might become the opening wedge by which devastating taxes would be levied against the cooperatives. We recognize, of course, that this can be done only by further amending the law, but that is just what some seem to have in mind.

Electrical World, the recognized private utility magazine, carried on page 7 of its December 4 issue an article entitled "R. E. A. Cooperatives Face Federal Income Tax." The first sentence of the article reads: "The possibility of Federal taxation of the earned income of Rural Electrification Administration cooperatives was before a Senate committee this week as the tax bill, containing a provision for accounting of income by tax-exempt organizations * * * It goes on to quote a prominent member of the House Committee on Ways and Means which wrote the bill, as saying that the provision was inserted in good faith "as a means of finding sources of more Federal revenue."

Then Mr. C. W. Kellogg, president of Edison Electric Institute, the private utility organization, had the audacity to come before your distinguished committee on the 2d day of December and suggest that you levy income taxes on the

cooperatives. We quote here from his statement as it appears in your hearings, part 4, pages 394 and 395:

"As a source for raising the additional taxes which would be obtained from the private utilities under the rates of taxation contained in H. R. 3687, attention is called to the fact that at the present time publicly and cooperatively owned electric utilities are paying no Federal taxes.

"Any loss of revenue caused by exempting utilities from the increased rates provided in H. R. 3687 can be doubly offset by taxing governmentally owned utilities" (evidentally still referring to the co-ops) "on the same basis as the private utilities now pay."

The private power companies have been waging a terrific campaign against the cooperatives for several months in an effort to cripple or kill them. Mr. Kellogg has been a ring leader and chief spokesman in this campaign. You can see why we would be apprehensive.

This bill has moved rather rapidly. It was introduced in the House on the 18th day of November, passed the House on the 24th day, and came to the Senate on the 26th. We had no knowledge of the provision before the bill's introduction and therefore had no opportunity to appear before the House committee.

If your committee is to consider the suggestion of Mr. Kellogg, or if, irrespective of Mr. Kellogg's statements, the committee might have in mind ultimately further taxing the cooperatives in this manner, as is indicated in Electrical World's quotation from a member of the House committee, then we would much prefer to meet this issue squarely and frankly on the simple question of whether new tax burdens are to be imposed upon these cooperative nonprofit farm enterprises.

In closing, may we point out that in our cooperatives the farm members have merely banded together to render themselves electric service. A man cannot receive from himself taxable income for doing himself a service. He cannot any more do it through his cooperative than by setting up his own power plant serving himself individually.

I have just returned from a trip around the country during which I attended 10 very successful regional meetings of the rural electric cooperatives of all States. Some of the meetings were held after this bill came out and I can therefore tell you of my own personal knowledge that the co-ops are much concerned about it.

We respectfully urge you, therefore, to amend H. R. 3687 so as not to require the filing annually by the rural electric cooperatives of these burdensome returns.

STATEMENT OF GORDON G. CROWDER, CHAIRMAN, SPECIAL TAX COMMITTEE, NATIONAL COAL ASSOCIATION

Mr. CROWDER. Mr. Chairman and gentlemen, my name is Gordon C. Crowder. I appear here as chairman of the special tax committee of the National Coal Association, the trade association of the producers of bituminous coal throughout the Nation.

First, our committee is opposed to the imposition of a 95-percent excess-profits tax rate. We believe that consistent economical management should be encouraged, and we doubt that the estimated added revenue from this source will be realized. As to the decrease of one percentage point in the excess-profits credit allowed to the larger invested capital corporations it is believed that this is a discrimination solely on size.

Second, we believe the provision extending excess-profits-tax relief to new mines, that is, those not in operation during the base period, and to lessors, as reflected in section 208 of the bill before the committee, should be adopted but with certain changes. Mr. Rolla D. Campbell, who originally presented this matter to the House Ways and Means Committee, will present to your committee details of the proposal. Our suggestion is that the provision should be altered along the lines of Mr. Campbell's proposal.

Third, the Association is of the opinion that under present war conditions and for the benefit of both employers and employees who

have other large burdens at this time, the tax on employers and the withholding rate on employees for old-age benefits should be kept at 1 percent.

Fourth, the industry is making a serious effort to maintain an increased production, but in so doing is deferring ordinary maintenance of its physical properties, in excess of safety standards, caused by shortage of labor beyond its control. While the allowance of tax-free reserves for deferred maintenance would be a new principle, it is entirely sound accounting to set up such reserves, and if they were invested in Government bonds the Government would have the use of such reserves until they were used. Any unexpended portion of these reserves could be included in taxable income for both normal and excess-profits taxes in years prescribed by this committee. The setting up of these reserves would provide funds for post-war employment.

Senator LUCAS. Is your theory similar to what the railroads present?

Mr. CROWDER. Practically the same thing, Senator. It is something beyond our control through the shortage of labor. It is a deductible item and we would like to reserve it and use it later when we have the labor to do it with.

Fifth, apparently through oversight in drafting the Revenue Act of 1942, section 720 of the Internal Revenue Code, which deals with the determination of the inadmissible asset adjustment, was not changed to be consistent with the invested capital computation under section 718. This is a technical matter and is explained in exhibit A, submitted with this statement.

Sixth, we believe section 114 (b) 4 of the Internal Revenue Code should be clarified with respect to percentage depletion treatment of development costs incurred subsequent to initial discovery. Details of this proposal have been presented by Mr. M. D. Harbaugh, vice president of the Lake Superior Iron Ore Association.

Seventh, Senator Johnson of Colorado has proposed an amendment to the pending bill to provide a proper definition of gross income from property for purposes of percentage depletion. Senator Thomas of Oklahoma has proposed an amendment to the pending bill dealing with termination of percentage depletion for certain minerals. The National Coal Association supports these amendments and urges that the committee adopt them.

Gentlemen, this concludes our presentation, and it is certainly a great privilege to appear before you today.

Senator WALSH. Mr. Campbell wants to appear, I suppose; does he?

Mr. CROWDER. Yes. I think he is on the list.

Senator WALSH. We will call him later.

Mr. CROWDER. He will be prepared.

(Exhibit A, submitted by Mr. Crowder, is as follows:)

EXHIBIT A

An inconsistency exists in section 720 (b) of the Internal Revenue Code, providing the basis for inadmissible assets adjustment.

It is understood that the discrepancy was recognized when the 1942 Revenue Act was being drafted, but through oversight the necessary change to section 720 was overlooked. An amendment correcting this discrepancy was proposed by Mr. Ellsworth C. Alvord when he appeared before the House Ways and Means Committee on October 12, 1943. It is contained in item 4 of Mr. Alvord's presentation and appears on page 629, hearings (unrevised), October 12, 1943, which is quoted below.

"(4) *Adoption of proper basis in inadmissible asset adjustment.*—Section 720 and the applicable regulations provide that, for the purpose of the inadmissible asset adjustment, both admissible and inadmissible assets shall be taken at their adjusted basis for determining loss. This is correct insofar as it requires a loss basis to be used, since this is the basis upon which paid-in capital and accumulated earnings and profits are computed for purposes of section 718. It fails, however, to take into account that the adjustments to such basis, which are prescribed by section 113, are not those which are proper in computing earnings and profits for invested capital purposes. To be consistent with the invested capital computation, the adjustments which should be employed are those proper under section 115 (1) for determining earnings and profits. A similar difficulty was discovered and remedied in section 718 (a) (2) by the Revenue Act of 1942 but through inadvertence the corresponding change was not made in section 720. Section 720 (b) should therefore be amended to provide that the adjusted basis shall be the unadjusted basis for determining loss with those adjustments which are proper under section 115 (1) for determining earnings and profits.

Senator WALSH. Professor Fisher.

STATEMENT OF IRVING FISHER, PROFESSOR EMERITUS OF ECONOMICS, YALE UNIVERSITY

Mr. FISHER. The only point I wish to bring out here is that a distinction should be made in an income tax between that income which a man spends on himself selfishly and luxuriously and that part of the income that goes into helping win the war. I am only going to make one argument in favor of making that distinction, because I have made other arguments at a previous occasion. The argument I am going to make is that to make this distinction will help us fight inflation.

I proposed that Congress should so amend the income tax as to tax only that part of income which is spent on consumption goods and take off all taxes on the rest of income, that is, the part which is saved and invested. I stressed especially the need for untaxing corporate savings—undistributed profits—since such reinvested profits mean expansion of our facilities for fighting the war.

I argued that we should give every possible encouragement to expansion of war facilities and every possible discouragement to wasting our substance in luxurious spending.

In short, when we have to shoot away our savings we cannot afford to spend them away besides.

I learned that only a few of your committee then favored this idea of taxing spendings and untaxing savings.

Since then the idea has gained favor in the public press. Many editorials have been written in its favor, the last being one in the Syracuse Standard endorsing it a hundred percent, and enthusiastically.

Many businessmen have written me their hearty approval, as have three important labor leaders.

I do not propose to repeat the arguments I then made, especially as, since then, they have been fully set forth in my book, Constructive Income Taxation.

Instead, I shall now confine myself to the single argument that the more we tax spendings and the less we tax savings the better we can fight inflation.

In fact, I now venture to say that if we do not check spending and stop checking saving, we cannot escape drastic inflation.

The very best we can now do toward avoiding inflation is: (1) to spend as little as possible beyond what is necessary for health and efficiency; (2) to save as much as possible; (3) to put all our savings into the war effort.

If we were all to live, as nearly as is practicable, on bread and water and put everything we can produce, beyond that barest living, into the United States Treasury to be expended for the armed forces, we would be doing our very best—our very best not only toward winning the war but toward combating inflation. But there are two ways of putting funds into the Treasury—one by taxes and the other by loans.

The more expensive a war is, the larger the fraction of its cost which has to be paid by loans. I believe that in this present war the major fraction should be so paid, provided the loans are genuine loans made out of honest-to-goodness savings. When, instead, banks manufacture the money they lend, the loan is not such a genuine loan. It is inflationary.

If this war were no more costly than the first war I knew, the Spanish-American War, we should and could easily take it in our stride; that is, pay for it 100 percent out of taxes, with no war loans at all. But this war is too colossal.

If our total national income next year is the 150 billion predicted, and if next year's war costs are 100 billion, to pay that 100 billion out of taxes would leave only 50 billion to live on. That would not be enough to feed, clothe, and house 130 million people, not even enough to keep them alive. We simply must resort to loans, and increasingly as the war grows more costly.

I suspect that we have already nearly or fully reached the limit advisable for taxes. At any rate, I feel sure that more billions paid in taxes now will not do much, if anything, to check inflation. To check inflation we need to stimulate saving, both private and corporate, and to discourage unnecessary spending.

Everybody knows that untold billions are even now paid for luxuries. And while we are doing little through taxation to discourage unnecessary spending, we are doing much through taxation to discourage necessary saving.

Our present corporate taxes, including the excess profits taxes, are killing many geese that would lay golden eggs. These taxes, so far as they are on savings, are hurting not only big business but little business even more. What we need is not so heavy taxation on business expansion, checking that expansion, but heavier subscriptions to Government loans to create more expansion.

I think our present heavy taxes on corporations are very wrong, not only in failure to help the war effort as much as might be, but wrong also from the point of view of equity. A corporation is not an independent source of revenue. It is a purely fictitious person. The real persons behind that fiction are the stockholders. When we tax a so-called rich corporation 80 percent, we are taxing its poorest stockholders 80 percent. Our corporations are one-third owned by people with less than $5,000 a year.

It is hard for me to believe that the American people are so stupid as to think they are soaking the rich by these killing taxes—assuming even that they want to soak the rich.

I would transform all these indirect taxes on stockholders into direct taxes on them, equitably apportioned, and have no income

taxes at all on corporations except "stoppage at the source" taxes, as in England. Why such a system is believed to be impossible in America when it is possible in England, I cannot imagine.

I would, if necessary, require all private savings to go into War bonds and all corporate savings to go either into Government-approved war industry——

Senator LUCAS. May I interrupt you, sir?

Mr. FISHER. Certainly.

Senator LUCAS. What formula would you use, Professor Fisher, to put all those private savings into bonds?

Mr. FISHER. Compulsory savings?

Senator LUCAS. Yes, compulsory savings.

Mr. FISHER. It could be done, but I do not think it is necessary at first. I think we may have to come to it.

Make no mistake, inflation is a real problem. Despite all the warning of the President and the Secretary of the Treasury, the general public and many in Congress have not yet waked up to this fact. Inflation is already upon us. My wholesale commodity index, published weekly in the New York Times, shows prices have risen by one-third since the war began. The cost of living has risen by over a quarter, and the price of labor has risen by over three-quarters.

What is worse, the circulating medium has been swelled two and a half times. This purchasing power is now in the hands of the public and exerts a terrific inflationary pressure. Despite the noble efforts of Leon Henderson and his successors to sit on the safety valve while we constantly added heat to the boiler, the inflationary pressure is steadily exerting its influence toward raising prices not only of labor but of commodities.

Black markets are one evidence.

The chief reason for this growing inflationary pressure is to be found in increasing bank loans and deposits. When savings are discouraged the Government is forced to go to the banks and the banks issue newly created credit. This swells the circulation just as truly as if the bank or the Government used printing presses to turn out the new billions in the form of visible greenbacks.

The Government is to be congratulated in having been able to raise 15 billions without going to the banks. But I suspect that the public had to go and did go to the banks, just as in the last World War.

At that time I remember, while on a speaking tour to help the Liberty Loan drive, my fellow-speaker, before I could educate him a little on inflation, urged in his first speech that his listeners should buy bonds whether they had the money or not. "If you haven't the money," he said, "go to the bank and borrow it. If the bank wants security, give them the bond you buy." It's a sort of perpetual motion.

And it was just as unsound as perpetual motion. Such a subscriber to a Government loan, subscribing as he does out of nothing, or next to nothing, doesn't really help finance the war. What he does is to throw the cost on the poor and those with fixed incomes, whose cost of living he raises by his inflationary loan.

A similar and more curious case of perpetual motion has recently been reported, namely, that farmers are being lent money with which to buy Government bonds by one of the Farm Credit administrative agencies. In other words, the farmer lends the Government (by

buying bonds) what the Government lends him while, to complete the story, the Government gets the money to lend the farmer by borrowing of the bank—borrowing not preexisting money saved but money newly created for the purpose—invisible greenbacks.

Inflation has only just begun. If, as now seems likely, we continue such false financing, raising money not by taxes, nor by loans out of savings, but by the "invisible greenbacks" issued by the banks, we shall have terrific inflation. It could be far worse than in the last war, when prices doubled.

The only way to prevent this which I can see is by taxation and by loans out of savings, and the chief reliance must be on the loans out of savings. If, in our effort to raise impossible taxes, we kill the savings, then we cannot get the necessary loans out of savings.

By taxing savings as we are now doing, especially corporate savings—undistributed profits—we are defeating our very effort to prevent inflation, because that effort is misdirected. We are causing inflation by driving both the Government and the public to the banks.

The greenbacks of the Civil War have a bad name. So does the "continental" paper money of the American Revolution, an echo of which still resounds in our ears in the phrase "It isn't worth a continental."

Our modern way of inflation is not so barefaced; but concealment only makes it worse, for the Government gets the bank to issue the greenbacks and pays interest to the bank besides. The public then gets doubly stung, once in the high cost of living and again when future generations have to be taxed to pay off not only the principal but the interest.

We hear it said that we ought not to leave to the taxpayers of posterity the job of paying for the war. True, we ought not if we can help it. But we don't help it by taxing savings so as to require resort to the bank loans and the inflation which this involves.

On the other hand, if we encourage savings and out of these savings make loans to the Government—noninflationary loans—we at the same time make it easier for posterity to repay those loans. For the savings mean capital and capital bears income. Posterity must, in any event, have a big debt to pay. But if we cultivate savings we leave posterity some wherewithal to pay with.

But besides the voluntary loans there is another loan resource to prevent inflation. This is compulsory savings and I think we may have to come to this soon if we are to succeed. If we do I would like to see Northern University's Emeritus Prof. Paul Haensel's well-worked-out plan adopted of a refundable sales tax, which, therefore, is not a sales tax at all.

The most promising program for combating inflation seems, therefore, to be threefold: Taxing spending more, taxing savings less—or not at all, and making savings compulsory in the form of investments in war bonds.

I thank you.

Senator WALSH. How would you tax spending?

Mr. FISHER. By calculating spendings backward, just as when you go out in the morning with $50 and come back with $20, you know you spend $30. All you need is to take your total income and subtract anything except spendings.

Senator LUCAS. How is the Government going to reach that?

Mr. FISHER. The Government proposed this last year, you must remember; it proposed a spending tax, but they did it in a way to complicate the situation and therefore it was turned down by the Congress. It can be done in a way to simplify taxation. That is what I have done in my book, Constructive Income Tax Payments.

Senator LUCAS. You made one statement that rather intrigued me in which you stated that the Farm Credit Administration was loaning money to farmers in order that they might purchase Government bonds to prosecute the war. Is that an authentic statement?

Mr. FISHER. It was published in the papers about 3 weeks ago, I think.

Senator LUCAS. I am glad to have that information, because I shall check it.

Mr. FISHER. I have the clipping. I will send it to you, if you like, Senator.

Senator WALSH. Very well, sir.

Mr. Elisha M. Friedman.

STATEMENT OF ELISHA M. FRIEDMAN, CONSULTING ECONOMIST, NEW YORK CITY

Senator WALSH. You may state whom you represent, Mr. Friedman.

Mr. FRIEDMAN. I am here in the public interest, representing no organization.

Senator WALSH. Giving us your own personal views?

Mr. FRIEDMAN. Precisely.

Senator WALSH. On what phase of the bill?

Mr. FRIEDMAN. Corporation taxes.

Senator LUCAS. What is your business?

Mr. FRIEDMAN. I happen to be a consulting economist.

Senator WALSH. In New York City?

Mr. FRIEDMAN. New York City; yes.

I appeared before the committee in 1941 and in 1942 on capital gains. I appear here to plead against the rise in the rate of tax on income of corporations, and to supplement the brief submitted to this honorable body on August 7, 1942. Since then I discussed that brief with officials of the Treasury and of the National Resources Board, and pleaded against any further increase in the corporation tax rates during the war and for the post-war abolition of the corporation tax and substitution of the British system as a measure to facilitate reemployment after the war. In public statements they agreed, in principle, as I cited in my brief of October 18, 1943, to the Ways and Means Committee.

I. CORPORATE TAX PROPOSALS CREATE EVILS

The Treasury proposes that corporation income tax be raised from 40 percent to 50 percent. Such increase in corporate taxes will not control, but aggravate inflation. Heavy corporate income taxes will check post-war employment. The stockholder who takes the ultimate risk is penalized. The bondholder is favored. As corporate income

tax rates rose from about 18 percent in 1936 to 40 percent in 1942, new stock issues declined from 32 percent to 3 percent of new bond issues. In other words, when you get a very high tax on a corporation there is no incentive to economize, and after the war it creates the difficult problem of readjustment.

Senator LUCAS. Do you think 40 percent is too high?

Mr. FRIEDMAN. I certainly do.

Senator LUCAS. What percent would you have?

Mr. FRIEDMAN. I would certainly not raise it during the war.

Senator LUCAS. I did not ask you that. I asked you if you thought 40 percent was too high, and you said you did. What tax would you place on corporations in this emergency?

Mr. FRIEDMAN. Ideally, you should tax the corporations only for the nominal income tax of the individual. That means more dividends will be passed out to the stockholders, and then you would get a much larger sum in the tax on dividends. That is the British system. But, practically, during the war it is too early to shift over to the British system right now.

Senator LUCAS. You heard Dr. Fisher on that, did you not?

Mr. FRIEDMAN. I presented this thesis before the House committee in March 1942 and the Senate committee in August 1942, before he urged it.

Senator LUCAS. This is nothing new, then.

Mr. FRIEDMAN. Yes; there is a new thought there about shifting the sequence.

The tax deters the taking of risk and stimulates the search for security. Each of our 9,000,000 stockholders is a little P. W. A. When they are checked, the Government must undertake a big P. W. A. What sort of America will this create?

The tax compelled small business to shift from corporations to partnerships. The tax deters efficiency. Increased costs of wages and materials are virtually paid by the Treasury. For the first half of 1943 wages in United States Steel rose $75,000,000 and Federal taxes fell $64,000,000.

Taxes are paid in cash. But earnings are not in cash. High corporation taxes impair the liquidity of corporations. Since 1940, the liquidity ratio has declined from 266 to 199 percent as the corporation tax rose from 24 to 40 percent. Therefore, a rising corporation tax is a new risk against the borrower. The commercial banker and private investor must gamble on possible future unsound tax measures which may jeopardize the loan. A corporation income tax on top of an individual income tax constitutes severe double taxation.

Under Treasury proposals, this combined tax will exceed the corresponding British normal individual income tax of 50 percent.

The Treasury just released a table which I think you might want to look at. It shows the relative taxes of the American stockholder and of the British stockholder. I suggested to the Treasury that you print that report in the hearings, and I think it would be highly desirable that you print it.

Senator WALSH. You want the table on page 51 inserted in the record?

Mr. FRIEDMAN. Yes, sir; thank you.

Senator WALSH. Very well.

(The table referred to is as follows:)

COMPARISON OF TAXES IN UNITED STATES, GREAT BRITAIN, AND CANADA

Treasury Department, Division of Tax Research, Oct. 15, 1943; pp. 51, 52, 53

TABLE A.—*Comparison of total taxes applicable in 1942 to corporate profits in the United States, United Kingdom, and Canada earned by a corporation with $1,500,000 total profits, of which $1,000,000 were "normal" profits, and distributed to shareholders each owning ⅓₀ of 1 percent of the outstanding stock and assumed to have a personal tax exemption for a married person, no dependents*

	United States (1942 act)			United Kingdom			Canada		
I. TAXATION OF CORPORATION									
Total net income	$1,500,000			$1,500,000			$1,500,000		
Subject to income tax	1,000,000			1,000,000			1,000,000		
Subject to excess-profits tax	500,000			500,000			500,000		
Income tax	400,000			(1)			450,000		
Excess-profits tax	450,000			800,000			350,000		
Total tax, before post-war refund	850,000			[1] 800,000			800,000		
Post-war refund of excess-profits tax	45,000			100,000			66,667		
Total tax, after post-war refund	805,000			[1] 400,000			733,333		
Income distributable to shareholders	650,000			1,000,000			700,000		
Assumed dividend distribution to each shareholder [2]	650			1,000			700		
Total corporate tax applicable to each shareholder [3]	805			[1] 400			733		
	(1)	(2)	(3)	(1)	(2)	(3)	(1)	(2)	(3)
II. TAXATION OF SHAREHOLDERS									
Assumed other net income	.....	$5,000	$100,000	.....	$5,000	$100,000	.....	$5,000	$100,000
Total net income, including dividend received from corporation	$650.00	5,650	100,650	[4] $1,000	[4] 6,000	[4] 101,000	$700	5,700	100,700
Applicable to dividend received:									
Shareholder's tax	[5] 1.30	[5] 193	[5] 572	[6] 143	500	975	.....	[6] 366	[6] 639
Shareholder's post-war refund	[7] .52	[7] 13	.....	39	.....	.....	.....	70	.....
III. TOTAL TAX APPLICABLE TO DIVIDENDS RECEIVED									
Total tax, before shareholder's post-war refund	806.30	968	1,377	543	900	1,375	733	1,099	1,372
Total tax, after shareholder's post-war refund	805.78	985	1,377	504	900	1,375	733	1,029	1,372
IV. EFFECTIVE RATES OF TOTAL TAX [8]	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent
Before shareholder's post-war refund	53.4	68.6	94.6	33.8	64.3	98.2	51.2	76.7	95.7
After shareholder's post-war refund	53.4	67.7	94.6	33.6	64.3	98.2	51.2	71.8	95.7

[1] The income tax is excluded from the corporate tax since it is considered a personal income tax on dividends collected at source. The amount of the tax, however, is shown as income constructively received by the shareholder. See discussion of treatment of dividends in the United Kingdom under individual income tax, part III A.

[2] Each shareholder is assumed to own ⅓₀ of 1 percent of the common stock outstanding.

[3] Including 5-percent Victory tax.

[4] After refund for excessive withholding of personal income taxes by the corporation.

[5] Under the assumption that taxpayer has less than $600 other investment income.

[6] Under the assumption that taxpayer has at least $1,500 other investment income.

[7] Post-war refund of 40 percent of Victory tax paid.

[8] Total tax computed as a percentage of shareholder's current equity in total net income of corporation less undistributed corporate post-war refund.

Mr. FRIEDMAN. A stockholder in Great Britain would be paying $400, whereas a stockholder in the United States would be paying $805. The American stockholder pays it through the corporation, he does not get the dividend, the tax is deducted before his dividend is received. In Great Britain a corporation deducts at the source the stockholder's normal income tax. A little fellow who is exempt from the tax takes his dividend slip to the inland revenue department and gets a tax refund, whereas we impose a terrific burden on the assumption that everybody, even the smaller stockholder, can pay that tax. And that assumption is wrong. As you will see in table A, an American stockholder pays $805 in tax and the British stockholder pays $400. If you take the corporation tax and individual income tax together the American stockholder in the lowest bracket has already paid 55 percent as against 36 percent for a British stockholder.

A corporation income tax destroys the tax exemption of college and hospitals.

In both the United States and Great Britain, Government-bond yields declined about 20 percent since September 1939. In Great Britain common-stock yields declined sympathetically about 28 percent. Stock prices rose. But in the United States common-stock yields rose 24 percent. Stock prices fell. The higher the tax; the lower the market. The American investor was frightened by reckless and unreasonable taxation on corporations. He took refuge in bonds. Such tax policy penalizes expanding plant through stock issues.

Treasury proposals for raising corporation income taxes shake the economic foundations of the country. This is not so in Great Britain. All the evil effects of our corporation income tax are significantly absent in Great Britain.

Our Treasury proposals to increase corporation income taxes always break the stock market. The British are not subject to a double tax on corporate income but we are. Compared with September 1939, the London stock market is now about 50 percent higher, but the New York stock market is about 17 percent lower. If you raise the rates, the market will fall. If you lower the rates, the market will rise.

Under Treasury proposals, United States will have the highest corporation tax in the world, equaling the Nazis, who do not tax excess profits. The United States will have the highest excess-profits tax in the world, matching Great Britain's, which does not tax corporation income.

II. THE PRESENT TAX SEQUENCE IS UNSOUND

Your committee is considering the House bill which would raise the excess-profits tax from 90 to 95 percent. This would not be an unreasonable proposal if we had not, in 1941, changed the sequence of deducting the tax.

This memorandum is a plea to restore the original sequence, and levy corporate income tax first, then on any increased net income, levy the excess-profits tax. We used this sequence until 1941. Canada still uses this. It is an honest and sound procedure. Why should we reverse the procedure?

A basic principle of the Treasury has been abandoned and flouted in the actual legislation. The Treasury, in presenting the tax bill, March 1942, stated—

> Incorporated business will willingly pay additional taxes which will, after all, leave it in the aggregate about the same amount of income after taxes as during the years before 1940.

The companies that, as a tax base, used the average earnings of the pre-war years show earnings in 1942 far below the pre-war years. This is not true in either Canada or Great Britain. (See London Economist, July 31, 1943, pp. 147 and 154; May 29, p. 708; February 20, p. 241.) Our experience may seem strange. Even if there were a true excess profits tax of 100 percent, the earnings of our companies should still be at least equal to the pre-war base. This was true under the 1940 tax.

Why are these earnings lower than before the war? The reason is obvious. The law was changed in 1941. The tax on excess profits is levied not on the net profits after income tax, but on gross profit before income tax. Such so-called excess-profits tax reduces the gross profits down to the pre-war level. Then after that, we levy a corporate income tax which is now 40 percent. But in the pre-war years it was much lower, 15 percent in 1936, 15 percent in 1937, 19 percent in 1938, 19 percent in 1939, or 17 percent pre-war average.

When we raise the corporation income tax we really levy a second excess-profits tax. This is not the case in Canada. There the Government imposes a true excess-profits tax, as we did before 1941. First the tax on corporate gross income is deducted. The remaining figure is then the true net income or net profit. The wartime increase in such net profit is then siphoned off by the excess-profits tax.

The difference in the tax sequence may be seen in a simple case. Take a corporation showing earnings of $100 in pre-war years, paying say a 15 percent income tax, leaving net income after taxes of $85. In 1943 it shows earnings of $200. Under the original sound sequence a 40 percent income tax of $80 leaves net income of $120 compared to pre-war $85 and an excess profit of $35. Then a 95 percent excess-profits tax takes about $33 and leaves $87 net income after taxes, compared to $85 in pre-war years. Under the revised unsound sequence the excess profits is $100 and a 95 percent tax thereon leaves a balance of $5 or total gross earnings of $105. Then a 40 percent income tax thereon leaves $63 net income after taxes, compared to $85 in pre-war years. The excess-profits tax is, therefore, not 95, but 122 percent. Was this the intent of Congress?

III. TYPICAL CORPORATE EARNINGS ARE BELOW PRE-WAR

The following table I shows for typical American companies (a) the average pre-war earnings, (b) the actual earnings for 1942, under our altered and erroneous method of taxing away excess-profits tax first, and then (c) the potential earnings for 1942 under our original and correct method of deducting the income tax first, as the Canadian Government still does. Note that wartime earnings are less than pre-war earnings under the altered method and slightly more than pre-war earnings under the original method.

TABLE I.—*Earnings per share*

Name of company	Average actual pre-war earnings	Deducting 90-percent excess-profits tax before 40-percent income tax, 1942 actual	Deducting 40-percent income tax before 90-percent excess-profits tax, 1942 potential
	(a)	(b)	(c)
INDUSTRIALS			
American Can	$5.61	$4.03	$5.10
American Smelting	5.25	3.99	5.43
American Tobacco	4.69	4.28	5.02
General Electric	1.53	1.56	1.78
General Motors	4.00	3.55	4.25
Montgomery Ward	3.86	3.65	4.32
National Lead	1.16	.87	1.20
United States Gypsum	4.33	4.27	4.69
RAILROADS			
Chesapeake & Ohio	4.07	4.25	4.36
Norfolk & Western	19.74	15.35	21.35
UTILITIES			
American Gas & Electric	2.38	2.21	2.59
American Telephone	9.79	8.79	11.71
Commonwealth Edison	2.15	1.74	1.91
Consolidated Edison	2.21	1.79	1.79
Public Service of New Jersey	2.64	1.22	1.63
Commonwealth & Southern, preferred	8.96	7.34	10.39

IV. RISING EXCESS-PROFITS TAX IS TOLERABLE UNDER FORMER SEQUENCE

A rise in rate of a true excess-profits tax from 90 to 95 percent would have but little effect if the excess-profits tax were figured correctly, after deducting the corporate income tax, as shown in table II.

TABLE II.—*Earnings per share*

Name of company	Average actual pre-war earnings	Deducting 40 percent income tax before 90 percent excess-profits tax 1942 potential	Deducting 40 percent income tax before 95 percent excess-profits tax 1942 potential
	(a)	(b)	(c)
INDUSTRIAL			
American Can	$5.61	$5.10	$5.10
American Smelting	5.25	5.43	5.43
American Tobacco	4.69	5.02	4.95
General Electric	1.53	1.78	1.63
General Motors	4.00	4.25	4.25
Montgomery Ward	3.86	4.32	4.22
National Lead	1.16	1.20	1.16
United States Gypsum	4.33	4.69	4.61
RAILROADS			
Chesapeake & Ohio	4.07	4.36	4.29
Norfolk & Western	19.74	21.35	20.96
UTILITIES			
American Gas & Electric	2.38	2.59	2.59
American Telephone	9.79	11.71	11.25
Commonwealth Edison	2.15	1.91	1.91
Consolidated Edison	2.21	1.79	1.79
Public Service of New Jersey	2.64	1.63	1.63
Commonwealth & Southern, preferred	8.96	10.39	9.70

V. RISING EXCESS-PROFITS TAX IS HARMFUL UNDER PRESENT SEQUENCE

However, under the erroneous method that we now employ, a 5 percent rise in the excess-profits tax, say from 90 to 95 percent, reduces the earnings of companies further below the pre-war base, as shown in table III. How does this square with the professions of the Treasury? Is this the intent of your committee?

TABLE III.—*Earnings per share*

Name of company	Average actual pre-war earnings	Deducting 90 percent excess-profits tax 40 percent income tax, 1943 actual	Deducting 95 percent excess-profits tax before 40 percent income tax, 1942 theoretical
INDUSTRIALS			
American Can	$5.61	$4.03	$3.82
American Smelting	5.25	3.99	3.76
American Tobacco	4.69	4.28	4.10
General Electric	1.53	1.56	1.56
General Motors	4.00	3.55	3.51
Montgomery Ward	3.86	3.65	3.56
National Lead	1.16	.87	.79
United States Gypsum	4.33	4.27	4.26
RAILROADS			
Chesapeake & Ohio	4.07	4.25	3.63
Norfolk & Western	19.74	15.35	14.42
UTILITIES			
American Gas & Electric	2.38	2.21	2.08
American Telephone	9.79	8.79	[1] 8.20
Commonwealth Edison	2.15	1.74	1.73
Consolidated Edison	2.21	1.79	[2] 1.79
Public Service of New Jersey	2.64	1.22	1.12
Commonwealth & Southern preferred	8.96	7.34	6.59

[1] Allows for lower exemption of invested capital companies.
[2] Would probably not be subject to excess-profits tax even under the latest tax proposals.

(All the above tables were compiled by the Value Line Investment Survey of New York from company reports to stockholders.)

Our present procedure is based on unsound bookkeeping, and an indifference to the corporations' ability to furnish post-war employment to labor.

VI. HEAVY INDUSTRY AND RAILROADS ARE HURT

The effect on heavy industry is even more serious. The manufacturers of steel, equipment and machinery and the railroads themselves, use the invested capital base for determining excess profits. Because of the depression their earnings before the war were very low. For instance, the United States Steel Corporation before the war showed earnings of 2.95 percent on the invested capital (in 1936 3.15 percent, in 1937, 5.56 percent, in 1938, 0.03 percent and in 1939, 3.05 percent). At that time heavy industry operations averaged a fraction of its capacity.

Obviously when industry is working at maximum capacity, the earnings would be substantial. However, when the earnings are limited to say 5 or 4 percent, the increase is largely removed by first levying the excess-profits tax. Then under our procedure we impose

a 40 percent income tax on the evened-down earnings, thus reducing the earnings to about 3 or 2.40 percent.

Mr. Emil Schram, former head of the R. F. C., speaking at Richmond, Va., November 17, 1943, cited two cases in point.

> A $200,000,000 corporation which just earned its invested capital in 1942, found its net return down to 3.64 percent after paying the 40 percent combined normal and surtax rate. Under the proposed changes, including also the raising of the excess profits tax rate to 95 percent this return is cut to 3.20 percent. In the case of $500,000,000 corporation, the permitted net return is cut from 3.28 to 2.81 percent.

The heavy industries show the evil effect of the present unsound sequence. For example, United States Steel Corporation showed in 1942 earnings of $5.35 per share, with a tax base of 5 percent of the invested capital, and deducting first a 90 percent excess-profits tax, then a 40 percent income tax. In that year it showed the highest record for volume of sales and volume of wages. But the earnings for the stockholder were the smallest per-dollar of sales in its history, except for 2 years. For each dollar in dividends paid to the owners of common stock, workers received $22 in wages and the Government $6 in taxes, and 31 cents was carried forward for future needs.

TABLE IV.—*Earnings per share*

Name of company	Deducting 90 percent excess-profits tax before 40 percent income tax, 1942 actual	Deducting 95 percent excess-profits tax before 40 percent income tax, 1942 potential	Deducting 40 percent income tax before 90 percent excess-profits tax, 1942 potential	Deducting 40 percent income tax before 95 percent excess-profits tax, 1942 potential
Invested capital base	5%	5%	4%	4%
United States Steel	$5.35	$4.03	$7.10	$6.44
Youngstown Steel	$5.66	$4.55	$5.15	$4.96

Source: The Value Line Investment Survey, New York.

What does this table show? Even on a base of 4 percent on invested capital, the heavy industries show a better record of earnings per share under the sound method of levying an excess-profits tax on the true net income after deducting the income tax than the companies show on an invested capital base of 5 percent under the unsound method of levying an excess-profits tax first on the gross income before deducting income tax.

Companies that use the invested capital base are usually in heavy industry and experience considerable fluctuations in volume of business and volume of employment. As a post-war measure, which may be needed earlier than you think, should we not encourage companies to take risks and embark on business ventures which would improve their possibilities of employment? Our present method of taxation seems reckless and disregards the ability of the corporation to employ labor after the war.

VII. IS THE TAX METHOD LEGAL FOR RAILROADS AND UTILITIES?

Gross corporate profits before income tax are not a legal base for levying excess profits. The United States Supreme Court held:

> In calculating * * * a proper return it is necessary to deduct from gross revenue the expenses and charges * * *. All taxes which would be payable * * * are appropriate deductions." *Galveston Electric Company* vs. *Galveston;* 258 U. S., 388, 399; 1922).

The I. C. C. allowed the railroads a 5¾ percent net return after taxes, and public utility Commissions allow utilities a 6 percent return. Courts, under a test of constitutionality, approve such returns. Can Congress now cut their return to 3 or 2.4 percent, as is now proposed by the Treasury? The courts have held the following returns to be confiscatory, viz, 4.59 percent in *Mobile Gas Co.* v. *Patterson* (1924), 293 F. 208; also 3.65 percent in *Edison Light and Power Co.* v. *Driscoll* (1928), 25 F. Supplement 192; also 2.48 percent in *Kings County Lighting Co.* v. *Prendergrast* (1925), 7 F. (2d) 192.

VIII. CONCLUSION: CHANGE SEQUENCE OF INCOME AND EXCESS PROFITS TAX

What is the conclusion? Deduct corporate income taxes before figuring true net income and before levying the excess-profits tax thereon. Under such procedure, companies using an average earnings base would then meet the Treasury formula that "additional taxes will leave the corporation about the same amount of income after taxes as during the years before 1940." For companies that use the invested capital base, such procedure will leave them the 5 or 6 percent specified in the law rather than the 3 and 3.6 percent which they now have left. Both types of corporations could then better meet the postwar employment situation and thus relieve the Government of "make-work" programs, which burden the budget or increase the debt, interest and taxes. British companies show a 5 percent return on capital after excess-profits tax. (See London Economist references above.)

IX. THE SALES TAX IDEAL IN WARTIME

But an additional large source of revenue is untapped. The United States is the only belligerent that has no sales tax. The writer was opposed to a sales tax when the individual income tax was light. The argument against the sales tax that it is regressive disappears under an income tax reaching a bracket of 96 percent. The writer was opposed to a sales tax in times of peace. But in times of war a sales tax becomes a form of universal service. Those not at the front can serve by contributing funds. The purchasing power of pennies has fallen in terms of materials and commodities. But it has risen in terms of ideals and hopes. Of these never could small funds buy so much.

X. RECOMMENDATIONS

The committee might consider the following recommendations on the corporation income tax: (*a*) Permit increased reserves for wartime depreciation; (*b*) Exempt amortization of debt; (*c*) Permit reserves for economic transition to peace; (*d*) Treat preferred stock dividends exactly like bond interest. Both are fixed charges; (*e*) Tax publicly owned corporations competing with private enterprise. In Soviet Russia the hydroelectric plant at Dnieperstroy paid a 40 percent corporation tax (not 50 percent). But our own T. V. A. and municipally owned utilities pay no Federal taxes. If they did, the Treasury could collect $150,000,000 in revenue from them and at least $50,000,000 from holders of their securities, now tax exempt; (*f*) Shift our corporation tax to the British basis after the war.

Responsible Treasury officials publicly favored this trend in policy. Hon. Randolph E. Paul stated so in addresses at the Detroit Economic Club, March 1, 1943, and at the New York New School, November 16, 1943.

XI. A MINIMUM PROGRAM

As a sound and realistic program, the corporation income tax should be deducted before excess-profits tax, if you raise the rate to 95 percent. As a minimum program, if you retain the present unsound and unrealistic sequence, the rate of 90 percent of excess-profits tax should not be raised, and invested capital base should not be lowered to 4 percent.

Now, I amplified that in considerable detail in the House hearings in which I showed that the proposal by the Treasury puts the stockholders in a panic. From March 1942 when the Treasury first made its proposal of a tax rate of 55 percent down to April 28, when the House committee threw out the proposal, the stock market took a nose dive. It turned up on the very day when the House announced that it rejected the 55-percent rate.

Senator LUCAS. How are you going to get the tax?

Mr. FRIEDMAN. That is the essential part of the story.

Senator LUCAS. I am not talking about corporations. I am talking about taxes. You are talking about primarily having the corporate tax reduced so stocks can go up, so you can have some risk capital in this country.

Mr. FRIEDMAN. Yes.

Senator LUCAS. I am interested in how we are going to get the taxes to win the war.

Mr. FRIEDMAN. If you follow the British procedure and do not tax the corporation there will be more money paid out in dividends and the tax rate goes up into the higher brackets.

Senator LUCAS. Let me ask you this: What is the total amount the Treasury collects now in the corporate tax?

Mr. FRIEDMAN. I think it is about $15,000,000,000.

Senator LUCAS. Assume it is $15,000,000,000, what would it be under your plan?

The amount of the corporation taxes collected was submitted by Hon. Randolph E. Paul in a statement at the House hearings on the 1943 Revenue Act (pp. 53, 56, and 126).

Corporate income and taxes

[All figures in billions of dollars]

	Present	Program	Difference
Corporate net profit	24.5		
Corporate income tax	4.7	5.8	+1.1
Excess-profits tax	10.8	10.8	0
Total corporate tax	15.5	16.6	+1.1
Individual income tax	17.4	23.9	+6.5

This table answers your question, Senator Lucas. Corporation income tax in 1943 constitutes only 30 percent of the total taxes on corporations and only 27 percent of individual income taxes. The pro-

posed increase in individual income taxes exceeds the total actual corporation income tax paid.

Obviously, any revenue obtained from the corporation income tax could also be obtained through the individual income tax on the stockholders—and more justly. There is no corporate income apart from the stockholder's income.

Mr. FRIEDMAN. If you abolish the corporation income tax?

Senator LUCAS. We have eliminated the corporation income tax and let the stockholders pay, as you suggested a moment ago.

Mr. FRIEDMAN. You ask, Senator Lucas, how else would you collect the money now paid in corporation income taxes? Under the British method, we would then tax only the undistributed profit. The British tax a corporation for the normal individual income tax, but that applies also to the undistributed profits, and the Treasury can make that calculation. It is a very simple one. I would say of the total amount of corporation income tax received from the corporation, you would probably get 70 percent back through increased rates on individual income taxes. I think Mr. L. H. Parker filed a brief to that effect last year and tried to make that very calculation, Senator. You will find it in the House hearings. He assumed all the money that is now being paid into corporation taxes trickled over into dividends, and then he applied the average individual income-tax rate. You would get most of it back anyway. If you tax 40 percent of 100 percent of the corporation's income now you get a certain amount. But, if you abolish the 40-percent tax and pay out more dividends, surely you would hit the 40-percent level at $14,000 now and under the new proposal between $4,000 and $6,000.

To get back to your question as to where we will get the money from, I say you would get a good part of it back from individual income taxes, because the dividends would be increased. You would get a good part of it back from inheritance taxes. The inheritance taxes ran around $400,000,000 for the last few years. If you abolish the corporation income tax of 40 percent, then all incorporated property—farms, real estate, and stocks—will rise in value about 60 percent. Thus, you would get a 60-percent increase in the inheritance taxes. That is, $250,000,000 there. Mr. Parker figured out you would get a good part of the loss of the corporation tax back in the individual income tax.

The individual income tax could be increased. In fact, the Treasury proposed to increase individual income taxes by 6.5 billion dollars, which figure compares with the present corporation income tax of $4.7 billions. Obviously, if there were no corporation income tax, dividends distributed would be larger and the Treasury would receive substantially larger taxes from individual incomes.

Mr. Paul's statement (p. 56 of the House hearings) shows that the 40 percent bracket is, under the present law, applicable to individual incomes in the bracket beginning at $14,000 and under the Treasury proposal would apply to the bracket of incomes beginning at $4,000.

The Treasury recently released a memorandum entitled "Comparison of Taxes in the United States, Great Britain, and Canada," October 15, 1943. Table 1, page 12, shows the difference in the treatment of income tax and corporation tax in the United States and Great Britain. In the fiscal year 1942–43, the corporation income tax plus the excess-profits tax raised 12 percent of the total taxes in Great Brit-

ain and 33 percent in the United States. But in the same year, the individual income tax raised 35 percent of the total taxes in Great Britain, but only 21 percent in the United States. Again the same memorandum, table 4a, page 20, compares the individual income tax in the United States and Great Britain. For individual net incomes before personal exemption, a $2,500 income pays 12 percent in the United States and 24 percent in Great Britain, and a $5,000 income pays 19 percent in the United States and 33 percent in Great Britain. Obviously, our individual income taxes are lower and our corporation income taxes are higher than in Great Britain. According to table A in my statement (taken from table 2, page 51, of the above Treasury memorandum) our corporation income tax per small shareholder is twice as high as in Great Britain.

There is inherent injustice in our procedure. The corporate earnings belong to the stockholder. To levy a flat tax of 40 percent on the corporate income assumes that all stockholders have equal capacity to pay. That is not true.

You ask, Senator Lucas, for recommendations on the the corporation income tax. After the war abolish it and shift over to the British system. This would be equitable to the small stockholder and would make private enterprise work smoothly.

Now, in the midst of the war do not raise the rates of corporation income tax. Instead, deduct the corporation income tax first before levying an excess-profits tax. But if you do not adopt this rational and realistic procedure, at least do not raise the rates on either the corporate income tax or the excess-profits tax even now in the midst of the war.

You wrote into the present law a tax limit of 80 percent of total corporate earnings, regardless of the rate of tax—normal, surtax, or excess profits. Should you not write also another tax limit, viz, net earnings after taxes should not be less during wartime than before the war?

If you must add a 5-percent tax somewhere on corporate income, then levy a special 5-percent wartime tax on dividend income exceeding, say, $5,000, thus sparing the little stockholder.

Then I think you ought to increase heavily all the excise taxes. I was amused yesterday to hear the jewelry people and fur people ask for tax exemption. One cited a poor woman who has got to pay $200 for a fur coat, and who will have to pay also for the 25-percent tax. He overlooks the fact that papers in Washington, Chicago, and New York advertise mink coats at $15,000. I remember in the last war, Lloyd George said:

> The merit of very high excise taxes is you will either get the money or you will check consumption and have money available for bonds.

Senator DAVIS. If you have taxes on the farmers that are too high then you will not get the trappers on the farms and in the woods to trap them, because there will not be enough profit in it. They will pass the tax back to the trapper.

Mr. FRIEDMAN. The answer to that is you can put the tax high enough to give you an increased income without having a catastrophic effect. After all, in wartime you do not need trappers. Some of those trappers ought to be out shooting the enemy instead of shooting squirrels.

Senator DAVIS. That is all right, but if you do not have the trappers shoot the squirrels there would not be any furs to sell to get the tax.

Mr. FRIEDMAN. The war dislocates economy. It would be impossible to raise money and to allow the luxuries to be taxed lightly as they are. If you go up to any big city you will find men in work clothes buying expensive fur coats with cash. It is a form of tax evasion. Enormous amounts of money are spent for luxuries.

Senator DAVIS. It is your opinion that the 40-percent income tax is too high?

Mr. FRIEDMAN. It is, but I would let it stand during the war, even though it is bad in principle. It should be abolished after the war. But while it is in force, we ought to deduct the corporation income tax before figuring excess profits because there are no excess profits before taxes.

Senator WALSH. I do not mind saying there are so many bad features about this bill, in my opinion, that after it is discussed on the floor there will not be anything left, unless we find some new sources of revenue.

Mr. FRIEDMAN. I shall say a word on the sales tax, if I may.

Senator WALSH. It is certainly getting a great shellacking before the House and Senate.

Mr. FRIEDMAN. It is a simple tax device and very productive.

Senator WALSH. That does not mean that I do not favor exploring and finding new ways of increasing the revenues of this country in this period of the war.

Mr. FRIEDMAN. I think you must have higher excise taxes, higher individual income taxes, and I think a sales tax is inevitable. I do not see why we should be the only belligerent in the world that hasn't a sales tax. If all the arguments that are put up against it are valid, why, the sales tax would not work in other countries. But it does work, and it works very successfully. It works in England where labor has a great deal to say. In Great Britain they have a graduated sales tax, and labor swallowed it completely and endorsed it. It is amazing that we have not educated the country. We ought to teach the people who are opposed to the sales tax that it is working elsewhere. In all the democratic countries, in Great Britain, Canada, Australia, South Africa, they have a sales tax. The argument against it should fall to the ground on the basis of experience.

Senator WALSH. We thank you, Mr. Friedman.

Mr. Benson, Mr. Hensel, and Mr. Bradley, please.

STATEMENT OF EZRA T. BENSON, EXECUTIVE SECRETARY, NATIONAL COUNCIL OF FARMER COOPERATIVES

Senator WALSH. I understand you gentlemen want to discuss section 112 of the code.

Mr. BENSON. Yes, Senator. My name is Ezra T. Benson. I am executive secretary of the National Council of Farmer Cooperatives.

Senator WALSH. And these other people are representing the same organization?

Mr. BENSON. They are not here in person. They would have been here had we not agreed that I would make the statement for the three of them.

Senator WALSH. They are favoring your statement?

Mr. BENSON. This is a statement for the National Council, and they are in full agreement on it.

The National Council of Farmer Cooperatives is a conference body representing more than 4,600 farm coperative associations having a total membership of more than 2,300,000 farmers. These farmers are distributed in every State in the Union and in 98 percent of the counties in the United States. All council policies are established by the unanimous consent of its 14 commodity divisions.

A farm cooperative association, ordinarily known as a farm co-op, is a voluntary business association established by farmers to market their farm products or to purchase farm production supplies. Essentially a farm cooperative operates only as an agent for its members or for other farmers. A true farmer cooperative can neither, as respects itself, make a profit nor sustain a loss. In the case of a marketing cooperative which sells the products of farmers, the co-op pays back to the farmers all that it receives from their products, less the cost of operation. In the case of a purchasing co-op, it purchases for farmers their supplies at the lowest possible cost and charges them in addition thereto only the actual cost of operation.

Senator WALSH. Your position is, as I understand it, you are opposed to that provision of this bill which requires these farm cooperatives to make returns.

Mr. BENSON. I am not opposed to it; but favor modification.

May I read through the very brief statement?

Senator WALSH. I am afraid I am anticipating too much.

Proceed.

Mr. BENSON. Membership in a farmer co-op is open and voluntary. No one is forced to join a cooperative. Farm cooperatives will generally also permit nonmembers to avail themselves of their facilities. The Capper-Volstead Act, however, under which the farm co-op operates, does not permit these co-ops to do more than 50 percent of their business with nonmembers.

The real purpose of a farm cooperative is to improve production, lower costs of distribution, integrate marketing and production operations, improve quality, eliminate waste, and prevent expensive duplication of efforts on the part of farmers. By cooperative action, the farmers are enabled to very substantially reduce their overhead, especially as relates to distribution. In his individual capacity, the farmer is unable to protect his economic interest in competition with highly organized and powerful business and industrial giants. The farm co-op, by permitting the farmers to pool their efforts and resources together, enables the farmers to match large industrial competition.

Senator WALSH. This bill seeks to change that. Do you favor the change?

Mr. BENSON. We do not object to some change. I explain that here.

Senator WALSH. The previous witness objected to it. You heard him, I suppose.

Mr. BENSON. No; I did not.

Senator WALSH. Proceed.

Mr. BENSON. Because farm co-ops act essentially as agents for individual farmers, and in that process do not make profits for themselves, Congress over a long period of time has included farm co-ops in the

category of organizations exempt from taxation under the provisions of the Internal Revenue Code, section 101, paragraphs 12 and 13.

The profits made by individual farmers whose equipment is purchased by, or whose farm products are marketed by farm cooperatives is, or course, subject to taxation, and, to the extent that farm co-ops aid the farmer in making larger profits he, of course, pays larger taxes.

The impression seems to be prevalent in some quarters that farm co-ops are analogous to an ordinary business corporation, and that consequently the nonpayment of taxes by a farmer co-op is in the nature of special privilege by the Government. This is an entirely fallacious idea. An ordinary business corporation makes a profit itself on all business transacted by it, which it in turn distributes as dividends on their investment to its stockholders. On the other hand, the savings that are effected by a farm co-op through its cooperative method of doing business are not profits of the co-op and are therefore not paid to the patrons of farm co-op on any capital investment. These savings are paid to the patrons of the farm co-op, that is, those who buy farm supplies and sell farm products through the co-op. The savings are distributed to nonmembers in the same way and in the same proportion and extent as to those who are members or stockholders in the farm co-op. In fact, a great many farm co-ops do not have stock of any kind, and even where stock is issued, it is issued only as a mechanism for the vesting of managerial control in the persons responsible for the organization or maintenance of the co-op. Only a small fixed financial return is allowed to members who contribute to the capital of the enterprise. And even as respects the managerial control of a farm co-op, most co-ops provide that each stockholder, regardless of the amount of his stock holdings, is limited to one vote.

In both theory and practice a farm co-op is essentially a partnership of farmers. A co-op is exempt for the same reason a partnership is exempt. It is only the agent of the members, and only the members are subject to tax.

What must be understood then, before this committee, is that the so-called tax exemption that has always been accorded to farm cooperatives is an exemption based on the nature of the business and method of operation of a farm co-op. It is not a special privilege.

The present bill before your committee, by section 112, requires all legal entities exempt from taxation by the provisions of section 101 of the Internal Revenue Code (except religious, educational, and charitable organizations) to file income-tax returns.

This section has had the consideration of the legal and tax committee and also the executive committee of the National Council of Farmer Cooperatives.

After careful study, the National Council takes the position that the proposal to require the filing of detailed income-tax returns by more than 10,500 farmer cooperatives throughout the country would be a needless and burdensome expense both on the part of the cooperatives and on the part of the Government in examining these returns. Since a farmer cooperative is exempt from taxation because it makes no profit, we fail to see any real reason for the futile expenses of making income-tax returns.

On the other hand, we want it clearly understood, and this is our position, Senator, that the farmer cooperative movement has nothing

to conceal from either the Members of Congress or the American public, and if Congress in its wisdom feels that it is advisable for the Commissioner of Internal Revenue to obtain further information as to the business conducted by farmer cooperatives, the council will not interpose any other objection but will lend its assistance in obtaining that information.

I might interject there that at the present time farmer cooperatives are filing information returns with the Internal Revenue, and if those returns are not adequate then we would not object to a more comprehensive return.

The policy of the National Council has thus been formulated in the following resolution adopted by the National Council:

In view of the fact that bona fide farmer cooperative associations are now, and under the provisions of H. R. 3687 will remain tax exempt, the National Council of Farmer Cooperatives feels that it would be an unnecessary and burdensome expense, both to farm cooperatives and the Government, to require such farm cooperatives to file income-tax returns; but that in the event Congress in its wisdom feels that all organizations now made exempt by section 101 of the Internal Revenue Code from payment of taxes should nevertheless file income-tax returns, the National Council of Farmer Cooperatives, in behalf of farm cooperatives, will not object thereto:

Provided that the present bill be amended so as to provide: (1) That the return to be filed by agricultural cooperatives be an information return on a special form to be provided by the Secretary of the Treasury that would make possible a reflection of the true nonprofit character of such agricultural cooperative, and as to marketing cooperatives should require a statement of the amounts received from its patrons for purchases made for them, and the disposition or distribution thereof;

(2) That the information return should be filed with that division of the Office of the Commissioner of Internal Revenue which is charged with the responsibility of determining the eligibility of agricultural cooperative associations to tax exemption under section 101 of the Internal Revenue Code.

(3) That the filing of such information return shall have the same effect as the filing of regular income-tax return as provided in section 285 (a) of the Internal Revenue Code.

You will note that the resolution I have read proposes an amendment to existing section 112, to provide that the returns to be filed shall be information returns. The reason for this suggestion is obvious. If, as suggested by the report of the House committee, the purpose of section 112 is to elicit information as to the business done by tax-exempt organizations for the purpose of determining future tax policies, then the returns to be filed should be on forms which give correct information. Farmer co-ops are already filing reports currently with the Commissioner of Internal Revenue for the purpose of showing the character of their operations. If this information is not sufficient, and Congress wants additional information, the Commissioner can change the form. It would be impossible, however, for a farm cooperative to fill out the form of income-tax return prescribed for an ordinary business corporation because that form calls for a showing of profit and loss. A true farmer cooperative, as I have said, can make no profit or loss. Consequently a form requiring a farmer cooperative to show a profit would not give the Commissioner of Internal Revenue, or the Congress, any real information about the business of the farmer cooperative. If, therefore, the committee feels that notwithstanding the nontaxable character of farm cooperatives the Commissioner of Internal Revenue should nevertheless have full information with respect to their business, we propose in the interest

of eliciting that information, that section 112 be amended by inserting after the sentence ending on page 28, line 18, the following:

With respect to farmers, fruit growers, or like associations which are exempt from taxation under section 101 (12) and 101 (13), such associations shall file an annual information return, on a form especially prepared by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, containing a verification or written declaration that it is made under the penalty of perjury, which information return shall (1) be in such form as will make possible a ready disclosure of the nonprofit character of the operation of the association; (2) be filed with that division or section in the office of the Commissioner of Internal Revenue as is charged with the responsibility of determining the tax status of such association, in the first instance; (3) be deemed a return within the provisions of section 275 (a); and (4) in the case of marketing associations, state the gross proceeds received from the farm products marketed by or through the association, and the distribution or disposition thereof; and, in the case of purchasing associations, state the gross proceeds received from supplies purchased by or through the association and the distribution or disposition thereof.

This amendment would do three things—

(1) It would require cooperatives to give not uninformative information as to their lack of profits and losses but in the case of purchasing associations, the gross proceeds received from supplies purchased by or through the association, and the distribution or disposition thereof; and in the case of marketing associations, the gross proceeds received from farm products marketed by or through an association, and the distribution or disposition thereof.

(2) Such returns would be filed with that division of the office of the Commissioner of Internal Revenue as is charged with the responsibility of determining the tax-exempt status of co-ops. That is where the present information returns are filed and where they could be put to most use.

(3) These returns would have the effect, as is only fair, of starting the running of the statute of limitaions. At the present time the statute of limitations does not run against a co-op except where it files a regular return. If Congress requires co-ops to give the information here suggested they should have the benefit of the statute of limitations.

I hope, gentlemen, that you will appreciate that this statement has been made with the aim of giving the committee some constructive help.

Senator WALSH. Granger Hansell.

Senator JOHNSON. Mr. Chairman, Mr. Luke Smith, a prominent industrial leader of Colorado, has been doing some constructive thinking on the difficult problem of Federal taxes. At my request he prepared a brief analysis of a tax plan that he believes we would do well to consider. I desire to place it in the record where it may be studied by the committee and the Treasury.

(The analysis of the tax plan referred to is as follows:)

ANALYSIS OF A TAX PLAN

(By Luke Smith)

Taxes: This situation is so mixed up with law upon law that it takes more lawyers, accountants, and clerical help to handle the complicated mess than it takes to produce needed goods for the war.

All present tax laws should be repealed and a straight transaction tax law should be enacted, without allowing anybody exemptions. The same rates should be applied in all cases.

The only special taxes other than on the above basis should be such as the gasoline tax law, which operates the same as the principle outlined in the above plan.

The plan above is sound because the facilities of the Government are used in proportion to their gross income and not net income. Net income taxes are not right because a successful operator is not as much of a burden on the Government as one who does the same amount of business yet loses money.

If everyone pays the same rate of taxes regardless of their total income, all have a feeling of equality as well as refsponsibility. The question will arise where taxes are pyramided, which is so, but what difference does it make whether 1 cent is paid 10 times or 10 cents once. Arguments will come up that this form of taxation could not be applied to every form of transaction, such as transfer of stocks, etc. If this uniform system of taxation is used any sale of stocks or bonds would constitute a sound transaction, and therefore shady deals would be eliminated. Remember there should be no exemptions.

There should be no revenue stamps on legal documents, unless they constitute a form of collecting the transaction tax on the transfer of titles. Bank deposits and bank loans should not be considered in collecting transactions tax, but all other interest, stock and bond transfers, and property deals should be taxed.

The Revenue Department could operate on one-half of the personnel, because the debit side of the ledger is all that would have to be checked by it.

This proposed tax system would be a relief to everyone concerned, but under the present systems there are always those who are looking for loopholes which are used in every case possible to keep from paying to the support of Government.

The time is ripe now or will be soon for a practical solution of the tax muddle, and the only solution is to repeal the present tax structure and start all over with a completely worked out plan before its enactment into law is attempted. But the proper organization can do the job. The only trouble with any plan of this is that it is not complicated enough to suit the complicators.

Congress, however, has authority to pass such a law under the sixteenth amendment passed July 31, 1909, and became effective February 25, 1913.

Unless a few of the things mentioned in the foregoing are put into effect, private industry as well as the entire American system will be overcome by the socialistic form which is controlled by bureau upon bureau which the taxpayer has to pay for, and which cannot be paid for under the present system.

STATEMENT OF GRANGER HANSELL, ATLANTA, GA., GEORGIA MARBLE CO.

Senator WALSH. Mr. Hansell, Senator George, who is ill, has paid to me his regrets that he could not hear you, and he asked me particularly that you be given a chance to be heard.

Mr. HANSELL. Thank you.

Mr. Chairman, I shall make my remarks as brief as possible. I am appearing in connection with section 115.

Unquestionably the use of "tax umbrella" corporations should be ended promptly, but fairly. We hold no brief for them. Many of the "umbrella" devices resorted to are so flimsy that under *Gregory* v. *Helvering* (293 U. S. 465), *Griffiths* v. *Comr.* (308 U. S. 355), and like cases, the tax dodger will be disappointed. Hocus-pocus schemes and semifrauds may be left to the commissioner and the courts for disposition, with complete confidence in the result.

But there are perfectly open, upright, and legitimate transactions which have taken place since October 8, 1940, which come within the proscription of section 115 as now worded. For illustration, the situation of the Georgia Marble Co.

This corporation had about $2,500,000 invested. The controlling stockholder was the president, Col. Sam Tate, who, about 1936, due

to age and illness, retired from the active management and the business declined under subsequent management. Then Mr. Tate died. In order to raise funds to pay his debts his controlling stock in the company, about 65 percent, was sold in March 1941. The company had substantial tangible and intangible assets. The new controlling stockholders determined that it was advisable to sell assets not used or needed in the business. The company in the last 2 years liquidated unused assets, some at less than cost, others at a profit. It offset the losses against the profits so that no tax resulted. The operations of the company are again profitable, and the company is now using the excess-profits credit based on its invested capital, under the old management and the loss carry-over of other years, to reduce its taxes in the normal way.

These were thoroughly honorable, legitimate transactions—not subject to any criticism legally or morally under existing law. Of course the new owners were not unaware of the tax situation in making their sales and their tax returns. No businessman with any intelligence at all operates in ignorance of tax consequences. Avoiding or reducing taxes is one of the principal purposes of management and investors. When individual rates run to 90 percent and corporations to 95 percent, it is inevitable.

Under section 115 as now drawn, all of the dealings above referred to could be proscribed—because the new owners gave one of their principal considerations to tax reduction through the use of deductions, credits, and allowances. The sale of the assets at a loss would not be allowed to produce a deduction which could be offset against the profit from the sale of the other assets; the profits from the business operation would have no excess-profit credit, and under the bill would be taxed up to 95 percent; and the company would have no deduction for a loss carry-over.

I submit that these results are not intended by the Congress—they would be intolerable burdens on an already hard-pressed economy. The section as drawn kills a fly on a baby's head by hitting it with an ax—it burns the barn down to kill the rats—kills the dog to be rid of the fleas.

SPECIFIC OBJECTIONS

1. Acquisition made or availed of: The section provides that if one of the principal purposes for which the acquisition was made or availed of is the avoidance of Federal income or excess-profits tax, then the tax shall not be avoided. Any acquisition of any property or interest in a corporation is damned, regardless of the purpose of acquisition, if it is later availed of to reduce taxes.

The section speaks of avoid, not evade. I take it that avoid is synonymous with reduce. The tax statutes recognize innumerable deductions, allowances, and credits which reduce or avoid income and excess-profits taxes properly and legitimately:

(*a*) A factory completely closed down due to war restrictions may be principally used or availed of to provide allowances for depreciation to offset profits from other operations; (*b*) assets bought for $110,000 have declined in value to $10,000. They may be sold for $10,000 and the loss of $100,000 used as a credit or deduction to avoid a profit of $100,000 realized on the sale of other assets. The profit of $100,000 might produce a tax of $95,000. The tax of $95,000 might

be avoided by a sale which produced only $10,000, and the sale at a loss with the consequent credit or deduction would be principally availed of to avoid a tax.

The section uses the words "acquire" and "acquisition"—which include every and any means by which ownership was secured—by gift, foreclosure of a mortgage, or on pledged securities, purchase, inheritance, device, and so forth. The Supreme Court has held that "acquired" included inherited in the I. R. C.; *Brewster* v. *Gage* (280 U. S. 327). Under any of these methods, if the stock or property were subsequently availed of with a principal purpose to avoid a tax, the act would apply. The manner, propriety and purpose of acquisition are completely immaterial. The only question becomes: Would it avoid a tax?

The evil really aimed at is purchasing voluntarily a "tax base," for no other substantial business reason than to get a tax base. Why not phrase the act to carry out this purpose? The section should read that the principal purpose of acquisition "and use," not "or use," was tax avoidance. Is there any justification for saying that if the stock of a company or a property were acquired prior to October 8, 1940, it can be principally used to reduced taxes, but not if acquired after that date?

One of the principal purposes: The section condemns if one of the principal purposes of acquisition or use, and so forth. It is submitted that in these days of very high tax rates, the considerations of the tax results of any acquisition or use of property is inescapable—and the lawful avoidance of a tax is in the very nature of things one of the principal considerations in every purchase, sale, or operation.

Mr. Randolph Paul says in his work on Federal income taxation, section 5332 (written before he became the spokesman for the administration):

> * * * Nothing is more understandable than the temptation to avoid taxes and * * * a desire to minimize tax liability is the nature of mortals. It rarely involves moral turpitude. There is nothing malicious or reprehensible in it. * * * High tax rates put a premium on it. * * * No sane citizen wants to overpay his taxes. Everyone may do what he clearly has a legal right to do and no one is required to pursue a course which gives rise to greater tax liability if another course is open which will lessen liability. He may resort to any legal methods not tainted with fraud to diminish tax liability. This is true though the primary motive, even the sole purpose, of his acts is to reduce tax liability. Where tax avoidance is the motivation, however, transactions will be rigorously scrutinized. Of course, fraud will vitiate a transaction.

Mr. Roswell Magill said on September 21 (77 Trust Estates 327):

> Taxes have become a major factor in determining the form and character of investment, of business transactions generally * * *.

He continued later in the same article, page 330:

> It is fortunate that legislators and laymen alike recognize the leading role the tax system plays, not only in draining our pocketbooks, but in regulating day-by-day transactions in business and family life.

The paramount importance of the part played by income and excess-profits taxes may be illustrated by an actual case in Atlanta: The organizer of a corporation engaged in the coffee business wishes to retire on account of his age and health, and sell his stock. He owns 475 out of 600 shares of the corporation. The company will earn $86,000 before taxes in 1943. What is his stock worth? It depends altogether on his company's tax situation. If his company has no excess-profits

credit, its net income after taxes is $23,000, and the tax about $63,000. He will be lucky if he can sell for $100,000.

But if this company had an excess-profits credit that eliminated excess-profits taxes, its net after taxes would be about $51,000, and the stock would be worth $250,000, instead of $100,000.

Now if he sold the stock for $250,000 on the strength of its excess-profits credit and its net after taxes, it is unavoidable and undeniable that one of the principal purposes for which the purchaser would avail of his acquisition would be to avoid excess-profits taxes through claiming the excess-profits credit, and so save about $30,000. And the Commissioner could, and presumably would, find that that was one of his principal purposes, and that would automatically cause the disallowance of this credit. Indeed, it might well be the deciding factor in determining whether or not to buy.

If that old man who founded the coffee business sold out before November 18, 1943, and after October 8, 1940, for $250,000 on the faith of his tax situation, this act will rob the buyer of $150,000—because he will not get the base he thought went with the business—his excess-profits credit is automatically eliminated. If the old man hasn't sold out before now, this section as now worded will rob him of $150,000, because it is now worth only $100,000, since no buyer can use the stock.

The thought expressed in the Ways and Means Committee report is that the objective must be tax avoidance. The same wording should be carried through into the statute, which should read the principal purpose, and so forth, not one of the purposes. If there are substantial legitimate business reasons for the acquisition and use, the fact that there are tax advantages also should not be fatal. In the very nature of things, securing tax advantages have properly and necessarily played a principal part in all business purchases and sales. The only way to keep taxes from playing a principal part in every situation would be the impossible way of cutting taxes to a nominal rate.

As drawn, the section will put a prospective purchaser of property or stock in this situation: If he looks into the tax features of a property or business and finds that the situation is such that the excess-profits-tax credit or loss carry-overs allow the corporation to keep more than 5 percent of the profits (100 percent of the profits less 95 percent tax) that will, of course, largely influence him, and the Commissioner properly will rule that one of the principal purposes was to acquire that tax credit—and immediately that credit is lost. If the purchaser is a fool, and does not consider the taxes, he will still lose the credit, if the company happens to have one, by subsequently availing of it.

No existing business, nor any substantial interest therein, could be bought with any assurance as to earnings after taxes, for the previous history of a corporation for tax purposes will be wiped out if any substantial interest in its stock changes hands after October 8, 1940. Its excess-profits credits and its loss carry-overs may be obliterated. Its prospective, but as yet unrealized, losses through decline in value or obsolescence of assets still owned, can never be realized if they would result in any deduction, credit, or allowance taxwise. The reason is that the Commission under the section could properly say in every case that one of the principal purposes for which the business was acquired or availed of was the avoidance of a tax through the excess-profits credit, the loss carry-over, or the realized loss.

Nonacquiring stockholders' plight: The section does not require, for the above results to follow, that the acquiring person shall have bought all of the stock of the corporation—not even control. The section's words are "an interest in, or control of, a corporation." Presumably, the commisisoner would exercise some discretion here, and would require that the interest would be substantial, but obviously it need not be a control, for the statute says "an interest or control." What interest will suffice to make the corporation lose its credits, allowances and deductions? Ten percent, or 40 percent might give actual control; 51 percent, which might give legal voting control; 80 percent, which is control for the reorganization section; or 95 percent, which alone suffices for the consolidation section? Is the required interest in the corporation—which acquisition may verily be the kiss of a tax death—ownership of the fundamental common, nonvoting common, or preferred, or what combination of any of them? Under the wording the commissioner would have unlimited discretion to determine what he thought would be a sufficient interest or control to make the section applicable.

A most unjust penalty is heaped on the stockholder of the corporation who has not sold out to the acquiring person. The old stockholder may have thought he had stock in a corporation that could make and keep a reasonable profit after taxes, but due to the acquirer's acquisition, the excess-profits credit is swept away, and 95 percent of the profits go for taxes. Or the stockholder might have thought he could realize something through the liquidation of the company, but he finds these prospects halved because the corporation's profits on liquidation sales will be eaten up with taxes and correlative losses disallowed. Through no act of his own and no intent attributable to him, his values have been forfeited.

Let me illustrate with an actual case: The founder of a business owning 60 percent of the stock died; his stock was sold in 1943 to raise money to pay estate taxes. The company had a fine tax base, and about a quarter million in assets, but it wasn't making money. The new controlling owners bought an existing business which is proving very profitable, provided the company's tax base is not disturbed. The minority stockholders have done, and could have done nothing; the action of the majority stockholders was honorable and aboveboard, thoroughly legitimate. The minority stockholders' investment—and the majority's, too, for that matter—is worthless if, after the acquisition of the new business, the existing base cannot be used as a credit to reduce excess-profits taxes.

"The Commissioner finds:" These words should be stricken, because they might be urged as establishing some sort of finality for the commissioner's findings, if there were any evidence to sustain them, and thus withdraw them from the consideration of a court or a jury—leaving the finding not substantially reviewable. Such a final determination of a factual issue is contrary to the genius of our law. It should be subjected to adequate review. The history of liberty has largely been the history of observance of procedural safeguards," says Frankfurter in *McNabb v. U. S.* 63 Sup. Ct. 608.

"Unlimited discretion of Commissioner:" One might have faith in the present commissioner—and be willing to trust to his wise judgment in administration of this section. The gentlemen who represent the Treasury are doubtless honorable and discreet. But it

is proposed to give the commissioner and these gentlemen a blank tax due bill to fill in against any corporation in America where there has been a substantial change in ownership since October 8, 1940.

The commissioner acts through hundreds of agents. Some of them are honest zealots. They apply the letter of the law, regardless of fairness or common sense. Some of them have grudges, and some of them have pets and friends, and all of them are human and can err; and all naturally want preferment to their calling.

This vague and limitless discretion of the commissioner will provide a perfect field day for the ambitious investigators of the Treasury. Every transaction since October 8, 1940, would be scrutinized to see whether the acquirer of any property or any stock in a corporation was getting a tax reduction thereby, and if so, then out it goes. The proposed section would enormously increase the complexity of the law, and the extent of investigation into consciences and purposes. Only a crystal gazer could guess the result.

Perhaps where a closely held corporation dissolves and the business is carried on by a partnership, the partners want deductions, credits, and allowances an individual gets that a corporation doesn't, and so avoid a tax. This is a method of excess-profits tax avoidance of the widest use, and the language of the statute is so all inclusive and indefinite that it might cover it.

The proposed statute does no more than hint at the "tax umbrella racket." The committee report gives no details of the evils aimed at—not a single illustration; not a word is found on the subject in the 1,700 pages of the House Hearings. There is an elusive tax dodging rabbit the committee is after. But instead of accurately describing it, and giving the commissioner a suitable gun to go hunt it with, the committee gives the commissioner a 2-ton blockbuster, and says in effect: This had happened since October 8, 1940; drop this and kill everything since that date.

> Now go and smite Amalek, and utterly destroy all that they have, and spare them not; but slay both man and woman, infant and suckling, ox and sheep, camel and ass. (I. Samuel 15: 3.)

"Retroactivity." The section proposes to retrospectively affect all tax years after 1939—going back 4 years.

Retroactive taxation has been generally condemned by courts and political leaders. Business was assured that the current tax bill would not be retroactive. Representative Doughton and Senator George were quoted June 16, 1943, in the New York Times, page 13, column 1, as follows:

Representative Doughton said:

> Every reasonable effort will be made to pass a new tax bill this year, the main provisions of which will be effective January 1, 1944.
>
> The conferees made it clear that there would be no more retroactive taxes, although Senator George explained that this did not rule out the possibility that increases in selected excises might not be made effective on date of the bill's final approval, if that is before January 1.

The avoidance of taxes is a perfectly natural and universal aim. Poor Richard would say if here today: "A tax penny avoided is a penny saved." Why should such a heavy and unfair hand now be laid on lawful avoidance?

Means of tax avoidance have been availed of immemorially. When a method of avoidance becomes serious Congress plugs the loophole, and properly so in its discretion. But I recall no instance in tax legislation

when the statute has reached back for 4 taxable years. Illustrations of prospective plugging are innumerable. The Supreme Court in the *Field case* held that property passing under a power of appointment was not part of the appointor's estate. You plugged that prospectively. You disallowed interest payments on a loan to buy paid-up life insurance—but the disallowance was not retroactive. Last year you plugged many loopholes prospectively—you taxed property, subject to a general, but unexercised, power—but you gave the taxpayer a chance to get out from under—you did not even plug immediately.

Many very gross injustices would result from the retroactive feature of this bill. The rules under which losses could be taken, loss carry-overs enjoyed, excess profits calculated, and credit carry-overs had, were all drawn by the Congress, with the most expert assistance obtainable. Where these rules have been followed without fraud or chicanery, it is, I submit, nothing short of a fraud on the taxpayer to retroactively amend the rule, and to visit a terrible tax penalty on one who violated this retroactively, in complete ignorance and innocence of any violation.

In the seventh inning of a game you are changing the rules to knock out a home run that was legal when made in the third inning. In the eleventh round you are changing the rules to make a good blow in the fifth a foul. Congress made the rules, and if the taxpayer has abided by them in good faith, why penalize him?

SUGGESTED SECTION

The Ways and Means Committee refers to "devices which have come to our attention." What they are the committee does not detail. One hesitates to attempt to draft a substitute without having before him the information the Ways and Means Committee had. Perhaps the following would do the job, and avoid what are conceived to be grave objections to the present draft.

SEC. 115. ACQUISITION MADE AND AVAILED OF TO AVOID INCOME OR EXCESS PROFITS TAX—

IN GENERAL.—Chapter 1 is amended by inserting after Sec. 128 the following new section:

SEC. 129. ACQUISITION MADE AND AVAILED OF TO AVOID INCOME OR EXCESS PROFITS TAX.

(a) If a person or persons after November 18, 1943 acquire directly or indirectly any property (other than stock in a corporation), or all the outstanding stock of a corporation, and the principal purpose for which it is acquired and availed of, is the avoidance of Federal Income or Excess-Profits Tax by securing the benefit of a deduction, credit, or allowance, then such credit, deduction, or allowance shall be disallowed to the extent that it reduces Federal Income or Excess-Profits Taxes.

(b) If less than all of the outstanding stock of a corporation is acquired by a person or persons after November 18, 1943, and the principal purpose for which such stock was acquired, and the principal purpose for which it is availed of thereafter is the avoidance of Federal Income or Excess-Profits Taxes thru the securing of some deduction, credit, or allowance, then such deduction credit, or allowance shall be reduced in the same proportion as the stock so acquired bears to the total outstanding stock on that date.

(c) If there were at the time of acquisition of such property or of such stock, a substantial business reason therefor other than the securing of such credit, deduction, or allowance; or if there is some substantial business reason thereafter for the transaction or continuance of ownership or condition out of which flows such deduction, credit, or allowance, then this section shall not be applicable.

(d) Taxable years to which applicable. The amendments made by this section shall be effective for all taxable years beginning after November 30, 1943.

Senator JOHNSON. Under that principle you could not avail yourself of any relief of any kind?
Mr. HANSELL. As now drawn?
Senator JOHNSON. Yes.
Mr. HANSELL. Yes, sir. That is exactly the point, sir.
It is so broad and so all-inclusive that it covers everything.
Senator WALSH. Thank you, sir.
Mr. Voorhees.

STATEMENT OF ENDERS M. VOORHEES, CHAIRMAN, FINANCE COMMITTEE, UNITED STATES STEEL CORPORATION

Senator WALSH. Mr. Voorhees, you are representing the United States Steel Corporation?
Mr. VOORHEES. Yes, Mr. Chairman.
Senator WALSH. Are you an officer of that corporation?
Mr. VOORHEES. I am, sir. I am chairman of the finance committee.
Senator WALSH. You want to be heard on the bill in general?
Mr. VOORHEES. In general, yes, sir.
Senator WALSH. You may proceed.
Mr. VOORHEES. As chairman of the finance committee of United States Steel Corporation, I am not here to seek any special advantages or privileges for that corporation. I am here to suggest to you that it is to the advantage of all of us to shape national tax and financial policies so that all of us will be able to do our full part in rebuilding the Nation after the war. I shall use the records of United States Steel because those are the records I know. And, although I shall confine myself exclusively to the facts of United States Steel, I believe that what I have to say applies substantially to all corporate business whether large or small.

We in the management of United States Steel know only too well that the tremendous efforts and wastes of war cannot and should not leave any of us unscathed. We are not projecting any plans on the idea that United States Steel is coming out of this war stronger than when it went in. Our production record since 1940 entitles me to say, I believe, that United States Steel has proved itself a great national asset ever since its formation, by reason of its ability to furnish the most important of our basic materials in vast quantities when and where needed, and that it has been one of the great factors in raising the American standard of living.

I shall direct your attention to two main points: First, to the growing tendency to confuse costs and income and to tax as income what are really costs, and, second, to the imminent danger that the upsurge of certain Government-controlled costs pressing against Government-controlled prices will defeat the tax system. In either or both events, the result is a levy on the tools of production and exchange—call it a capital levy if you like—which will render not only United States Steel but all other business enterprises helpless to produce more and better goods in the years to come.

This matter of producing more and better goods goes to the very heart of our national life and intimately concerns all of us. "More and better" has lost face in recent years as being just a sounding off. But there is a deeper meaning which goes to the spirit of America, for the opposite of "more and better" is "less and worse." U. S. Steel can exist only as it promotes the production of more and better goods for the

customer. U. S. Steel is, broadly, only a consolidation or gathering together of the tools of production and exchange. By tools of production I mean manufacturing plants, mines, railways, steamships, warehouses, and the like, and by tools of exchange I mean such things as stocks of goods needed to make the exchanges. These tools of production and exchange, sometimes called capital, are used by U. S. Steel in a cooperative effort to do more and to do it better than could the individual. That is why U. S. Steel came into being. That is the reason for its continued existence.

I am emphasizing this point, and in a moment I shall present the record to prove that I state the facts, because of a growing thought or attitude that a corporation is a thing of itself and even a system of power, and therefore can be charged with certain responsibilities which in fact are not within its ability to discharge. The plain truth is that neither U. S. Steel nor any other business corporation has any mystical power to operate and to hire men if it has no customers, nor any mystical power to turn out first-class, well-priced goods with worn-out tools or against costs beyond the control of management. This truth ought to be obvious, but apparently it is not so to at least a part of our people, who hold the notion that a corporation has within itself the independent economic power to dictate price, quality, and quantity to the customer and therefore the power to pay taxes, wages, and other cost without limit.

U. S. Steel for some years has tried to show exactly how it functions. You will find attached to the statement which has been handed to you and marked "Exhibit A," a summary of the account which we used in our report for the year 1942. (In the annual report, at page 24, you will find the whole history of U. S. Steel told in the same terms.)

You will note that the summary shown in exhibit A answers the question—"What did you do with the money we paid you?" You will also note that the account does not contain such words as "net income," "profits," and "surplus," and that there are no subheads such as "profits before taxes." We hold that such terms and practices are inaccurate. We all know that a business never comes to a dead stop except at the dissolution and therefore the figures designated as "net income" and as "profit" are not terminal figures, but merely estimates. We hold that there can be only one kind of income and that is the figure obtained by subtracting all the costs from all the receipts from customers. It is confusing to insert subtotals. All the costs within a fiscal year cannot be determined during the year. If corporate managers take a period as closed and declare dividends on the results, or if taxing authorities take the period as closed and tax on the results, it may come about, through the emergence of costs after the fiscal period, that the managers have been declaring dividends and the authorities have been taxing on what were really costs disguised as income.

The first cost element shown in exhibit A comprises wages, salaries, social-security taxes, and pensions. In our presentation—as distinguished from the usual accounting statement where such an item is not shown—we have grouped these important costs together.

The next item, Purchased Products and Services, is self-explanatory and so should be the following item—Wear and usage. The cost of wear and usage in production is inescapable and the amount provided is based on engineering fact. Yet this cost has been violently objected

to by many in and out of the Government for a number of years. Depreciation, depletion, and obsolescence of the tools of production seem to be the first topic for attack when anyone wants to make it appear that more money has been earned than has been stated. Some have even become so confused that they have claimed that these elements are no part of cost at all and that they should be ignored. Wear and usage must be presented for what it is—the cost of the wearing out of the tools of production used by the workers.

The next cost element is one about which general misunderstanding exists. The additional cost caused by war represents management's estimate of the cash expenditures which, because of the high rate of operations, must be deferred until a future time and which will be spent or provided for in the transition to a peacetime basis at the end of the war. It includes deferred maintenance and repairs, reconverting and relocating facilities from wartime to peacetime use, costs arising out of reemployment of returning servicemen and retraining them to new skills, losses on raw materials and supplies not needed in the post-war period, and other similar costs. There is nothing contingent about such costs; they are a vital part of present costs. They are analogous to the cost of transporting soldiers home, which, even though paid out after the war is won, is nevertheless a cost incurred in its winning, and is thus assignable to nothing else than the war. These are the kinds of costs which I had in mind when I spoke of confusing costs with income and taxing costs as though they were income.

Interest, also shown, is definitely one of those costs which are inescapable—assuming the use of any borrowed funds for the purpose of providing the tools of production for the use of workers.

The next element of cost is taxes. There are many in our Government who consider that taxes are not a true cost. But the real fact is that taxes are as inescapable as any other item of cost and they cannot be ignored by management in the conduct of the business or the formulation of policy. If the exchange of goods and services, tax costs—as in the long run all other costs—are paid by the customer.

The sum left over after meeting all costs is paid in part to the owners, as wages for the use of the tools, and in part is carried forward for future needs of the enterprise. It is obvious that there must be a return over the years to the owners sufficient to induce them to furnish future tools. And without the tools which, because of their cost, only the pooled savings of many owners can furnish, the worker would be nearly helpless, for it is the provision of tools that has caused the advance in our living standards. The human being is no stronger than he was a century ago when, as in the Orient today, he had to struggle from early morning until late at night for a mere sustenance. I shall return to this point later.

The sum carried forward for future needs is in the nature of insurance which is as important to the security of the workers and the publid as it is to the owners, for it must stand the losses during the periods of bad business, the drastic changes in machinery demanded by scientific progress, the payment of long-term debt and other obligations, as well as the meeting of emergencies which are bound to occur but which cannot always be foreseen.

These emergencies are of many kinds. And not the least of them are those brought about by wide fluctuation in the volume of our

business. For instance, in 1929 customers bought from us goods in the sum of more than a billion dollars. In 1932, they bought from us only a little more than a quarter of this amount, or $288 million. We in the management cannot base our future plans on the thesis that some bright sprite or bevy of sprites is about to invent a mechanism certain to regulate customers and prevent fluctuations. Planning on the basis of theory is not a substitute for preparing on the basis of experience. We in management know only too well that a full order book must bear the costs of a lean order book. Depression losses are boom costs.

It is evident from this analysis that U. S. Steel is a cooperative effort to provide and to use a collection of tools for production and exchange. The nature and efficiency of tools and the manner of their use by men determine the scale of our national living. I shall now show what the tools of U. S. Steel have meant to the progress of this Nation. I shall reveal to you in bare figures what to me is an amazing story of human gains. The figures are in men, in tons, and in hours; the gains are in living, in freedom, and in the power to defend them. Take exhibit B. It gives the reason for our material progress, the point to which I said I would return. It is a truism, but it needs repeating, that a nation can grow wealthy only as its per capita production increases.

Let us compare the record of 1942 with that of the first full year of operation—1902. In both years the tools supplied by the owners were used to capacity. Any percentage increase in tons of finished steel purchased by customers is an understatement because tons cannot measure the vast improvement in steel or the fabrication of those products which are not sold on a tonnage basis.

Tons of steel bought by customers	Increased 131 percent
Tools provided by the owners	Increased 153 percent
Number of workers	Increased 100 percent
Total hours worked by all employees	Increased 13 percent
Pounds of steel per hour worked	Increased 104 percent

Take the figures another way. By the use of tools, a man's work for an hour in 1902 resulted in 29.7 pounds of steel. By 1942, the tools had so improved that the hour of work resulted in 60.6 pounds of steel. The hours worked in 1942, with the tools of 1902, would have resulted in 10.1 million tons. The actual shipments in 1942 were 20.6 million tons.

That, gentlemen, is the record of United States Steel under the system we now have. I for one would not want to scrap this system before it was certain that we had a better one. Our system depends upon the voluntary supplying of the tools of production and exchange, their voluntary cooperative use and the voluntary purchase by customers of products and services.

The tools can come from only three sources—from "Wear and usage," from "Carried forward for future needs," and from "Funds from new owners." "Wear and usage" contemplates the replacement of tools as they wear out. "Carried forward for future needs" can be used for the purchase of new tools and is the measure of a corporation's ability to continue to produce more and better goods. The willingness of new owners to risk their money for new tools depends upon the return being made on the old money already in the tools. Keeping the tools intact and keeping open the money sources are of

supreme importance if our Nation is to maintain a productive and progressive economy.

Let us see what is happening right now. In comparing the first 9 months of 1943 with the first 9 months of 1942, on the same basis, you will note from exhibit C that we received in 1943 from the customer $1,447,000,000, an increase of $67,000,000 over 1942. But wages, salaries, social-security taxes, and pensions increased $100,000,000. Purchased goods and services and wear and usage increased by $29,000,000 and $9,000,000 respectively. Federal taxes on income decreased $53,000,000 and the amount for owners and carried forward for future needs declined $13,000,000.

The decline in Federal tax revenues from U. S. Steel means that Government, to collect as much tax money, must turn to some other point in the economy. In a wartime economy, the controls imposed by Government affect the normal relationship by shifting the cost from one group to another. Our record shows that, with fixed prices and rising wage costs, Government revenues from corporation taxes decline and must be recouped by additional taxes on the public generally, or by liquidating the return to owners. Fixed selling prices mean that costs push one another around inside enterprise, with a resulting squeeze first upon the owners, then upon Government, and, finally, upon the workers and the whole public.

The total of all costs—wages, purchased goods and services, wear and usage, additional war costs, interest and taxes—leaves an income of but $50,000,000 from the $1,447,000,000 of customers' purchases in the first 9 months of 1943. This income is subject to division—part to the owners as wages for the use of tools and part carried forward for future needs. Our cumulative preferred dividend costs $25,000,000 a year. The amount of the common dividend is the same as that paid since 1940, and, except for the payment of $1 in 1937, no payments were made in the 8 years 1932–39 inclusive. The total available for future needs for the 9 months of 1943 is about $5,000,000. This sum is equal to about 2 days of U. S. Steel's current pay roll.

The presentation of U. S. Steel's record in cost elements common to every business makes wholly apparent the small discretionary power the managers now have with respect to major costs, and reveals that certain kinds of demands on U. S. Steel may not be demands on the corporation at all, but actually demands upon the customer. For instance, if the customer does not pay a price covering all costs, industry loses the power to sustain itself. If the economies of more efficient production are absorbed by certain groups, the public does not benefit from improvements and inventions and the general exchange of goods and services is impeded.

The trends exhibited in the 1942–43 comparisons are even more marked if we compare the current cost rates with those of a prewar year, such as 1940. Here is what we find with respect to major items:

Customers' purchase	Increased 86 percent
Wages for workers	Increased 102 percent
Federal taxes on income	Increased 292 percent
Owners' wages for use of tools	did not increase
Carried forward for future needs	decreased 86 percent.

We do not know what orders may be issued in the future by various Government agencies with respect to products, prices, and wages and,

of course, we do not know when the war will end. But it can be noted that wage-rate increases for coal miners are under discussion and that demands are being formulated for increases in steel wages.

Even a small increase in wages would not only reduce the payments to owners or carried forward for future needs, or both, but also would make operative the carry-back provision of section 710 (c) of the Revenue Act of 1942. A substantial increase in wages would in effect put the tax mechanism in reverse and the Federal Government would pay back to U. S. Steel more than it collected from it. Thus the wisely enacted provision of Congress to offset in part post-war losses would become the means of paying wartime wage increases, and in the process U. S. Steel, although operating at capacity, would be squeezed dry and picked clean.

With these facts before you, may I again say, with all the emphasis I can command, that there cannot be an economy in which ends do not have to meet, and in our fluctuating economy they can only meet through that which is carried forward for future needs and through the willingness of owners to provide tools in the hope of being paid for their use.

(Mr. Voorhees submitted the following exhibits:)

EXHIBIT A

United States Steel's sales and costs, year 1942

	1942
Customers' purchases	$1,885,951,692
Costs:	
Wages, salaries, social-security taxes, and pensions	782,661,701
Purchased products and services	648,401,843
Wear and usage	128,161,580
Estimated additional war costs	25,000,000
Interest	6,153,892
State, local, and miscellaneous taxes	48,255,157
Estimated Federal taxes on income	155,500,000
Total	1,794,133,123
Income	71,818,569
Dividends:	
On cumulative preferred stock	25,219,677
On common stock	34,813,008
Carried forward for future needs	11,785,884

EXHIBIT B

Tools and progress, United States Steel's record

Items	Amount		Percent increase
	1902 (first year)	1942 (latest year)	
Tons of steel bought by customers	8,912,906	20,615,137	131
Tools provided by owners	$689,259,777	$1,740,709,564	153
Number of workers	168,127	335,866	100
Total hours worked	390,774,451	690,115,109	13
Pounds of steel per hour of work	29.72	60.62	104

United States Steel's sales and costs, 9 months of 1943 and 1942

	9 months [1]		1943 change from 1942
	1943	1942	
Customers' purchases	$1,446,647,855	$1,379,168,145	$67,479,710
Costs:			
Wages, salaries, social security taxes, and pensions	671,332,660	571,668,720	99,663,940
Purchased products and services	463,360,916	467,514,543	-28,875,368
Wear and usage	94,762,728	85,760,004	9,002,724
Estimated additional war costs	18,000,000	18,000,000	
Interest	5,083,118	4,388,601	694,517
State, local, and miscellaneous taxes	31,325,284	26,132,695	-4,807,411
Estimated Federal taxes on income	79,800,000	132,300,000	-52,800,000
Total	1,396,364,706	1,315,764,563	80,630,133
Income	50,283,649	63,403,577	-13,150,928
Dividends:			
On cumulative preferred stock	18,914,787	18,914,787	None
On common stock	26,100,755	26,100,755	None
Carried forward for future needs	5,228,136	18,387,064	-13,150,928

[1] Both periods adjusted to same basis.

Senator WALSH. What is the concrete suggestion that you have to make?

Mr. VOORHEES. The concrete suggestion I have to make is that with respect to our taxes at the present time any further increase in corporate taxes will decrease our ability to carry on through the period of the future, based on the fact that insofar as costs are concerned, the costs of a properous period must carry the losses of the depression period. For example, Mr. Chairman, let us take the depression of 1932, or the period of that depression. During that period the circulating tools of U. S. Steel, commonly called working capital, decreased $275,000,000. The profits of the prosperous periods before that had to be called on to that extent. I do not know of anything that we have seen with respect to the present or the past that leads me to believe that the future is very much different than the past.

Senator WALSH. So you think it is an opportunity to build up a surplus?

Mr. VOORHEES. Absolutely.

Senator WALSH. Your principal customer, perhaps your sole customer, is the United States Government now?

Mr. VOORHEES. Yes.

Senator WALSH. The sole customer?

Mr. VOORHEES. I wouldn't say the sole customer, I would say very nearly the sole customer, yes.

Senator WALSH. So, the United States Government is really paying the taxes.

Mr. VOORHEES. But they have to take the taxes from somebody before they can pay them.

Senator WALSH. It comes out of the United States?

Mr. VOORHEES. It comes out of the public, sir.

Senator WALSH. It comes out of the United States Treasury?

Mr. VOORHEES. Yes, sir, or the public.

Senator WALSH. We appreciate having your views.

Mr. VOORHEES. Thank you, sir.

Senator WALSH. Now, Mr. Wolfe.

Is there anybody on this list of witnesses who would like only a minute or two to present a brief?

(No response.)

Senator WALSH. Well, Mr. Wolfe, come forward.

Mr. WOLFE. Mr. Chairman, since I would like about a half an hour, I would willingly wait until the first thing after lunch.

Senator WALSH. That is very kind of you.

Mr. Chapman.

STATEMENT OF A. B. CHAPMAN, CONTROLLERS INSTITUTE

Senator WALSH. Mr. Chapman, you represent the Controllers Institute?

Mr. CHAPMAN. That is right.

Senator WALSH. You object to the invested capital rate?

Mr. CHAPMAN. Yes, sir.

Incidentally, Mr. Chairman, I wish my acquaintanceship with this committee were on as informal a basis as I was listed on the calendar before it was corrected.

In view of the short time available, I would be very glad to submit for the record the institute's prepared statement.

Senator WALSH. Very good.

Mr. CHAPMAN. It contains a number of recommendations with respect to changes that should be made in existing law in order to eliminate the continuing errors and inequities and discriminations. I shall merely address myself for a few moments to the two objections which the institute has with respect to the House bill.

Their first objection is to section 205, which, as you know, proposes a further reduction in the invested capital credit. I think the committee is aware of the fact that this credit has suffered a progressive deterioration since the 1940 act. Originally the rate was a flat 8 percent on invested capital. Then in the 1941 act the rate was reduced to 7 percent on all invested capital over $5,000,000. The second step was taken in the 1942 act in which the rate was reduced to 7 percent on only the second $5,000,000 of invested capital, 6 percent on the next $190,000,000, and only 5 percent on all over $200,000,000.

The committee reports on the 1942 bill do not give the justification for this final reduction, but an examination of the hearings will indicate that it apparently was made on the basis of a representation by either the Treasury or the joint committee that certain general statistics indicated that these larger invested capital heavy industrial corporations are incapable of making in normal peacetimes more than 4 or 5 percent, or I think they even suggested 3 percent on their invested capital. These statistics have never been made available. I do not think they were included in the hearings, although I think one of the members of the committee suggested that they should be.

I do not know how the results could have been obtained, unless the figures were based perhaps on earnings during the base period, 1936 to 1939, which was a period of subnormal earnings of these heavy industries, or perhaps were based on an average over a period of years, taking into consideration the losses during the depression years, or perhaps they may have been determined by computing earnings after taxes, which is of course the incorrect method of determining earnings or computing invested capital.

In any event, it is the institute's firm conviction that these heavy industrial corporations have clearly established their ability in prior peacetime periods of normalcy to make more than 5, 6, or 7 percent

on their invested capital, and consequently the rate that now prevails in the 1942 act fails to give these corporations a fair return.

The justification given in the House committee report for this additional reduction to 6, 5, and 4 percent on everything over $200,000,000 is that there is a discrepancy between the income credit and invested capital credit in the sense that earnings since 1939 are allowed to be added to the invested capital computation, but they are not added to the income credit computation.

Senator WALSH. What does the Controllers Institute consist of?

Mr. CHAPMAN. The Controllers Institute consists of the controllers of the various corporations throughout the country. I think the controllers of some 1,800 or more corporations are represented.

The institute would point out that this justification in the House bill is untenable, for two reasons:

In the first place, if this were a discrepancy between the two credits, that correction should be made, for it is perfectly obvious that the simple method of correcting it would be to eliminate from the invested capital computation earnings accumulated since 1939. This would produce a result substantially different from the reduction of the rates on the entire invested capital. At any rate, you cannot line up the two credits by making them similar in all respects.

Furthermore, the invested capital corporations do not get any adjustments by reason of bad years in the base period. The two credits are entirely different, and the institute is convinced that at the present time the rates allowed on invested capital are too low to protect normal earnings, and certainly no further reduction should be made.

The second objection that the institute has is to section 115. I know that the committee has just recently heard from a witness from Georgia who, I think, quite clearly pointed out the fault with section 115, which is that it casts doubts and uncertainties upon perfectly sound and legitimate business activities and transactions, and the draftsmen of the section have failed to limit it in its scope so that it will apply solely and properly to tax-evasion devices that have become more common than we would like to see, in efforts to escape the excess profits tax.

I think I would conclude, from an examination of the calendar, that there have been a number of witnesses appearing before this committee objecting to both section 205 and section 115, and the institute urges that this committee may see fit to eliminate section 205 and to at least insist upon a revision of section 115 that will cut it down to a proper size.

Thank you.

(The brief submitted is as follows:)

BRIEF OF CONTROLLERS INSTITUTE OF AMERICA SUGGESTED AMENDMENTS TO THE INTERNAL REVENUE CODE

INTRODUCTION

The members of the Controllers Institute are ever mindful of the urgent necessity that every dollar of income possible be made available to the National Government in time of war. The easiest answer would be, "Take everything." It is obvious that is not the correct answer, and also that any qualification results in less immediate revenue to the Government.

The very high rates in effect in recent years have made all thinking men in this country aware of two facts about taxes above all. First, that there is a point in taxation beyond which the return to the Government costs the Nation too much;

in other words, such a policy quickly results in reducing the sources of earnings on which taxes may be imposed. The second is that the higher the rates, the more essential it is that the law eliminate inequities and inequalities.

It is the prerogative of Congress to determine whether the rates are already too high, or can be raised a bit more. This memorandum is addressed to those inequities in the present law and in H. R. 3687 which the high rates now in effect have magnified.

1. PROPOSED REDUCTION IN EXCESS-PROFITS CREDIT BASED ON INVESTED CAPITAL

The Institute is unqualifiedly opposed to the reduction in the excess-profits credit based on the invested capital proposed by section 205 of H. R. 3687. Such reduction is shown by the following table:

	H. R. 3687 present	Existing law present
First $5,000,000 invested capital	8	8
$5,000,000 to $10,000,000 invested capital	6	7
$10,000,000 to $200,000,000 invested capital	5	6
Over $200,000,000 invested capital	4	5

The reason given on page 23 of the House Ways and Means Committee report on H. R. 3687 for these reductions in the invested capital credit is to compensate for what is asserted in the report to be an obvious advantage of the invested capital method over the average earnings method. This advantage is found in the fact that under existing law companies using the invested capital credit are permitted to include in their credit a percentage of earnings accumulated since January 1, 1940, whereas companies using the average earnings credit do not have this right.

As will be seen below, the reductions under H. R. 3687 in the invested capital credit percentages goes far beyond any such "equalization" purpose since they have the effect of depriving the taxpayer of not only the credit based on earnings accumulated since January 1, 1940, but also of a very substantial part of its credit based on invested capital at January 1, 1940.

The effect of the proposed reduction in the invested capital credit is shown in the following tabulation:

Invested capital at Jan. 1, 1940	Reduction under H. R. 3687 in excess-profits credit	Equivalent reduction in invested capital under present law	
		Amount	Percentage of invested capital
$10,000,000	$50,000	$833,333	8.3
$50,000,000	450,000	7,500,000	15.
$100,000,000	950,000	15,833,000	15.8
$200,000,000	1,950,000	33,000,000	16.5
$300,000,000	2,950,000	58,000,000	19.7
$500,000,000	4,950,000	99,000,000	19.8

The following illustration is submitted to prove the improbability of the accumulation of earnings since January 1, 1940, in any such amount as the equivalent reduction in invested capital shown in the foregoing tabulation:

1. Invested capital		$200,000,000
2. Excess-profits under present law		12,150,000
3. Assumed net income for tax purposes (high income assumed to emphasize the point under discussion)		40,000,000
4. Amount subject to excess-profits tax		27,850,000
5. Normal and surtax on item 2 at 40 percent		4,860,000
6. Excess-profits tax at 90 percent on item 4	$25,065,000	
Less: Post-war 10 percent refund	2,507,000	
Balance		22,558,000
7. Total normal tax, surtax, and excess-profits tax		27,418,000
8. Net income remaining after taxes		12,582,000
9. Assumed dividend, 70 percent		8,807,000
10. Accumulated earnings for year		3,775,000
11. Ratio of accumulated earnings for 1 year to invested capital, percent		1.9
12. Effective reduction in invested capital credit under H. R. 3687, percent		19.5

Aside from the foregoing discrepancy between the proposed reduction and the stated justification therefor, the Institute is opposed to any further reduction in the invested capital credit and is, in fact, convinced that the reduction which occurred in the 1942 act was wholly unwarranted. It is submitted that a halt must be drawn to any further deterioration of the invested capital credit—which has been progressive since the Second Revenue Act of 1940. The reductions in the credit which have already occurred have had the result of subjecting normal profits to the excess-profits tax, and have been made in a manner that has created a severe discrimination against the larger corporations in the heavy industries field.

The Second Revenue Act of 1940 provided a credit of 8 percent on all invested capital. The first step away from equality was taken in the Revenue Act of 1941, in which the rate was reduced to 7 percent on all invested capital over $5,000,000. The second step was taken in the 1942 Act, in which the rate was reduced to 7 percent on only the second $5,000,000 of invested capital, 6 percent on the next $190,000,000 and only 5 percent on all over $200,000,000. The Institute's opinion that the 1942 reduction has already prevented the invested capital credit from affording the larger corporations protection from excess profits tax on normal earnings is based upon its conviction that such corporations, in prior periods of normalcy, have demonstrated their ability to earn more than 5 percent, 6 percent, or even 7 percent on their invested capital before taxes. The proposed further reduction goes so far in the wrong direction that the resulting effect upon the war effort and the ability of the larger corporations to meet the requirements of the post-war period becomes extremely serious.

The equalization theory for the proposed reduction is untenable—even if the reduction took the form of eliminating the earnings accumulated since 1939 rather than a further reduction in rates.

The average earnings credit and the invested capital credit are entirely different types of measures of normal earnings. If such a theory were to be followed, a true equalization of the two credits would require numerous changes, including, in the case of the invested capital credit, the removal of discrimination against the larger corporations and elimination of the effect of the depression years on their earnings accumulated prior to 1940. It is, of course, true that the accumulated earnings since 1939 have not been subjected to individual surtax, but the same is also true with respect to the accumulations prior to that date. There is no more justification for eliminating the accumulations since 1939 than there is for eliminating all accumulations from the invested capital credit, leaving the taxpayer with merely the properties originally paid in to the corporation. Certainly no taxpayer dares run the risk of section 102 solely for the purpose of using post-1939 earnings as a basis for invested capital credit.

The Institute recommends that the only change that should be made in the invested capital credit, is the elimination of the reductions in the credit that occurred in the 1942 act.

II. PREVENTION OF TAX-DODGING PRACTICES

Section 115 of H. R. 3687 provides in part as follows:

"If any person or persons acquires, on or after October 8, 1940, directly or indirectly, an interest in, or control of, a corporation, or property, and the Commissioner finds that one of the principal purposes for which such acquisition was made or availed of is the avoidance of Federal income or excess-profits tax by securing the benefit of a deduction, credit, or other allowance, then such deduction, credit, or other allowance shall not be allowed."

The House report indicates that this provision has been inserted for the purpose of protecting honest taxpayers from being discriminated against in favor of tax dodgers employing the practice of purchasing corporations "with current, past, or prospective losses, deficits, or large current or unused excess-profits credits for the purpose of reducing excess profits and income taxes."

The Institute is fully in accord with any effort to block tax-dodging practices and is in sympathy with the aim of protecting the honest taxpayer from the discrimination which results from the successful use of such practices by competitors. However, it submits that section 115 of the bill as now drafted is much too broad in its scope, and will have the effect of casting doubts and uncertainties upon legitimate business transactions. To this extent the provisions will defeat its own purpose. It is to be noted that the section as presently draftd disqualifies any acquisition of any interest in or control of a corporation or property if one of the principal purposes of such acquisition is the avoidance of tax by securing the benefit of a "deduction, credit, or other allowance."

Congress is well aware of the fact that with tax rates at their present levels substantially all legitimate busines stransactions require consideration of the tax consequences and such tax consequences frequently become one of the principal considerations. For example, no corporation will undertake the task of developing a new enterprise, or rejuvenating an old enterprise, into a profitable operation unless it is entitled to deduct the expenses incurred in connection therewith. Corporations which have had successful operations in the past may, perhaps on account of the war, be required to venture into new fields in order to continue to make profits. Their past record of normal earnings may represent a fair measure of the normal earnings that they should be permitted to earn from the new venture free of excess-profits tax.

A corporate enterprise with a complicated corporate structure may find it desirable to liquidate subsidiaries into the parent company in order that the unfavorable operations of one portion of the enterprise may be reflected against the favorable operations of another portion without paying the penalties of accomplishing this result through consolidated returns. On the other hand, a corporation owning the bulk of the stock of another corporation may acquire the remainder for fair value in order to effect an affiliation for consolidated returns purposes.

These are only a few of the illustrations that might be given of bona fide business transactions which would be put in jeopardy if section 115 is enacted into law in its present form. It should be remembered that both the honest taxpayer and the Treasury enjoy considerable protection under existing law under the well-known doctrine of the *Gregory case* as it has been expanded by later decisions. The institute recommends that reliance be placed on such protection unless the drafting experts succeed in curtailing the scope of section 115 to avoid the undesirable consequences that have been suggested above in respect of legitimate business activity.

III. POST-WAR RESERVES

While the war is in progress the primary concern of Government and business is to secure the maximum production of goods and services essential to the war effort. It would be folly, however, to so concentrate upon the present that we disable ourselves from enjoying the future for which we now fight. The future is dependent upon a strong and healthy industrial system in this country able to provide employment for returned soldiers and released war workers and to provide goods and services for their needs.

It is recognized by everyone that industry cannot change over to peacetime pursuits without tremendous costs. It will also be costly to rehabilitate our industrial plants. In any sound accounting sense these are costs arising out of the war period. Unless business can retain sufficient funds out of present earnings to rehabilitate their plants, replace their inventories, embark on new ventures, a large number of potential employers of labor and payers of taxes will be forced out of business. Separation allowances, additional social-security costs due to loss in merit rating, deferred repairs and maintenance, closing of marginal plants, deferred stripping and development of mines, replacement of stock piles are all additional costs of the war period which are not recognized under the code at present. The Controllers Institute is particularly aware of the dangers and needs of this situation, because it is the controller's duty to analyze results and prepare for the future. This institute strongly recommends a provision in the tax law to allow industry to retain free of taxes a sufficient amount to assure this post-war health of industry. Our recommendations for such post-war reserve are:

1. Amount: 10 percent of taxable income retroactive to taxable years beginning after December 31, 1941. This percentage should be applied to war earnings and, hence, should be retroactive to taxable years beginning in 1942.

2. Limitations on use: We believe there should be no limitation on use because of the administrative difficulties in any limitation and because it is desirable to have no hindrance to the free use of such funds in the post-war period.

3. Investment of post-war reserves: The amount of the reserves shall be invested in noninterest bearing bonds, nonnegotiable until the end of the war, as declared by the President, to be redeemable within 3 years after the end of the war.

IV. TAX-BENEFIT RULE FOR DEPRECIATION

The recent 5 to 4 decision of the Supreme Court in *Virginia Hotel Corporation* v. *Helvering* (63 S. Ct., 1260 (1943)) has brought into sharp focus one way in which

the Bureau has used the so-called allowed or allowable rule to injure taxpayers. The rule as stated in code section 113 (b) (1) (B) provides that the basis of property shall be reduced by the amount "allowed (but not less than the amount allowable)" in prior years, and was intended to correct an alleged abuse after the enactment of the allowable rule in 1928 whereby taxpayers were said to have claimed less depreciation allowable in closed years than was allowed.

The Bureau has used the allowed or allowable rule far beyond its intended scope. In fact, it has even been used against taxpayers exactly as it was claimed taxpayers had misused the allowable rule against the Bureau. The first misuse is illustrated in the *Virginia Hotel Corporation case* referred to above. Here the taxpayer took an admittedly excessive amount of depreciation in a year in which no tax benefit resulted from the deduction. The Commissioner claimed that this depreciation was allowed although admittedly not allowable and must reduce the basis under code section 113 (b) (1) for gain or loss. The majority said this was correct statutory construction, but the minority disagreed both as to construction, consistency, and fair dealing.

A companion and extended administration misuse of this section arises through confusing the deduction for a particular year with the proper adjustment to basis, the latter being a cumulative calculation. Examples are given in regulation section 19.113 (b) (1)-1 and section 19.23 (l)-5 wherein the Bureau calculates the adjusted basis by reducing the basis each year by the greater of allowed or allowable depreciation, even though the cumulative allowable may be less than such amount, and despite the fact that in some years the amount allowed (i. e., deducted) was in excess of taxable income, and the return was not audited by the Bureau.

An even more pernicious misuse of this section is through assertions by the Commissioner in many cases that a greater amount was allowable than claimed by the taxpayer in past years, though not allowed. In these cases the Commissioner disregards the fact that the Bureau limited, approved, or reduced such past depreciation, and asserts that the taxpayer cannot rely on Bureau action but should have tested its rights to higher depreciation in the courts.

In all justice and fair dealing, such misuse of a loophole amendment should not be countenanced. A simple amendment will remedy the situation and preserve the intended loophole purpose.

"(a) The portion of subparagraph (B) of section 113 (b) (1) preceding the first period shall be amended to read as follows:

> "(B) In respect of the period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization and depletion. The amount of the adjustment shall be the aggregate of the deductions on such account theretofore taken which resulted in a reduction of the taxpayer's tax, but not less than the aggregate of the deductions theretofore allowable, any prior final determination by the Commissioner of the amount of the deduction allowable for any earlier period being conclusive.

"(b) The amendments made by this section shall be applicable with respect to taxable years beginning after December 31, 1938.

"(c) For the purposes of the Revenue Act of 1938 or any prior revenue act the amendments made to the Internal Revenue Code by subsection (a) of this section shall be effective as if they were a part of each such revenue act on the date of its enactment."

It was claimed in 1928 that the allowed rule left a loophole which should be closed. This led to the substitution of "allowable" for "allowed." It can be seriously doubted that there was such a loophole. It must be admitted that depreciation can be taken only once, and once used up is gone forever. The purpose of the deduction is to return the capital investment without paying tax on the return of such capital. To the extent that depreciation does not offset taxable income, a tax is paid on return of capital. Hence, it should make no difference to the Government when depreciation is taken so long as it is taken but once against taxable income. The enactment of this desirable simplification could be effected by putting a period after the word "tax," above, in 113 (b) (1) (B) and eliminating the balance of (a).

V. INVOLUNTARY LIQUIDATION OF "LIFO" INVENTORIES

The Congress provided in the 1942 Revenue Act that inventories which were carried on the last-in, first-out basis could be replaced in subsequent years at basic inventory prices, if the liquidation during 1942 was through causes not within the control of the taxpayer. This was an equitable provision to keep pre-war increments from being realized and taxed at war rates.

It is a fact, however, that there was a great amount of involuntary liquidation of inventory during the year 1941 in the urgent defense program. Much of the war effort was actually started in 1940. This is evidenced by the fact that Internal Revenue Code, section 124, the amortization section, was originally effective from June 11, 1940, and was made retroactive in the Revenue Act of 1942 to January 1, 1940. The Institute recommends that the involuntary liquidation provisions be made retroactive to January 1, 1941. The suggested amendment to Internal Revenue Code, section 22 (d) (6) would merely consist of changing the date in the first sentence thereof from December 31, 1941, to December 31, 1940, and inserting immediately following the words "tax return for such year" the words "or before the expiration of 6 months after the date of the enactment of the Revenue Act of 1943, whichever is later."

VI. ACCELERATED DEPRECIATION AND OBSOLESCENCE

During the war and emergency periods since early 1940, most of industry has been operating at capacity, and in war industry in particular, greatly over what was considered normal capacity. Necessarily, industrial equipment has had its useful life greatly shortened. Repair parts and labor have not been available; repairs that had to be made were made with substitute materials and with inferior repair men; machines were forced to perform work for which they were not designed nor fitted; all equipment has worked long hours without time for proper repairs and maintenance; the acceleration of research plus the great amount of new plant and equipment installed has made a large part of the pre-1940 industrial equipment obsolete or inefficient for peacetime conditions. The provisions for depreciation and obsolescence in the Internal Revenue Code are general in character, but the administration of the law is such that proper recognition of the acceleration of depreciation and obsolescence is denied to practically all taxpayers.

The Controllers Institute recommends the addition to Internal Revenue Code, section 23 (1) immediately before the last paragraph thereof, the following:

"Proper recognition shal be given for variation in use of depreciable property and for changes in useful life because of changing economic conditions.

"For taxable years beginning after December 31, 1939, a taxpayer shall be entitled, at his option, to the following allowance in addition to normal depreciation for ordinary full-time usage:

"For usage 80 to 100 percent in excess of ordinary use, 25 percent.

"For usage 175 to 200 percent in excess of ordinary use, 50 percent.

VII. AMORTIZATION

Internal Revenue Code, section 124 makes no provision for emergency facilities retired before the end of the 5-year amortization period because of obsolescence, end of useful value, or wearing out. In many cases, such facilities have had to be replaced in order to continue war production. A provision should be added to Internal Revenue Code, section 124 (c) as follows:

"Where emergency facilities are retired or abandoned and are replaced by facilities similar in character or usefulness, the unamortized cost shall be deductible in the taxable year of such retirement or abandonment."

VIII. FOREIGN WAR LOSSES—RECOVERY IN EXCESS OF BASIS

Under Regulations 103, section 19.127 (C) 1 (added by T. D. 5258 April 13, 1943) treating with the recoveries of war losses included in gross income, taxpayers suffering war losses for which they have received tax benefits, must include and pay taxes on recoveries. The amount received in excess of the amount charged off is subject to the capital gains provision of the income-tax law. It is the feeling of the Institute that any gain over and above net amount written off and for which a tax benefit has been received by the taxpayer, unless represented by actual cash, should not be taxable to the taxpayer until such time as it actually disposes of the asset. This amendment is necessary in order to put the taxpayer in the same position as if the loss had not been sustained, in which event the unrealized appreciation would not have been taxed.

IX. CONSENTS EXTENDING STATUTE OF LIMITATIONS

The Revenue Act of 1942 provided that for taxable years beginning after 1942, if the taxpayer and the Commissioner had signed a consent extending the statute,

the statute of limitations would remain open for the taxpayer as long as the period of the consent plus 6 months. This is an administrative matter relieving both parties of much needless paper work and trouble. All taxpayers have 3 years after filing their return within which to file a claim for refund. Hence, all taxpayers have until approximately March 15, 1944, to file claims for refund for taxable years starting January 1, 1940. There is no sound reason, therefore, why the great helpfulness of the above-discussed provision should not be made retroactive to taxable years beginning on and after January 1, 1940.

X. INTEREST RATES ON DEFICIENCIES

Generally, the assessment of deficiencies in income tax or excess-profits tax is due to honest differences in opinion between the Commissioner of Internal Revenue and the taxpayer, and not to the desire of the taxpayer, in effect, to borrow money from the Government. Therefore, interest charged on deficiencies should represent solely a fair rate of compensation for the delayed payment of the funds, and not a penalty.

When the 6-percent interest rate on deficiencies and refunds was first established, it was fair in view of general interest rates then prevailing. However, in recent years, interest rates have been steadily declining, as evidenced by the lower interest rate paid on Federal and State obligations, corporate bonds, mortgages, and commercial loans. Under prevailing low interest rates which from present indications will continue for many years, the continuance of a 6-percent interest rate on deficiencies constitute the imposition of a penalty, in addition to interest, on taxpayers.

It is inevitable that many years of controversy and litigation will be required to clear up the complexities of the present tax act. Under these circumstances, the retention of the 6-percent interest rate on deficiencies will prove especially onerous.

It is recommended, therefore, that the rate of interest accrued after January 1, 1944, on deficiencies should not exceed 3 percent, and, when this is done, the rate of interest on refunds should be reduced accordingly.

XI. TAX PAYMENTS FOR NORMAL, SURTAX, AND EXCESS-PROFITS TAXES SHOULD BE CONSIDERED AS PAID ON ACCOUNT OF EITHER OR ALL

Under the Revenue Act of 1940, the income tax and surtax were allowed as deductions in determining income subject to excess-profits tax. The revenue act of 1941 made the excess-profits tax deductible in determining income subject to income tax and surtax. Under the Revenue Act of 1942, the income subject to excess-profits tax is allowed as a deduction in determining the income on which income tax and surtax is payable. Thus, while the income tax and surtax are imposed under chapter 1 of the Internal Revenue Code whereas the excess-profits tax is imposed under chapter 2 of the code, and the first two taxes are determined on Form 1120, whereas the excess-profits tax is computed on Form 1121, these three taxes are interdependent, one tax affecting the other.

The Tax Court of the United States has held that where the taxpayer appeals against the determination by the Commissioner of Internal Revenue of additional declared value excess-profits tax, the Court is not authorized to give effect in its decision to the overpayment of income tax resulting from the increased deduction for the declared value excess-profits tax. If the courts follow the same rationale in connection with the income tax and surtax and the excess-profits tax, the taxpayer will be required to pay more than the aggregate taxes due from it, unless it protects itself by filing a claim for refund for each tax separately.

Another example of the inequitable results from treating the income tax and surtax separately from the excess-profits tax, is the requirement to pay interest on any deficiency in the payment made on the basis of the tentative return, either on Form 1120 or Form 1121, as compared with the taxes shown in the completed respective returns. Numerous cases arise where the taxpayer underestimates excess-profits credit on a tentative return, thereby overpaying the excess-profits tax, which ordinarily creates an understatement of the income subject to income tax and surtax, and yet it cannot offset against this deficiency the overpayment with respect to excess-profits tax. Similarly, where the excess-profits credit has been overstated in the tentative return, the result is ordinarily that the excess-profits tax has been underpaid but the income tax and surtax has been overpaid, in the tentative return.

Accordingly, the Institute urges that the Internal Revenue Code be amended retroactively to 1940 to require combining the income tax, surtax, declared value excess-profits tax, and excess-profits tax for the purpose of adjusting these

taxes on the basis of tentative returns to the amounts shown for these taxes in the completed returns, and for the determination of deficiencies and refunds. Such an amendment would simplify the work of the Commissioner of Internal Revenue, the courts, and the taxpayer.

Excess Profits Tax

XII. DOMESTIC CORPORATIONS OPERATING ABROAD SHOULD NOT LOSE THEIR EXCESS-PROFITS EXEMPTION THROUGH JOINING A CONSOLIDATED RETURN

Under section 727 of the Internal Revenue Code, prior to its amendment by section 223 (a) of the Revenue Act of 1942, a domestic corporation with 95 percent of more of its gross income from foreign sources and 50 percent or more of it from active business was exempt, as it should be, from excess-profits tax. The Revenue Act of 1942, however, denied this exemption to a corporation otherwise qualified if such corporation becomes or is a member of an affiliated group of corporations filing consolidated returns under section 141 of the code. The reason for this exclusion apparently was solely an administrative one to make the income and excess profits tax consolidated groups identical.

It is submitted that the exercise of the tax consolidation privilege should not cause the loss of any exemption from excess profits or income tax otherwise enjoyed. The effect of the present provision might well be to cause the reincorporation in a foreign country of a business otherwise foreign except for its incorporation to the detriment of United States business. It reflects a qualification of the privilge granted by sections 141 and 730 of the code to file consolidated returns which is not warranted.

The Institute recommends that such corporations be eliminated from the consolidated return for excess-profits-tax purposes.

XIII. RESTRICTION OF SECTION 742 (F) (1) TO ADJUSTMENTS IN CASES OF DUPLICATION

Section 742 (f) (1) of supplement A under the income credit provides that where the stock of the component corporation has been acquired since December 31, 1935, for a consideration other than the issuance of the acquiring corporation's own stock, the base period experience of the component corporation prior to the date of acquisition of its stock by the acquiring corporation shall be excluded from the acquiring corporation's base period net income. Such exclusion shall be "in such amounts and in such manner as shall be determined in accordance with regulations prescribed by the Commissioner with the approval of the Secretary."

This section, which was new in the 1942 revision of supplement A, is obviously intended merely as a prohibition against a duplication in the acquiring corporation's base period net income. The opportunity for duplication arises only where the consideration other than stock paid by the acquiring corporation constituted an income-producing asset for the acquiring corporation prior to its exchange for the component corporation's stock.

It is submitted that, in the first place, the section is wrong in principle. The surviving enterprise reflects the component's business rather than the business which might have been carried on with the assets disposed of in consideration therefor. Therefore the correct method of adjustment would be to eliminate the base period experience of the acquiring corporation attributable to the consideration paid for the stock. However, if the method of adjustment now provided for in the section is to be continued, the Commissioner's regulations have disregarded the limited purpose of the section and require an automatic elimination of the component corporation's experience regardless of whether any duplication would otherwise exist in fact. The section obviously gives the Commissioner sufficient discretion to require no adjustment except in actual duplication cases. Since, however, the Commissioner has not restricted the adjustment requirement to such cases, Section 742 (f) (1) should be amended so as to provide specifically that taxpayers shall have the opportunity to establish that no duplication will result by including the component's base period experience.

XIV. FOREIGN-TAX CREDIT—INVESTED-CAPITAL COMPANIES

Foreign-tax credit, section 131: This credit against the United States tax for foreign taxes on income from foreign sources has long been on the statute books and was intended to eliminate duplicate taxation. Some revision of this section was necessitated by other unrelated amendments to the code under the 1942 Revenue Act. However, section 131 was altered in such a way that it brought

about an apparent unintended penalty, restriction, or rather limitation of the amount of foreign-tax credit. Various limitations are provided to guard against an excessive credit, the net effect of which is to limit the credit to no more than the effective rate of United States tax. Prior to the Revenue Act of 1942, the limitation under section 131 took the form of restricting the foreign-tax credit to the same proportion of the United States tax as the taxpayer's net income from foreign sources bore to its entire normal tax net income. Any unused portion of the foreign tax was then allowable as a credit against the excess-profits tax, the corresponding formula being the ratio formed by the taxpayer's excess-profits net income from foreign sources and the total excess-profits net income. As amended, the section now provides, in effect, that in computing the limitation of the foreign-tax credit, the normal-tax net income in the denominator of the limitation formula shall be increased by the amount of credit for adjusted excess-profits net income. Thus, the denominator becomes greater than the amount of income subject to the normal and surtax—resulting in a dilution of the foreign-tax credit for normal and surtax purposes. While this change effects other situations it is particularly burdensome to those taxpayers who use the invested capital basis for excess-profits-tax exemption and who have income by way of dividends from foreign sources. Obviously, for the purpose of the normal and surtax on such dividend income, the foreign-tax-credit formula should have as the numerator the amount of such foreign dividends and as the denominator the total income subject to normal and surtax only, whereas now the denominator includes also the excess-profits net income.

XV. CORRECTION OF BASIS ADJUSTMENT IN SECTION 720

Section 720, which prescribes the inadmissible asset ratio adjustment in computing invested capital, provides that for the purposes of that section the assets shall be taken into the computation at their adjusted basis for determining loss. As the section now stands, the adjustments to basis are apparently those prescribed by section 113 which are not the proper adjustments in computing earnings and profits for invested capital purposes. Rather, the adjustments should be those prescribed by section 115 (l) for determining earnings and profits for invested capital purposes. A similar flaw originally existed in section 718 (a) (2), but that section was corrected in the Revenue Act of 1942. The same correction should be made in section 720.

XVI. APPLICATION OF SECTION 718 (C) (5) TO REORGANIZATIONS

As a general rule a deficit in the taxpayer's earnings and profits does not impair its invested capital under the invested capital credit. Section 718 (c) (5), added by the 1942 act, gives recognition to the fact that this general rule should carry through in the case of a so-called identity reorganization so that the predecessor's deficit in earnings and profits shall not be reflected in a reduction in the invested capital of the successor. It is submitted that a consistent operation of the use of tax basis in lieu of cost in computing invested capital requires that section 718 (c) (5) be expanded so as to apply to reorganizations generally.

XVII. REVISION OF SECTION 761

Section 761, as added by the 1942 act, is a substitute for sections 718 (a) (5) and (b) (4) of the prior law. The section prescribes the adjustment to be made in the parent's invested capital upon a tax-free liquidation of a subsidiary. Where the stock of the subsidiary is held by the parent with a carry-over basis, the adjustment prescribed in section 761 is the same as that which was prescribed by sections 718 (a) (5) and (b) (4) except that where the adjustment is downward it may have the effect of reducing the parent's invested capital in an amount in excess of the accumulated earnings and profits of the parent. The limitation in the earlier provisions should be reinstated in order to produce a fair reflection of invested capital for the enterprise after the liquidation, at least in those cases where the subsidiary was originally created by the parent corporation and deficits have occurred in the operations of the subsidiary prior to liquidation. In such a case, the liquidation operates to produce the same result as if the operations of the subsidiary had been carried on from the outset by the parent. This is the correct result.

XVIII. CORRECTION OF SECTION 722 WITH RESPECT TO POST-BASE-PERIOD CHANGES IN CHARACTER OF BUSINESS

Section 722 should be clarified to eliminate any ambiguity as to the right of a taxpayer to establish eligibility under the section by reason of post-base-

period changes in the character of the taxpayer's business, in the case of a taxpayer in existence prior to January 1, 1940. This right is already specifically afforded to new corporations coming into existence since December 31, 1940, and unquestionably both the old and new corporations should be treated alike. Recognition of such changes as eligibility factors will not permit the inclusion of income realizable from war activity in its constructive base-period-net income since the taxpayer is automatically limited to the amount of income that the change would have produced during the base period. Although it is submitted that section 722 (b) (5), properly construed, should permit consideration of such possible base-period changes, section 722 should be revised to eliminate any uncertainty on this score.

XIX. BASE PERIOD ADJUSTMENT FOR PENSION TRUST DEDUCTIONS

Beginning with the Revenue Act of 1928, contributions by an employer to a pension trust which qualified under certain tests prescribed by the various revenue acts have been allowed as deductions. Prior to the adoption of the Revenue Act of 1942, contributions during the year covering pension liability applicable to prior years (accruals for past service of employees or accruals for pensions to be paid to employees retired in prior years) or for the purpose of placing the pension trust on a sound financial basis, were allowable as deductions in equal parts over the 10-year period commencing with the year contribution was made.

Thus, the portion of the contributions to pension trusts during the years 1928 to 1935, inclusive, which were allowable as deductions over a 10-year period, served to reduce the excess-profits net income for all or a part of the base period even though such expenses were not incurred in connection with the operations during this period. To the extent the taxpayer is allowed similar 10-percent deductions during the excess-profits year for contributions made to the trust in prior years, there is consistent treatment of this situation in the base period and in the excess-profits years. However, in those cases in which the deduction allowed for 1940 and subsequent years for pension contributions does not include any part of contributions in prior years, the use of the base-period income without elimination of the deductions allowed in that period of prior year pension trust contributions results in subjecting normal earnings to excess-profits tax.

For example, a corporation in existence for many years set up a pension trust during the year 1930 and its contributions to the trust in that year included the pension liability not only on wages and salaries paid during that year but also on the wages and salaries paid during prior years. Accordingly, the contribution during 1930 for past service was allowed as a deduction over the years 1930 to 1939. Thus, the income of each of the base period years was reduced by 10 percent of the 1930 contribution for past service plus the contribution for the current year while the contributions to the trust after 1939 covered the accrued liability on wages and salaries for the current year only.

In section 711 (b) of the Internal Revenue Code, Congress authorized adding back certain abnormal deductions in the base period, which otherwise would have distorted the determination of normal earnings. In order to remedy the inequitable situation described herein, it is urged that section 711 (b) be amended retroactively to the year 1940 to add back to base-period income the deductions allowed in that period for contributions to pension trust in prior years to the extent they exceed similar deferred pension deductions in the excess-profits tax year.

CAPITAL STOCK TAX

XX. THE CAPITAL STOCK AND DECLARED VALUE EXCESS PROFITS TAX SHOULD BE REPEALED

The capital stock tax and the related declared value excess profits tax should be abolished. The high rate of income and excess profits taxes has greatly weakened the effective yield of the capital-stock tax and thus there remains, even under today's need for revenue, little to commend the continuance of this guesswork tax.

The capital stock and declared value excess profits taxes are universally recognized as wrong in principle because they are predicated on the taxpayer's guesswork. In July of each year when capital stock tax returns are due, it is most difficult to attempt a forecast of earnings for the balance of the year in those cases where earnings fluctuate from month to month and where unpredictable capital gains are involved.

The abolition of these two taxes would be an important step in the simplification of the corporate tax structure, without substantial loss of revenue.

Senator WALSH. Benjamin Botwinick.

STATEMENT OF BENJAMIN BOTWINICK, REPRESENTING THE AMERICAN BUSINESS CONGRESS

Senator WALSH. You represent the American Business Congress?

Mr. BOTWINICK. That is correct, sir.

Senator WALSH. What is the American Business Congress?

Mr. BOTWINICK. The American Business Congress is a national organization of small businessmen and I am chairman of their tax committee. I am a certified public accountant in public practice in the State of New York. Besides, my wife and I control Acker, Merrall & Condit Co., a retail business organized in 1820.

We are submitting herewith a memorandum to you that covers our main recommendation—one that we regard as noncontroversial. Our recommendation has been partially met in the provision of the House bill which increases the corporate excess profits exemption from $5,000 to $10,000. We believe that corporations earning less than $25,000 per year should not be subject to the excess-profits tax.

We have a number of other proposals which we are going to forego presenting at this time because we are conscious of the fact that you are trying to get out a tax bill before the end of 1943. We do not believe that this is the time to discuss the general revisions and ramifications of the tax law. God knows, the entire law needs drastic simplification, and, after such simplification is obtained, rigid old-fashioned enforcement.

It is my own personal opinion, and that of practically every medium and small-sized businessman with whom I have discussed the problem, that the biggest source of new revenue lies in simplification and enforcement of the law. How can the Bureau of Internal Revenue spend time enforcing laws when they lie awake nights trying to decipher the most complicated verbiage in English literature? The law is so complicated today that there isn't an accountant or lawyer in the country who can, in all honesty, call himself a tax expert.

We would like to present a more detailed tax program in 1944 when we hope Congress will undertake to rectify the present "patch-work quilt" that has been built up since 1913. We recommend that the technical staff of the joint congressional committee be greatly expanded so that they can do a thorough job of revision. The technical staff knows what can and should be done.

On our main proposal, I want to go into some detail. Briefly, it is that corporations earning less than $25,000 per year should not be subject to the excess-profits tax. We do not propose that the exemption shall be increased from $10,000, that is in the proposed bill, to $25,000. That is not necessary. What we do propose is that where a corporation had no average earnings during the base period, had very low invested capital, had borrowed capital which it has repaid and does not choose or cannot avail itself of the present relief provisions of the bill, that it is still entitled to a minimum credit of $20,000 besides the $5,000 exemption (or $15,000 besides the $10,000 exemption). We do not think that the House or the Senate believe that corporations earning within $25,000 are making excess profits.

We believe that the effect on governmental revenues would be infinitesimal. As a matter of fact, it is our belief that revenue will be increased. When a corporation that does not have any excess-profits credit is fortunate enough to earn $20,000 or $25,000, and finds that it must pay 90 percent of everything above $5,000 in taxes, it will manage to find somewhere to spend most of the income subject to excess-profits tax. As a result, the Government gets little or no tax. On the other hand, if corporate income up to $25,000 were subject only to normal and surtax rates, full taxes would be collected.

Senator JOHNSON. Why did you pick $25,000?

Mr. BOTWINICK. I picked $25,000 because for normal and surtax rate purposes, incomes up to $25,000 of corporations are put in a special category.

Under the 1940 excess-profits-tax law, they did not need that special provision, because you had graduated the rates of excess-profits taxation:

In the 1940 law rates ranged from 25 to 50 percent, 25 percent, I believe, on the first $20,000. In 1941 they started with 35 percent, and we had a provision, as I recollect, that the normal and surtaxes be deducted before computing the excess-profits tax. In 1942 the graduation provisions were taken away and corporations were taxed 90 percent on everything in excess of a $5,000 exemption and the company's excess-profits credit.

You would be surprised at the tens and tens of thousands of corporations that are started with the brain power of its management, with little capital, and that gradually build themselves up to a position of some size, building up capital through earnings that are plowed back into the corporation.

Under the law as it is written today, a poor corporation is kept continuously poor, and those who have built up a surplus in the past are the only ones who ever will have a surplus.

The House very rightfully simplified the personal tax laws by incorporating the Victory tax in with the general tax.

In effect, this is an essential corporation tax simplification program. I have taken it up in detail with many officials of the Treasury Department, I have taken it up with Mr. Stam and Mr. Chesteen of the technical staff of the joint congressional committee. I have taken it up with big business representatives, and to date I have yet to see a person who has anything to say against our proposal.

We would like to get the average businessman back to the ethics that he used to have. The tax morals of the country today have sunk to such low levels that it is shameful. Everyone is tax conscious, either he is tax-evasion-minded, or legal tax-avoidance-minded. Let us get businessmen back to their essential business problems and not have them spend days and nights on how to avoid taxes.

It is an essential function of big business to have a tax department to study the various tax ramifications, but why should small business be devoting all of its time on such problems?

From the viewpoint of the Bureau of Internal Revenue, I think they have on file today at least 35,000 to 40,000 excess-profits relief applications with many, many more coming in. It has been estimated that at least 80 to 90 percent of those relief applications would not have been filed if you had had a provision of this sort, giving the corporation a minimum credit, not in addition to its regular credit, but in lieu

of all other credits, of $20,000; or if you stick to a $10,000 exemption, a minimum credit of $15,000. Don't give corporations the benefit of graduated taxation for normal and surtaxes on the one hand and then take it away with a 90-percent tax on everything above $5,000 with the other hand.

I know many Representatives in the House, and Senators, have been looking for ways to really aid the small businessman and the white-collar man, the great middle class in this country. They have been unorganized. I do not know if they will ever be organized. I hope that is not necessary. They are the real forgotten men in this country today. They usually mind their own busines they don't cry when taxes hit them, and they have no pressure groups. I think it is the duty of the representatives on both sides, since they haven't got the pressure groups—and I hope never will have—to consider their problems.

Senator WALSH. Have you any further suggestions?

Mr. BOTWINICK. I do not want to lose the beauty of the forest because of the trees by going into other problems that are equally important.

Senator WALSH. You cover them in your brief?

Mr. BOTWINICK. No. Only the excess profits problem, also the history of how this excess-profits rate was born, and why the exemption was cut to $5,000 in conference last year, because the corporation normal and surtax rates of 45 percent as originally passed in the House last year were cut down to 40 percent, and in order to make up the revenue loss Congress put back the capital-stock tax and the declared value excess-profits tax, which were originally taken out, and decreased the excess profits exemption from $10,000 to $5,000.

In general, we think that Congress should decide how much revenue it needs and try to assess it in the most equitable manner. If you listened to all of us you would have no additional taxes. We think you have to spread the tax base in the broadest possible manner, and definitely not take any existing persons out of the tax base, as the Treasury tried to do. Tax luxuries, yes; but the taxes on luxuries are not to be taken out of the businessman's pocket. In other words, if the fur tax, for example, is going to result in a large decreased volume of business to the furrier and therefore his income is going to be reduced even though the tax will be passed on to the public, at least O. P. A. can recognize that factor in the pricing adjustment that they give to the furriers. That is also true with other excise taxes that Congress, in its judgment, deems are necessary at this time.

While I am on excise taxes, there is a serious fallacy in the law right now where floor taxes are imposed. Congress imposes a floor tax on certain commodities so that all of the product from the date the tax goes into effect is tax-paid. As to the increased taxes involved, you have rightfully regarded the additional excise taxes as being in effect only for the duration of the war and 6 months thereafter, but you have not provided for a refund to the businessman on the inventories which he has on hand when that tax goes out of effect. What is he to do? Lose the tax on the merchandise which he has on hand 6 months after the war? In the case of whiskies and wines, for example, the tax is probably 25 to 30 percent of the value of the product. If a retailer had a $50,000 inventory on hand, the date that the tax goes out he immediately takes an inventory loss on that

figure. He will not take the loss. What would probably happen would be a complete sacrifice disposal of all of the merchandise he has on hand. That is true of any other product where you have floor taxes involved.

Where you have floor taxes you must provide that when the tax is reduced there should be a floor tax refund, and I am not a believer in post-war refunds.

Senator WALSH. I do not think you need give much concern to the time when the taxes will be reduced. That promise only softens the blow.

Mr. BOTWINICK. Insofar as excess profits taxes are concerned, there is no question that they are going to be reduced, and I am very much concerned, as Commissioner Helvering was when he left the Treasury——

Senator WLASH. With the amount that the Treasury would get?

Mr. BOTWINICK. With what will happen to this country fiscally if we had two or three depression years after the war and had not only not collected the current revenue because of losses but made refunds to corporations and individuals through the loss carrybacks and through the excess-profits carrybacks. There is plenty of justification for them, but still I ask you who is going to need the money more if we have depression years? Business o the Government? Are we going to refund practically all of the taxes we have collected from business if we have such depression years? It is a problem that we should very seriously consider.

The real economic casualties of the war are not the large corporations which have converted to war production and are concerned about renegotiation, reconversion reserves, post-war loss, carry-backs, and other methods of retaining as much as possible of past and present profits. Surely labor with its excess spending power that is continuously pushing prices upward, has not been hurt economically by the war. The real economic casualties are small businessmen and the so-called white-collar class—the groups that normally constitute the great middle class. These two groups are the forgotten men of today. They seldom get aroused, but they are now deeply incensed. They have been caught in the middle of a cross-fire between big business, labor, the farmer, and bureaucracy. They were caught in this cross-fire long before Pearl Harbor; but since then it has been merciless. Plenty of sincere and crocodile tears have been shed for small businessmen, but with the exception of the assistance given small war plants by the Small Business Committees of Congress, we know of nothing that has been done to help them.

When the 1942 tax law was enacted, even the benefit of graduated tax rates, that was inherent in our corporate tax law for many years, was taken away from small business. This benefit was taken away by the imposition of a 90-percent excess-profits tax on all income in excess of a $5,000 specific exemption and average earnings or invested capital credit.

Last spring the American Business Congress asked me to prepare a memorandum on this subject and to recommend a remedy.

The memorandum which we are submitting has been discussed in detail with both Treasury law-drafting officials and the technical staff of the Joint Congressional Committee on Internal Revenue Taxation. All agreed that alleviation for small business was necessary and that our recommendation was deserving of serious consideration.

Senator WALSH. Thank you, Mr. Botwinick.

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

EXCESS PROFITS RELIEF FOR SMALL BUSINESS

(A report of the Committee on Taxation of the American Business Congress (Benjamin Botwinick, chairman), New York, N. Y.)

Notwithstanding all of the efforts made by Congress to provide for the many unforeseen hardships which may arise under the excess-profits-tax law, no provision has been made for the obvious hardships and inequity toward small business having little or no average earnings credit or invested capital credit. We are sure that Congress never intended that poor corporations should be kept poor for the duration and years afterward. Yet in our opinion that will be the effect of the law as at present written.

Although numerous relief provisions have been incorporated in the 1942 and prior revenue acts, they can seldom be of assistance to small business. They are, probably of necessity, much too indefinite and involved. A small business cannot afford necessarily large professional fees in order to establish a constructive excess-profits credit base of $15,000, of $20,000. It is probably much more difficult and involved to gather the necessary data and prepare a case for a small business than a large business.

We quote from the opening remarks of an address by Randolph E. Paul, general counsel for the Treasury, before the New York State Society of Certified Public Accountants at the Waldorf Astoria Hotel on May 10, 1943:

"I have been asked to speak to you tonight on the general relief provisions of the Revenue Act of 1942.

"I am glad to be able to tell you that the regulations relating to section 722 have recently been issued, and that copies of them will be available within a few days. I know that the delay in their issuance has created difficulties for those of you who have already begun to prepare claims for general relief, and I regret that you have been caused this inconvenience. However, I am sure that you appreciate the difficulties which confronted us in drafting these regulations, and that you will agree that it has been wise to make haste slowly in their preparation.

"I am sure that you will agree that the success with which the excess-profits tax will achieve the ends it was designed to serve will depend upon the success with which these provisions are administered. As the House Ways and Means Committee stated in its report on the 1941 version of section 722, 'The success or failure of legislation of this type depends to a considerable degree upon its intelligent and sympathetic administration.' The general intent of Congress in enacting section 722 is reasonably clear, but in providing, 'for the many unforeseen hardships which may arise under the excess-profits-tax law' Congress was forced to express its intent in general, rather than in specific, terms. Hence, the task of interpreting the intent of Congress in those specific cases where the excess-profits tax is claimed to be 'excessive and discriminatory' will devolve upon those whose responsibility it is to administer the tax statutes.

"This is a responsibility which cannot be accepted lightly. If the relief which Congress intended to give taxpayers is arbitrarily denied them, the excess-profits-tax law can become an instrument for the destruction rather than for the preservation of competitive enterprise. New and growing businesses, as well as businesses which were depressed during the pre-war years, will be deprived of the means with which to reestablish themselves in the post-war economy.

"On the other hand, if the relief provisions are permitted to become instruments for widespread tax avoidance, we shall have failed in our efforts to eliminate profiteering and to achieve an equitable distribution of the costs of the war.

"The line between eligibility and ineligibility for relief under section 722 will not be an easy one to draw. But drawing the line is a recurrent difficulty in those fields of the law where difference in degree produce ultimate differences in kind." *Harrison* v. *Schaffner* (312 U. S. 579 (1941).)

"Responsibility for the successful administration of the general relief provisions must also rest in part upon taxpayers. The greater the number of unreasonable and exorbitant claims filed, the more difficult it will be for the Government to administer relief fairly and fully to those who deserve it. It is, therefore, highly important that businessmen should understand the principles underlying section 722, so that they may better appreciate the character and the extent of the relief which those provisions were designed to afford. For this knowledge and understanding, businessmen will rely heavily on the men of your profession. I am,

therefore, very glad to have this opportunity to discuss with you some of the more difficult problems which are likely to arise in the administration of section 722."

There followed an interesting scholarly and comprehensive analysis of section 722 and other relief sections of the excess-profits-tax law. Nevertheless, the brains of the accounting profession left the meeting completely bewildered as to the ultimate application of the various relief provisions to specific cases.

The history of the development of the present excess-profits-tax-law rates and exemption clearly shows less and less consideration for the problems of small business. To a certain degree small business is itself to blame because it has never been organized in a qualified manner so that its collective voice was heard. This is one of the first efforts to present a tax problem affecting small business in general rather than a specific small businessman or industry.

The first modern excess-profits-tax law was applicable to years beginning after December 1, 1939, and before January 1, 1941. The tax was based on the adjusted excess-profits net income in graduated brackets at the following rates.

TABLE I.—*Taxable years beginning in 1940*

Adjusted excess (profits net income)	Percent	Total excess (profits tax)
$0 to $20,000	25	$5,000
$20,000 to $50,000	30	14,000
$50,000 to $100,000	35	31,500
$100,000 to $250,000	40	91,500
$250,000 to $500,000	45	204,000
$500,000 up	50	

The following year the excess-profits tax law was amended, the rates in each of the above brackets being increased by 10 percent as follows:

TABLE II.—*Taxable years beginning in 1941 and ending before July 1, 1942*

Adjusted excess (profits net income)	Percent	Total excess (profits tax)
$0 to $20,000	35	$7,000
$20,000 to $50,000	40	19,000
$50,000 to $100,000	45	41,500
$100,000 to $250,000	50	116,500
$250,000 to $500,000	55	254,000
$500,000 up	60	

Up to this point the principle of taxation in accordance with ability to pay reflected by graduated tax rates is recognized, just as it is recognized for normal and surtax rates. The same principle that motivated special normal and surtax treatment for corporations having net incomes of less than $25,000, or net incomes between $25,000 and $50,000 was applied to excess-profits taxation.

The Revenue Act of 1942 which went to such extremes to grant relief to hardship cases completely dropped the graduated tax rate principle. To partially compensate small business for this drastic change in principle, the specific exemption from excess-profits tax was increased from $5,000 to $10,000, but just prior to final enactment of the 1942 Revenue Act on October 21, 1942, some very strange last minute changes took place while the act was before the conference committee.

Big business did not put up much of a battle against the change from the graduated rates of the 1940 and 1941 laws to the flat 90 percent excess-profits tax rate of the 1942 act. However, it did present strong opposition to the combined 45 percent normal and surtax rates desired by Congress and the Treasury Department. It is now well-known history that the 45 percent combined normal normal and surtax rates on corporations having net income in excess of $50,000 was reduced to 40 percent. This represented a very important concession to big business interests, but did not affect any corporation earning less than $50,000. These interests very graciously acquiesced in a reduction of the special exemption from excess-profits taxation from $10,000 to $5,000—a concession at the expense of small business, and one that added measurably to the numerous other troubles confronting small business.

We are sure that Congress never intended that corporations earning from $5,000 to $25,000—and which were unfortunate enough to have had little or no earnings during the 1936 to 1939 base period, and very low invested capital, should be subjected to a 90-percent tax on all income above $5,000. We believe that they expected that every corporation would be able to establish a reasonable excess-profits credit in addition to the $5,000 specific exemption. Under the present law many thousands of corporations find themselves without such excess-profits credit. As stated above, the various relief provisions of the law, intended to correct this situation, can very seldom be of help to such corporations.

We therefore strongly recommend that the following simple relief provision be adopted by Congress as part of the contemplated new tax legislation program:

If a corporation cannot or does not establish an excess-profits credit of at least $20,000—through any of the present methods of computation or through any other relief provision—such company may take a credit of $20,000. Such a relief provision will in no way affect or increase the credit of any corporation that can establish a credit of $20,000 or more through the present provisions of the law. It is a much more scientific and equitable approach to the problem of small business than a straight increase in the $5,000 specific exemption, since only those companies that are in dire need of this relief will get the benefit.

The effect on governmental revenue will be infinitesimal. The income reflected by the specific exemption of $5,000 and the proposed alternate excess-profits credit of $20,000 is, of course, subject to normal and surtax rates. Unless such relief (in the amount of $20,000) is granted, the principle of graduated rates of taxation on small corporations which has been in our revenue laws for many years will be almost completely nullified.

Many of our most eminent legislators and other statesmen have been very apprehensive about the fate of small business. They have sincerely but fruitlessly been seeking for ways to help small business weather the impact of war economy. Many others have been shedding crocodile tears while prophesying the extent of small business casualties. The people engaged in small business, the great middle class, have always represented the backbone of a democratic country. When they disappear, as we have seen in other lands, the country becomes a totalitarian state either of the left or the right.

In addition to small business casualties effected by war economy and taxes, there has been an almost complete cessation of new small business ventures. When a new business is contemplated—the investor knows he is taking certain risks. If the business loses money, he takes the loss alone. If it makes money, he shares the profits with the Government on a 90-10 percent basis—and he gets the 10 percent. Under the present excess-profits tax law there is absolutely no incentive to take such risks.

The present excess-profits tax law prevents most small businessmen from putting away any reserve to withstand the impact of the later years of the war; to replace worn-out plant, fixtures and equipment, or to withstand the rehabilitation period after the war.

Senator WALSH. A memorandum for inclusion in the record has been submitted by Mr. A. T. Kearney of the committee of vermiculite miners which will be inserted in the record at this point.

(The memorandum referred to is as follows:)

PART A

WASHINGTON, D. C., *December 2, 1943.*

VERMICULITE

Memorandum.

To the Honorable WALTER F. GEORGE,
Chairman of the Senate Finance Committee:

On November 12, you granted Mr. A. T. Kearney and Mr. George Coggins an interview on the subject of percentage depletion for vermiculite mines, for which interview we are very grateful.

Since that time, Mr. Randolph Paul has presented a memorandum to your committee which states in substance that the War Production Board has advised the Treasury Department that the current output of vermiculite is adequate to meet present wartime requirements, and that the bulk of this mineral is used for building insulation in competition with rock wool and asbestos.

We do not know the precise source from which information was obtained as the basis of Mr. Paul's statement, but we believe it was obtained from the mineral wool industry, which, to a limited degree, is competitive with the vermiculite industry and which does not have accurate information as to existing conditions in our industry.

We have endeavored to ascertain whether the large consumers of vermiculite have been requested to furnish information to the War Production Board or the Treasury Department, and have found only one instance where information was requested. Copy of the letter from the War Production Board and the reply are hereto attached. By reference thereto it will be found that the War Production Board was advised that the supply is inadequate to meet the present demand. From information previously assembled, we are certain that the principal consumers of vermiculite would report, as F. E. Schundler & Co. has reported, that the supply is inadequate to meet the demand—if inquiries were directed to them. From our own records, we know that the bulk of the mineral is not used for building insulation. Its strategic and essential uses are set out in the memorandum previously filed with members of your committee.

As you know, vermiculite was included with the class of minerals on which percentage depletion was allowed by the Ways and Means Committee of the House of Representatives. In its deliberations, the House Ways and Means Committee had before it the facts stated in the memorandum previously filed with the members of your committee. The facts stated in that memorandum are correct and there has been no change in the situation there depicted since the memorandum was originally prepared. Information this subject is available from the Nonmetallics Section, Miscellaneous Minerals Division of War Production Board.

Vermiculite is not only a strategic mineral and essential to the war effort (as indicated by copy of letter from War Production Board hereto attached), but it will have—when the war is ended—a unique place in the national economy. Because of its peculiar characteristics, it is adaptable to many commercial uses for which there is no presently available substitute.

Representatives of vermiculite miners have personally interviewed the members of your committee and have acquainted them with the facts on which our claim for percentage depletion is based. For that reason we had not planned to take the time of your committee in a hearing. If you would prefer that witnesses appear before your committee, we are now ready and anxious to appear to present any facts that you may deem material.

Respectfully submitted.

COMMITTEE OF VERMICULITE MINERS,
By A. T. KEARNEY.

WAR PRODUCTION BOARD,
Washington, D. C., November 1, 1943.

SCHUNDLER & CO., INC.,
Joliet, Ill.

GENTLEMEN: We are gathering information which will give us an accurate picture of the total production figures covering nonrigid thermal insulation products. The information which you submit will be held confidential, and will be used only in the sum total of all insulation products included in this category.

It is our undertanding that you can assist us with regard to vermiculite, used as insulation material, and we will appreciate answers to the following questions.

What was the total production of vermiculite used as insulation material for the calendar year 1942?

What is the estimated production of vermiculite used as insulation material for the calendar year 1943?

Please state the total quantity of vermiculite used as insulation material that could have been produced with available production facilities, allowing for ordinary and usual transportation and assuming the continuous demand and adequate fuel supply and favorable labor and transportation conditions, for the calendar year 1942; estimated for the calendar year 1943.

This information will be very helpful and we will thank you for an early reply.

Very truly yours,

J. L. HAYNES,
Director, Building Materials Division.
By CARL F. CLAUSEN,
Chief, Non-Metallic Section.

F. E. SCHUNDLER & CO., INC.,
November 9, 1943.

WAR PRODUCTION BOARD,
Washington, D. C.
(Attention: W. H. Clines, Chief of Mineral Wool Unit.)

GENTLEMEN: This acknowledges letter of November 1 written by Mr. Carl F. Clausen, Chief of Non-Metallic Section of the Building Materials Division. This letter asks for information as to the total production of vermiculite used as insulation material for the calendar year of 1942. Practically all vermiculite is used for insulation purposes.

From information received from our supplier and other sources, we believe the total production for 1942 was in the neighborhood of 56,000 tons. This year the production was somewhat less, approximately 45,000 tons.

You then ask that we state the total quantity of vermiculite used as insulating material that could have been produced with existing production facilities, assuming a continuous demand and adequate fuel supply and favorable labor and transportation conditions for the years 1942 and 1943. We cannot speak for other manufacturers of vermiculite insulation, but speaking for ourselves we might say that this year as well as last year we could have used considerably more vermiculite if same had been available if and when needed by us.

In 1942 we bought from the Universal Zonolite Insulation Co. for shipment to Joliet, Ill., 8,825 tons; we shipped to F. E. Schundler, f. o. b. Long Island City, N. Y., 1,319 tons, making a total of 10,144 tons of crude vermiculite.

In 1943 up to October 31 there were shipped to Joliet 5,230 tons, and to Long Island City, N. Y., 535 tons, making a total of 5,765 tons of crude vermiculite.

If vermiculite had been available in larger quantities we estimate that instead of 10,144 tons we could have used 25,000 tons in 1942. In 1943 we should have been able to use a similar amount, but apparently Universal Zonolite Insulation Co. is not in a position to ship as much as we want. In spite of the fact that we have given them orders bearing high priorities, shipments come forward too slowly and as a consequence we do a good deal less vermiculite business than we should.

If the above does not give you all the information you want we shall be glad to hear further from you on the subject.

Very truly yours,

F. E. SCHUNDLER, *President.*

OCTOBER 23, 1943.

Memorandum.

To: C. E. Wilson, Acting Chairman, War Production Board.
From: J. E. Eagle, Chief, Non-Metals Section, Miscellaneous Minerals Division
Subject: Vermiculite.

Vermiculite is one of the nonmetallics that has come into commercial use in the last decade in the insulation and refractory field.

Vermiculite is a hydrated silicate with micaceous properties. When heated above 300° F. the material expands or exfoliates. The crude ore is shipped to the general location where it is to be used before being exfoliated. Practically all industrial uses require the exfoliated product. It is presently being used in the war effort for:

(a) High temperature insulating products such as cements, insulating bricks and pipe covering in the steel, rubber, and oil industries.

(b) Building construction materials such as granular fill insulation and concrete and plaster aggregate for building construction, particularly war factory building and Army and Navy camps.

(c) Insulation and sound deadening material for gun compartments for combat airplane, ship decking in the shipbuilding program, oilless bearings for tanks, and other uses of a similar nature.

From figures furnished us by the three leading miners we find that there was produced and used in 1942 approximately 56,175 tons. The total production for the first half of 1943 was 16,685 tons.

All of the vermiculite mined in 1942 and 1943 has been sold and shipped to users as soon as it was mined and milled. There is no stock pile of this material in the country today. At present the three miners from whom our figures were obtained have orders on hand for approximately 10,625 tons.

The miners advise us that this backlog could easily be trebled if orders tendered had all been accepted and booked for shipment. These same producers estimate that they can meet only about one-half of the demand for the balance of this year.

The rating pattern for 1942 for the three principal mining companies was as follows: One company delivered 80 percent of its ore on A–1–A ratings. Another delivered only on AA–1, while the rating pattern of the third was as follows: 2.16 percent on AA–2 or higher, 39.18 percent on AA–5 to AA–2X, and 58.66 percent on A–10 to A–1–A.

For 1943 the rating pattern for one company was 95 percent AA–1, the second was 100 percent AA–1, and the third was as follows: 10.52 percent AA–2 or higher, 17.38 percent AA–5 and AA–2X, and 72.10 percent A–10 to A–1–A.

The conclusion to be drawn when the rating pattern is considered in connection with the uses we have outlined above is that the product is essential to the war effort.

PART B

VERMICULITE RESEARCH INSTITUTE,
Chicago.

SUMMARY OF MEMORANDUM REGARDING PERCENTAGE DEPLETION FOR VERMICULITE

1. Vermiculite is a nonmetallic mineral found in North and South Carolina, Colorado, Texas, Montana, and Wyoming.

2. The War Production Board has reported to the Ways and Means Committee that its continued production is essential to the war effort.

3. Vermiculite, a fireproof insulating material, is used principally in the war effort for combat war planes, airplane engine test sheds, oilless bearings for tanks, ship decking, fireproof bulkheads for ships, sound-deadening and insulating materials for walls, floors, and roof decks for hospitals, Army and Navy camps, and other types of war buildings.

4. Estimated 1943 production will be about 46,000 tons. Estimated demand for 1943 will be in excess of 65,000 tons.

5. Miners now in production are unable to get adequate depletion allowances on a cost or discovery basis.

6. Rising costs and Office of Price Administration restrictions have narrowed the profit margin to a point where mining no longer attracts much needed capital to a mining industry that is just getting under way.

7. All income taxes paid by vermiculite miners throughout the last 21 years total only $70,676.86.

8. Percentage depletion would permit miners to recover a part of the substantial amounts of money that have been spent in finding uses for products and in building a new industry and would stimulate exploration for and development of greatly needed additional deposits.

9. Processors and fabricators who purchase ore from vermiculite miners have invested more than $2,000,000 in their businesses. Estimated sales in 1942 by processors, fabricators, and dealers exceeded $6,000,000, on which total estimated income taxes in excess of $200,000 were paid.

10. If percentage depletion were permitted miners, a steady flow of a basic material to fabricators and processors would be assured. This would serve the war effort, continue tax revenue presently being collected from that source, and, in addition, would provide increase in tax revenue from processors, fabricators, and dealers which would more than offset any loss of revenue from vermiculite miners.

11. The Ways and Means Committee have voted to include vermiculite in the new revenue act with those minerals on which 15 percent depletion is allowed.

MEMORANDUM REGARDING PERCENTAGE DEPLETION FOR VERMICULITE

1. *What is vermiculite?*—Vermiculite is a nonmetallic mineral. Chemically, it is an aluminum magnesium silicate. It is found principally in North and South Carolina, Colorado, Texas, Arizona, Montana, and Wyoming. From 1937 to 1941 the production averaged about 22,000 tons annually. In 1942 the production was approximately 56,000 tons. There are numerous miners but the principal ones are Bee Tree Vermiculite Co., Asheville, N. C.; Vermiculite Co. of

America, Minneapolis, Minn.; and Universal Zonolite Insulation Co., of Chicago, Ill.

Vermiculite occurs in pockets and stringers which have no definite continuity. It follows no well defined lodes or veins. For this reason, exploration is difficult and expensive. Milling procedures and development of equipment are likewise expensive and difficult because there has been no known standard to follow. Each miner has been required to develop equipment and a procedure to meet the characteristics of its own mineral deposit.

2. *Uses of vermiculite.*—Vermiculite is used principally for—

(*a*) High-temperature and insulating products, such as cement, brick, pipe covering, and other like materials which are today being used extensively in the steel, oil, shipbuilding, and rubber industries.

(*b*) Heat conservation materials, such as insulating concrete for roof decks, floors, and walls for Army and Navy camps, warehouses, and factory buildings, together with plaster aggregate and loose granular insulation for heat conservation in homes and commercial structures.

(*c*) Other war uses, such as insulating materials for combat war planes, airplane engine test sheds, oilless bearings for tanks, ship decking, fireproof bulkheads for ships, and sound deadening and insulating materials for hospitals and other types of war buildings.

The essentiality of vermiculite in the war effort is confirmed by the report of the War Production Board.

3. *Present production.*—The three principal miners produced 31,967 tons of vermiculite in the first 9 months of 1943. Estimated production for the fourth quarter is 15,000 tons. Estimated demand for the year is 65,000 tons. Failure of miners to meet requirements is due to (*a*) lack of working capital, (*b*) increased mining costs, (*c*) uncertainty as to a return from operations as presently conducted, and (*d*) inability to attract capital.

If miners were permitted 15 percent depletion, all the factors retarding production would be favorably affected because working capital would be built up, costs lowered, there would be more assurance of some return, and additional capital would be more easily secured. The obvious effect of the allowance, therefore, would be increased production of a material now vitally necessary in the war effort.

4. *Depletion allowance will offset rising costs.*—In 1942 average mining costs for the three principal miners was $7.12 per ton. The average selling price was $9.68 per ton. The gross margin was, therefore, $2.56 per ton. For 1943 the average selling price was $9.68 per ton but average mining costs had risen to $9.19 per ton, leaving only a margin of $0.49. A profit margin as narrow as that now existing will not permit a steady flow of a basic material to fabricators and processors. Contract commitments plus Office of Price Administration regulations preclude relief through increased prices.

5. *Income taxes paid by mining companies.*—Two of the three principal mining companies have operated at a loss since their organization. The other company has been in business 21 years. It operated at a loss in 15 of those years. Total taxes for the 6 profit years, including 1942, were $70,676.86. The above figure is the total income tax paid by the vermiculite mining industry since its inception. It is estimated that no taxes will be paid by two of the miners in 1943. An estimate for the third company is difficult at this time. It seems clear, however, that increased mining costs will materially affect the net return on mining operations.

6. *Effect on vermiculite mining industry of lack of depletion allowance.*—Vermiculite mines presently in operation are located on farm lands, ranch lands, or on the public domain. The initial cash cost of the mining properties was small. While substantial amounts have been spent in development, the cost of the property that can be set up for purposes of depletion is small. The principal expenditures of the mining companies have been in the development of uses and markets for the products made from vermiculite. These expenditures have in reality built the value that exists in the mining properties, but under present revenue laws such expenditures cannot be made the basis for depleting the mines. Depletion on a cost basis will not, therefore, enable the mining companies to recover the substantial amounts which they have spent in creating value for the mining properties. Discovery depletion in most instances cannot be allowed because the mining properties have passed from the hands of the original discoverers. Unless percentage depletion is permitted, vermiculite miners will be denied any worth-while depletion.

7. *Fabricators and distributors of vermiculite products.*—The marketing of vermiculite products embraces three stages. The ore is mined and sold by the

mining companies to fabricators or processors in various parts of the United States. They subject it to a heat-treating process that expands the ore into loose granular form. The fabricators and processors either sell the expanded material to dealers or use it in the fabrication of mixed, formed, and fabricated products containing vermiculite. The dealers, in turn, sell to the consuming public.

There are today approximately 35 fabricators and processors in the United States. There are approximately 4,000 dealers. It is estimated that fabricators and processors have at present an investment in excess of $2,000,000 in their businesses. Gross sales by fabricators and processors for 1942 were approximately $3,000,000. Estimated net profits on such sales were approximately $750,000, on which estimated income and excess-profit taxes of $199,935 were paid.

We have been unable to get figures from many of the processors and fabricators, such as Harbison-Walker Refractories Co., Johns-Manville Co., Minnesota Mining & Manufacturing Co., A. P. Green Fire Brick Co., Firtex Co., Chrysler Corporation, and Eagle Picher Lead Co. Were figures available from these companies, it is believed the amounts above set forth would be materially increased.

Gross sales by dealers for 1942 are estimated at $3,139,500. Combined sales of fabricators, processors, and dealers for 1942 were, therefore, in excess of $6,000,000. Estimated net profit on dealers' sales would be approximately 10 percent, or $313,950. From this source, the Treasury undoubtedly obtains substantial tax revenue.

The vermiculite miners, therefore, are a basic industry, producing a mineral which provides two sources of tax revenue in addition to that provided by the miners themselves; that is, tax revenue from fabricators and processors, and tax revenue from dealers. Unless encouragement can be given to miners, the source of the basic mineral used by fabricators and processors and sold by dealers will dry up, with a consequent loss of revenue from those sources.

It is estimated by those fabricators and processors from whom figures were obtained that if vermiculite had been available in 1942 to meet their full requirements, they could have made additional sales of $2,029,350, on which additional net profit of $246,292 would have been earned. This increase in fabricator and processor business would have resulted in a proportionate increase in dealers' sales.

8. *Effect of proposed legislation on tax revenue.*—If 15 percent depletion were permitted to vermiculite miners, the estimated reduction in taxes for 1942 would have been $32,002.70. As against this loss of revenue, there would be a substantial gain in revenue from fabricators, processors, and dealers.

From the revenue standpoint, the problem is simply stated. Unless relief to the miners of vermiculite is provided in the form of reasonable depletion allowance, there is no incentive for them to expand their mining output to supply the tonnages that are needed to maintain the vigorous group of processors and fabricators that are now in existence. In addition, many more such establishments could be developed if an adequate tonnage of ore could be made available. The loss of revenue that may result from allowing such depletion will be negligible compared with that which can be obtained from the processing and fabricating activities that are sure to result from adequate ore production.

Senator WALSH. The committee will stand adjourned until a quarter past 2.

(Whereupon, at 1:10 p. m., an adjournment was taken until 2:15 p. m. of the same day.)

AFTER RECESS

(The committee resumed at 2:15 p. m., pursuant to recess.)

Senator WALSH. The committee will come to order. Mr. Wolfe. What is your full name?

Mr. WOLFE. My name is Morley Wolfe; I represent the National Lawyers Guild.

The CHAIRMAN. You may proceed.

STATEMENT OF MORLEY WOLFE, REPRESENTING THE NATIONAL LAWYERS GUILD, NEW YORK CITY

Mr. WOLFE. Mr. Chairman, an all-out war effort calls for an all-out tax program, one that goes to the limit of every taxpayer's ability to pay. In the face of the wartime financial needs, it is absolutely imperative that tax revenues be increased in every way possible without impairing national health, morale, and fighting efficiency.

H. R. 3687, the 1943 revenue bill passed by the House, commits a double offense against sound national policy in the present wartime emergency:

First, it fails to raise the maximum amount of revenue which is available without undue sacrifice. It fails to tax adequately certain classes of individual and corporate incomes well able to carry a heavier share of the tax burden, and it likewise fails to impose a proper share of the tax burden upon inheritances. It fails to plug important loopholes in the present law and to abolish unwarranted special privileges.

Second, it continues disproportionately heavy burdens upon the lower-income groups, encroaching upon subsistence standards of living. It is in the Nation's interest to reject any tax which cuts into the income of our people required to maintain health, morale, and productive efficiency. The paramount importance of health and morale is recognized in providing for the men in the armed forces. It must also be recognized in protecting the men and women who fight the battles of production on the farm and in the factory.

To meet the basic requirements of a wartime revenue measure, the Lawyers Guild urges the amendment of H. R. 3687 in accordance with the following proposals, so as to raise without undue sacrifice the billions in revenue needed to finance the war:

1. The combined normal and surtax rate on ordinary incomes of large corporations should be increased from 40 percent to at least 50 percent.

2. All profits above 4 to 5 percent on invested capital should be subject to the 95 percent excess-profits tax, with a special 65 percent substitute tax on profits in excess of average 1936–39 profits but below 4 to 5 percent of invested capital.

3. An integrated estate-gift-tax system, with a single exemption of $20,000 and a single set of drastically increased rates should be adopted. A maximum of $5,000 annually in gifts for each donor should be tax-free.

4. Special privileges should be eliminated. Mandatory joint returns should be required, with a special allowance for a wife's earned income. Percentage-depletion allowances to owners of mines and oil and gas wells should be eliminated. All governmental securities should be subject to taxation, with the Federal Government granting an appropriate subsidy to States, cities, and localities which borrow in the future.

5. Income-tax rates should be increased for family incomes above $3,000, and on commensurate levels for single persons, with a $25,000 ceiling on all net incomes, after taxes.

6. Personal exemptions should be allowed as a credit against the tax rather than a deduction against net income, and the tax credit

should gradually diminish as net incomes increase, finally vanishing at reasonably high income levels.

To eliminate unfair tax burdens which cut into the necessary subsistence of the lower-income groups, we favor:

7. Elimination of the 3 percent minimum tax atrocity substituted for the Victory tax abomination.

8. Restoration of income-tax exemptions to $750 for single persons, $1,500 for married couples, $400 for each dependent.

9. Limiting the earned-income credit to the first $3,000 of actually earned income and allowing it against the surtax as well as normal tax, instead of its total elimination.

Corporate taxes must be sufficiently high to prevent excessive war profits. The argument is repeatedly made that additional corporate taxation would drain the lifeblood of corporations. This argument is more emotional than factual. This argument ignores the startling figures submitted by the Treasury to the Ways and Means Committee.

Corporate profits (excluding dividends received) of profit-making corporations will reach the estimated level of 23.4 billion dollars for the calendar year 1943. The Treasury's estimate for 1944 is 24.5 billion dollars before taxes. These profits are more than three times the corporate profits for the year 1937, which was one of the most prosperous years of the thirties.

Although corporate taxes have risen substantiallly, they have failed to keep up with the pace of increased corporate earnings. For the year 1942, profit-making corporations will have left after taxes, 9.1 billion dollars; in 1937 they had left less than $6,000,000,000.

Nor have dividend payments shrunk. The average of dividends paid for the years 1936 to 1940 was 4.1 billion dollars; the highest figure was 4.8 billion dollars in the year 1937. For the years 1941, 1942, and 1943, dividends are estimated at 4.5 billion dollars, 4.1 billion dollars, and $4,000,000,000, respectively. Even after taxes and dividends are paid, the corporations of the country, including loss corporations, will have accumulated for the years 1942, 1943, and 1944, over $15,000,000,000 of undistributed corporate profits.

Although H. R. 3687 increases the excess-profits tax rate from 90 to 95 percent, and reduces the invested capital credit on capital in excess of $5,000,00, the average-earnings credit remains unchanged, so that corporations with large pre-war earnings continue to avoid their fair share of war-profits taxation. Because of the heavy capitalization of some corporations, and the prosperous pre-war earnings of others, the unprecedented profits of some of the largest and most profitable corporations will not be effectively recaptured by the excess-profits tax law. The record of corporate profits, previously cited, proves this.

The President, in his seven-point and anti-inflation message in April 1942, said:

> We must tax heavily and in that process keep personal and corporate profits at a reasonable rate, the word "reasonable" being defined at a low level.

In line with the tax plank of the President's 7-point program, we propose that the credit for equity-invested capital be reduced to 5 percent for the first $10,000,000 of invested capital and 4 percent

for the balance. We recommend that all profits in excess of the 4- to 5-percent return on invested capital be subject to the 95 percent excess-profits tax rate, without any post-war credit; and where a corporation's current profits are in excess of its average 1936–39 earnings, but below 4 to 5 percent of invested capital, we would tax the difference between such 1936–39 average earnings and the invested-capital credit, at the rate of 65 percent. By this plan, corporations increasing their earnings in wartime would pay an excess-profits tax on the increased war profits.

The profits subject to the Lawyers Guild's proposed 95 and 65 percent excess-profits tax rate would not be subject to the corporate normal tax or surtax. We recommend also that the credit for borrowed capital, now treated as invested capital to the extent of 50 percent be eliminated, inasmuch as interest deductions provide a proper allowance for the cost of such capital.

We recommend that additional corporate taxes be provided by increasing the present corporate surtax rate from 16 percent to at least 26 percent on corporations with incomes of more than $25,000. The 26 percent surtax rate has been proposed by the Treasury. Combined with the present 24 percent normal tax, the proposed minimum surtax rate of 26 percent would bring the aggregate of corporate income tax rates to at least 50 percent of corporate incomes above $25,000.

There should be no quarrel with the imposition upon corporations of a substantial portion of the increased load of taxation required by our national emergency, inasmuch as American corporate business is enjoying profits far in excess of those in pre-war years. American corporate business should not profit from the catastrophe of war.

As to estate and gift taxes, integration, exemptions, rates, we suggest the following:

Under existing law, an estate of $60,000 is entirely exempt from tax and an additional $30,000 may be transferred tax-free as a gift inter vivos. This means that $90,000 can still be transferred without paying a single penny in Federal estate or gift taxes. In addition, annual gifts of $3,000 to each donee may be made tax-free. Thus, the impact of estate taxes may be whittled away very substantially. It is no surprise, therefore, that the results of the existing estate tax system are fiscally disappointing. The estate and gift tax system needs thorough overhauling. If the job is done thoroughly, estate and gift taxes can be made to assume a place of prominence in the tax system, commensurate with their inherently progressive character.

Despite the very heavy increases in income-tax rates levied upon low incomes, estate and gift tax rates have remained virtually unchanged during the national emergency. Even the very moderate proposals of the Treasury to raise an additional $400,000,000 by lowering the estate-tax exemption from $60,000 to $40,000 and increasing estate and gift tax rates have been rejected.

We have noted that a principal avenue of estate-tax escape is through gifts made before death. What is required is an integration of the estate and gift taxes so that the rates shall be applicable to transfers in the aggregate, whether made before death or after death. In adopting an integrated estate and gift tax system, a single set of

drastically increased rates should be adopted with a single exemption of $20,000. Estate and gift tax rates should be brought in line with the drastic reductions in income-tax exemptions and the drastic increases in income tax rates which have been imposed upon the low-income groups.

In England there is no specific exemption, but estates of less than $400 are not subject to tax. In Canada, the exemption varies from $20,000 for a widow to $1,000 per heir. No tax is levied if the estate is less than $5,000.

As to annual gifts, instead of permitting annual gifts of $3,000 to each donee to be tax-free, the annual exclusion should be limited to a maximum of $5,000 in all for each donor.

As to estate tax deductions for contributions to controlled charitable or educational foundations, existing provisions also enable decedents to perpetuate, through charitable or educational trusts and corporations, family or similar control over their wealth, without paying the estate tax. In the case of gigantic fortunes, such as those of John D. Rockefeller, Andrew Mellon, and Edsel Ford, it has been a familiar device to create family controlled tax-exempt foundations whereby vast sums are transferred tax-free but the wealth remains under the control of the donor's family. This device has cost the Federal Government hundreds of millions of dollars in taxes, and constitutes a flagrant loophole in the estate-tax law. Transfers to such controlled foundations should be taxable, for they are in substance a device for appearing to give away wealth, while perpetuating the control of the wealth in the decedents' family.

Congress should tighten up the provisions designed to tax the transfer of property in anticipation of death. The existing rebuttable presumption that a gift is in contemplation of death, if made within 2 years of death, has not been productive of substantial revenue, although it has been productive of litigation. It is therefore recommended that the provision be amended to provide that all transfers made by a donor over the age of 65, to the extent that such transfers to any one beneficiary exceed, in the aggregate, a specified sum, shall be subject to the estate tax.

As to computation of credit for State taxes, the credit granted to a taxpayer against his Federal estate tax for death taxes paid to States consists of an amount up to 80 percent of the Federal tax paid under the 1926 Federal estate-tax statute. The Federal law has since been amended several times, with rates and exemptions revised, but the credit is still tied to the antiquated 1926 law. The credit should be adapted to the most recent estate-tax statute.

As to individual income tax, the basic individual-income-tax question is whether there are personal incomes which can and should be further taxed in order to help pay the financial costs of the war and in order to combat inflation. We believe there are such incomes and that they lie in the middle and upper income brackets.

The following table contains the Treasury's statistics of distribution, by net income classes, of income recipients, income payments and personal taxes at levels of income estimated for the calendar year 1944.

Net income classes	Number of income recipients	Percent of total number	Total income (in billions)	Percent of total income	Personal taxes (in billions)	Income less taxes (in billions)
$0 to $1,000	21,600,000	32.1	$19.2	12.2	$0.5	$18.7
$1,000 to $3,000	36,600,000	54.4	77.1	49.1	6.6	70.5
Total under $3,000	58,200,000	86.5	96.3	61.3	7.1	89.2
$3,000 to $5,000	6,700,000	10.0	30.7	19.6	4.0	26.7
$5,000 to $10,000	1,830,000	2.7	14.5	9.2	2.7	11.8
$10,000 to $25,000	460,000	.6	8.1	5.2	2.2	5.9
$25,000 and over	110,000	.2	7.4	4.7	4.1	3.3
Grand total	67,300,000	100.0	157.0	100.0	20.1	136.9

These statistics do support the much publicized statement that 80 percent of the national income is going to people earning less than $5,000 a year—but they also reveal the little publicized fact that the remaining 20 percent of the national income is received by a tiny minority of our population—in fact, 3.5 percent of the income recipients.

These statistics reveal the important fact that the average income, after taxes, is $865 for those with incomes under $1,000; the average is $1,926 for those with incomes between $1,000 and $3,000; the average is $3,985 for those with incomes between $3,000 and $5,000; rising to $6,448 for those with incomes between $5,000 and $10,000; climbing to $12,826 for those with incomes from $10,000 to $25,000; and reaching an average of $30,000 for those with incomes above $25,000.

These figures provide the answer to the question as to which income levels possess ability to pay additional taxes; and to the question as to which income levels possess surplus purchasing power which may exert inflationary pressure against price levels.

In this national emergency, when sacrifices are demanded of all, it is only fair that those with incomes above $3,000, which possess the ability to pay further taxes, should be called upon to make their utmost contribution to the financial costs of the war. We recommend therefore the adoption of the individual income tax increases proposed by the Treasury on incomes above $3,000.

The incomes of families whose earnings are under $3,000 a year leave no margin for additional taxes and afford no opportunities for inflationary spending. This is very clearly established by the very recent report of the Heller Committee for Research in Social Economics at the University of California, showing that a budget providing for the "standard health, decency, and moral well-being" of a wage earner's family of four in San Francisco requires $2,357.55 a year at March 1943 price levels. When taxes and War bonds are added, $2,991.79 will just balance the budget. The items comprising the budget as found by the Heller committee are shown on the following page.

Food	$916.85
Clothing	256.67
Housing	408.00
House operation	116.97
Furnishings	15.75
Medical care	179.04
Life insurance premiums	113.38

Recreation	$48.04
Church and charity	18.00
Miscellaneous	283.86
War bonds (10 percent of income)	300.00
Taxes	334.23
Total	2,991.79

Thus, a family of four with an income of $3,000 a year will have exactly $8.38 left—after necessities, War bond purchases, and tax obligations—and this margin has more than been absorbed by the increases in living costs since March 1943.

What is the character of the Heller budget which requires an annual income of $2,357.56 for a wage earner's family of four in San Francisco?

This budget allows $17.63 for food for a week. This means 63 cents a day per person for each day throughout the year. It allows $257.67 for clothing. This would permit the father to get one overcoat in 8 years, one suit every 3 years and one and a half shirts every year. He may have two suits cleaned and two shoe repairs jobs annually.

His wife can spend $75 a year, including the purchase of a winter and a summer coat every 4 years, a wool dress every 2 years, a rayon dress every 1½ years, two pairs of shoes each year, one sweater every 4 years. Her cleaning of clothes is restricted to one coat per year and two dresses twice a year.

The oldest boy may have a suit and a raincoat every 2 years, one school shirt each year, together with three pairs of corduroy trousers and four pairs of shoes, at a total cost of $69.14. A girl, aged 8, may have a coat every 2 years, a sweater every 2 years, three cotton dresses a year, four pairs of shoes, at a total cost of $47.09.

The family may live in a four-room house with a maximum rent of $34 a month. Only 70 cents is set aside each year for the total cost of schooling.

For spending money the entire family is allowed 93 cents a week. The husband and wife can go to a concert or theater three times a year and to a movie once a month, taking only one child each time. Excursions and vacation trips are eliminated.

The budget sets aside $179.04 a year to cover all medical, dental, and hospital care. If the family has no access to a group practice clinic, this budget allowance falls about $100 short of an adequate amount.

These itemizations are sufficient to indicate that the Heller budget merely provides for minimum maintenance, covering only the minimum needs of this family of four.

It is obvious therefore that a family of four having an income of $3,000 a year does not possess any excess purchasing power for every penny will be consumed in meeting its minimum needs, along with its War bond purchases and its tax obligations.

The family of four with an annual income of $3,000 has no capacity to pay additional taxes. The incomes above this level, however, can bear additional taxes and surtax rates should be increased for such incomes. For smaller families and for single persons, the level should be correspondingly reduced.

In the light of the minimum budgetary requirements, there can be no justification for any further lowering of the personal exemptions, which now begin at $500 a year for a single person and $1,200 for a

married person with a credit of $350 for each dependent. The exemptions were lowered in the 1940 Revenue Act; they were lowered again in the 1941 Revenue Act; and lowered still further in the 1942 Revenue Act. Moreover, their value to the taxpayer has been substantially reduced by the rise in the cost of living. In the face of a 24 percent wartime rise in living costs, the value of the $500 exemption is actually only $403 in pre-war purchasing power while the value of the $1,200 exemption is in reality only $960. Such levels cannot maintain even a minimum standard of living.

The lower income groups already pay a disproportionate part of their little incomes in indirect taxes of all kinds. Secretary Morgenthau, back in March 1942, stated that the Treasury's studies had shown that a single person earning $750 a year, not then subject to Federal income tax, paid direct and indirect Federal, State, and local taxes of $130, representing 8 weeks' pay. A married man, with no dependents, said Secretary Morgenthau, earning $1,500 paid $250 in taxes, 16.7 percent of his income, or an equivalent of 8 weeks' work.

To enable the working population to purchase the necessities required to maintain health and productive efficiency essential for production, married persons in the lower income brackets should be allowed an exemption of $1,500, with an additional allowance of $400 for each dependent. In terms of pre-war purchasing power, the value of these exemptions is actually $1,210 and $323—in view of the 24 percent rise in living costs. The exemption for single persons should be restored to $750, the value of which is only $600 in terms of pre-war purchasing power.

Under existing law, personal exemptions are allowed as a deduction from net income, and therefore serve to reduce the base subject to the normal tax, as well as the base subject to surtax. The amount of the exemption operates, in fact, to reduce the top bracket of the taxpayer's income. This method of computation gives the upper-bracket taxpayer a decidedly greater reduction in actual taxes paid, as a result of the personal exemption, than the lower-bracket taxpayer. Thus, the $1,200 personal exemption results in a tax saving of only $228 (at 6 percent normal tax rate plus the 13 percent surtax rate) to a married man in the lowest bracket. But to a taxpayer in the top bracket, the exemption means a tax saving of $1,056 (6 percent normal tax plus 82 percent surtax). The upper-bracket taxpayer, while possessing greater ability to pay, thus secures a far greater reduction in actual taxes paid than the low income taxpayer.

This discrimination in favor of the upper-bracket taxpayer should be eliminated by allowing personal exemptions (and the credit for dependents) as a credit against the tax, rather than against net income. The principle here proposed was endorsed by Colin F. Stam, Chief of Staff of the Joint Committee on Internal Revenue Taxation, in his testimony before the House Committee on Ways and Means in its hearings on the 1941 Revenue Act. It has also been recommended by Dr. Dewey Anderson, executive secretary of the Temporary National Economic Committee in his monograph Taxation, Recovery, and Defense.

In line with the recommendations made for restoring personal exemptions to the 1941 levels, at existing tax rates the "family status" tax credit should be approximately $175 for a single person with a net income of $750 or less, $350 for a married person with a net income of

$1,500 or less, and $90 for each dependent. If rates should change, the tax credit should be adjusted to reflect any such change. Thus under our proposal the tax would be computed on the amount of net income before exemption, and the credit would then be applied against the tax as a reduction in the tax, as so computed.

There is another change in the present personal exemption provisions, which we believe should be made. In order to accommodate exemptions to ability-to-pay, the amount of the tax credit should gradually diminish as net incomes increase, and should finally vanish altogether, at reasonably high income levels. For example, under our proposal, whereas a married man with a net income of $1,500 would obtain the full $350 tax credit, a married man with an income of $3,000 might obtain a credit of only $300, and a married man with a net income of $7,500 might obtain no tax credit whatever. In this way exemptions would be geared to ability to pay.

The basic reason for a personal exemption is to except from income taxation persons whose incomes are so small that they should not be subject to the income tax at all. Obviously, this reason has no application to taxpayers who are able to pay the progressive rates in the upper surtax brackets. In the high income groups, it is unnecessary to provid exemptions, since such incomes are adequate to provide for the taxpayer and his dependents without allowing exemptions. In order to preserve the basic principle on which the personal exemption is allowed, it is recommended that the personal exemption be allowed as a credit against the tax and be gradually reduced as the net income rises, until the credit vanishes entirely.

As to the earned income credit, the House-approved bill would eliminate the earned income credit. This is counter to the equitable principle of favoring earned income over unearned income. If simplification is desired, this objective can be achieved by allowing the earned income credit against the surtax as well as the normal tax so that the same tax schedule will be applicable to both. In line with wartime revenue needs, the credit might be limited to the first $3,000 of actually earned income.

The Ways and Means Committee rejected the Treasury's recommendation for the outright repeal of the Victory tax so as to relieve 9,000,000 hard-pressed families from an oppressive burden. Instead, it substituted for the temporary Victory tax, a permanent tax on the low incomes, calling for a minimum normal tax of 3 percent on incomes in excess of $500 for single persons, $700 for married persons, $100 for each dependent. Whereas the Victory tax would have expired automatically with the cessation of hostilities the substitution of the minimum tax is a permanent part of the income tax law and its removal will require affirmative action by Congress. Apart from the inequitable burden imposed by this minimum tax on incomes below the subsistence level, it calls for a set of exemptions different from those under the regular income tax. It is complex and confusing at a time when simplification of the tax system is desirable. In the interest of simplification and elemental justice, the minimum normal tax should be eliminated.

There are in our tax system certain provisions which grant special privileges to the relatively few, at the expense of the great majority of our people who must bear additional tax burdens for the revenue thus

lost. Secretary Morgenthau has said: "They are bad enough in time of peace—they are intolerable in time of war."

We recommend the elimination of such special privileges so as to provide for mandatory joint returns, taxation of governmental securities and the elimination of percentage-depletion allowances for oil and mining properties.

As to a sales tax, in war as in peace, a sales tax is unsound because it would impair the already inadequate standard of living of persons with low incomes. A general sales tax makes no distinction between rich and poor, between necessities and luxuries, and between large families and small families. The revenue derived from the sales tax is in very large measure realized at the expense of the essentials of life for the low income workers. The sales tax would, therefore, undermine the morale and productive efficiency of a large section of the working population. Moreover, it would hit hardest those people who are now bearing the brunt of the increase in living costs.

In addition to the utter unfairness of the sales tax the imposition of such a tax would seriously disturb our entire stabilization program. A general sales tax, more than any other tax, would produce an irresistable drive for higher wages and higher farm prices. It enters directly into the cost of living of all workers and into the index of prices paid by farmers which underlies farm parity prices. Thus, in the field of wages and in the field of farm prices, the efforts to hold the line against inflation would be upset.

Price ceilings would be seriously damaged since the sales tax would enter into industrial, agricultural, and commercial costs. Directly or indirectly, the ceiling prices and support prices, (guaranteed by the Government to farmers) of most farm products are linked to farm parity prices. It has been officially estimated that a 10 percent sales tax would increase the parity index by 6 or 7 percent. The operation of the parity formula would immediately raise the parity prices for agricultural commodities by 6 or 7 percent. Ceiling prices and support prices of various products would have to be adjusted to reflect these changes in parity.

Statistics of the Bureau of Agricultural Economics show that, if a 10-percent sales tax had become effective July 1, 1943, there would have been an average increase of 6 percent in retail food prices during 1944. This increase, added to a 10-percent tax on food sales, would raise food costs by approximately 16 percent. A sales tax is inflationary, not anti-inflationary, for it increases living costs by direct price increases and by indirect tax-induced increases in food prices, as well as developing inflationary forces by mutual interaction of price and wage increases. The sales tax would fan the fires of inflation and upset the stabilization program.

Finally, there are additional practical objections. Since a Federal retail sales tax will be a new tax, it would impose upon the Bureau of Internal Revenue an added administrative burden out of all proportion with the burden of collecting an equal amount of additional revenue from existing taxes. A retail sales tax would have to be collected by more than two and a half million business establishments scattered throughout the country. Trained personnel, accounting machines, automobiles, tires and gasoline would be required. Even if obtainable, adequate enforcement of this tax would divert valuable manpower and equipment which could better be employed in more

productive capacity. Nor can we overlook the fact that merchants would be required to keep adequate records. Here again, valuable manpower would not be employed in its most productive capacity.

In the interest of the war effort, additional revenue should come, not from a sales tax which burdens the poor, but from increased taxation of the large incomes, the unprecedented corporate profits and from large inheritances. The adoption of the guild's proposals would raise substantial revenues, aid in siphoning off the most dangerously inflationary incomes, and avoid cuts into the necessary subsistence of those who fight the battles of production on the farm and in the factories.

The enactment of the lawyers guild tax program would fit into the pattern of a democracy paying the tax costs of this people's war for survival. It would create a powerful instrument for victory.

I would like to submit for the record a small pamphlet containing the program of the National Lawyers Guild and a joint statement by various organizations.

Senator WALSH. They may be included in the report.

(The documents referred to follow:)

A 1943 WAR TAX PROGRAM

NATIONAL LAWYERS GUILD 9-POINT WARTIME TAX PROGRAM

(Prepared by National Committee on Taxation, October 5, 1943, Washington, D. C.)

The Lawyers Guild 9-point tax program set forth below is designed to aid in the fight against inflation, to raise additional revenues for the financing of the war, and to impose levies in accordance with the democratic principle of taxation according to ability to pay:

1. *Individual income tax.*—Rates should be increased on all family incomes above $2,500, and on commensurate levels for single persons, with a $25,000 ceiling on all net incomes, after taxes.

2. *Personal exemptions.*—Income tax exemptions should be restored to $750 for single persons, $1,500 for married couples, and $400 for each dependent. Personal exemptions should be allowed as a credit against the tax, rather than a deduction against net income, and the tax credit should gradually diminish as net incomes increase, finally vanishing at reasonably high income levels.

3. *Victory tax.*—The 5-percent tax on gross earnings above $12 a week should be repealed, and not replaced by other levies on low incomes.

4. *Corporate surtax.*—The existing income and surtax rates on corporate incomes above $25,000 should be increased from the present level of 40 percent to at least 55 percent.

5. *Corporate excess profits tax.*—An effective excess profits tax at the rate of 90 percent, without post-war credit, should be levied on profits above 4 to 5 percent of invested capital. Profits in excess of average 1936-39 profits, but below 4 to 5 percent of invested capital should be taxed at the rate of 65 percent.

6. *Estate and gift taxes.*—An integrated estate-and-gift-tax system, with a single exemption of $20,000 and a single set of graduated rates, drastically increased for all brackets, should be adopted. A maximum of $5,000 annually in gifts for each donor should be tax free.

7. *Special privileges.*—Compulsory joint returns should be required, with a special allowance for a wife's earned income. Percentage depletion allowances to owners of mines and oil and gas wells should be eliminated. Interest from all outstanding Federal securities and from all outstanding and future issues of State and local securities should be subject to taxation, with the Federal Government granting an appropriate subsidy to States and localities which borrow in the future.

8. *Excise taxes.*—Heavy excise taxes on luxuries and nonessentials should be imposed. Consumers should be allowed to deduct, for income-tax purposes, taxes levied on cigarettes, gasoline, liquor, cosmetics, fur, jewelry, etc.

9. *Sales tax.*—A general sales tax or other tax burdens on the already heavily taxed low-income groups must be rejected.

A 1943 WAR TAX PROGRAM

The vital question facing Congress in undertaking the task of raising billions of dollars in new revenues is this: Are the new levies to come out of the profits of business and the pockets of the comfortable and the well-to-do, or are they to come out of the earnings of the average man and woman in this country?

Our main thesis is that corporate business, with its phenomenal profits, and the segments of our population which are receiving comfortable and large incomes should bear the brunt of new levies; and that the time has come to call a halt to the imposition of new tax loads on the average American family, namely, the family with an income under $2,500 a year.

There are 20.6 million families in this country with incomes under $2,500, or 61.8 percent of all the Nation's families.[1] They received in 1942, 29.7 percent of the aggregate income of all families, and bought 38.8 percent of the country's consumers' goods and services. They thus constitute 6 out of every 10 families, receive less than $3 out of every $10 of the national family income, and spend less than $4 out of every $10 spent by consumers.

This average American family, which we assert should not be subjected to additional new levies, is to be contrasted with the comfortable and rich families, which we assert should be subject to new levies. These families, with incomes above $2,500 comprised only 38.2 percent of the Nation's families in 1942, or 12.7 million families, but they received 70.3 percent of the total income of all families, and bought 61.2 percent of our national purchases of goods and services.

THE AVERAGE AMERICAN IS ALREADY BEARING AN EXCESSIVELY HEAVY TAX BURDEN

Secretary Morgenthau stated on March 16, 1942, that Treasury studies had shown that a single person earning $750 a year, not then subject to Federal income tax, paid direct and hidden indirect Federal, State, and local taxes of $130. This constituted 17.3 percent of his income and represented 8 weeks' pay. A married man, with no dependents, said Secretary Morgenthau, earning $1,500 paid $250 in taxes, 16.7 percent of his income, or an equivalent of 8 weeks' work. These figures approximate the results of the study made by Gerhard Colm and Helen Tarasov of the Department of Commerce, for the Temporary National Economic Committee ('Who Pays Taxes, Monograph No. 3), which reached the following conclusions as to the Federal, State, and local tax burdens of income classes up to $3,000:

Income classes	Federal, State, and local taxes	
	Percentage of income	Amount
Under $500	21.9	Up to $109.
$500 to $1,000	18.0	$90 to $180.
$1,000 to $1,500	17.3	$173 to $259.
$1,500 to $2,000	17.8	$267 to $356.
$2,000 to $3,000	17.5	$350 to $525.

These were the figures at a time when personal income-tax exemptions were $1,500 for married persons and family heads and $750 for single persons. Since then the exemptions have been lowered to $1,200 and $500, respectively.

These were the figures at a time when there was no so-called Victory tax of 5 percent on all incomes above $12 a week.

These were the figures at a time when the income-tax rate on the first $2,000 of taxable net income was 10 percent, not 19 percent, when the taxes on tobaccos, liquors, and admissions were substantially lower than at present.

In a word, the average American family now beats a substantially heavier burden of taxation than the approximately 17 percent of his entire income, as reported by the Treasury a year and a half ago.

[1] The figures used throughout this memorandum as to national income, the distribution of incomes, and consumers' spendings and savings, unless otherwise indicated, are taken from Civilian Spending and Saving, 1941 and 1942, Office of Price Administration (Division of Research, Consumer Income and Demand Branch), Mar. 1, 1943).

THE AVERAGE AMERICAN FAMILY HAS BORNE THE BRUNT OF THE NATION'S SACRIFICE IN THE BATTLE AGAINST INFLATION

The President's 7-point program for combating inflation, announced on April 28, 1942, was a well-rounded plan for attacking from all angles our No. 1 economic problem. Taxes, price control, wage stabilization, ceilings on agricultural products, rationing, credit control, and voluntary savings were interrelated parts of a unified program, calling for sacrifices from all segments of the population, not merely the average American family. As enacted and as administered, however, the average American family has borne a disproportionately heavy burden of the Nation's sacrifice to combat inflation, while other segments of our Nation have profited handsomely.

(1) *The tax plank.*—We have already referred to the taxes imposed on the average family. The booming net profits of corporations, discussed, at pages 5–6, infra, provide incontrovertible testimony of the startling fact that for American business the wartime tax program to date has not meant net sacrifice, but has permitted large net profits. Nor have the increases or changes in the income, estate, gift and other Federal taxes, been adequate to require of the families in this country with incomes in excess of $2,500 a year tax payments commensurate with their incomes, or the Nation's needs. Tax exempt securities still afford a haven of tax exemption for this portion of our people, who make up the bulk of the Nation's investors in securities. Separate income-tax returns for husband and wife still sharply cut down their income taxes. Last year, Congress canceled billions of dollars of tax liability in connection with the adoption of the so-called pay-as-you-go tax plan, thereby granting subsidies to taxpayers, which grew larger as the taxpayer's income increased. There is no more striking commentary on the essentially regressive character of our wartime tax program to date than the enactment of a basic 24 percent income tax rate (i. e., the income tax plus the Victory tax), the lowering of personal exemptions to $23 a week for a married man and $10 a week for a single man, and at the same time the refusal to limit wartime incomes, after taxes, to $25,000 a year.

The tax plank of the antiinflation program has, thus, borne down heavily upon the average American, without requiring anything like commensurate sacrifice by the rest of our people.

(2) *The wage stabilization plank.*—The outstanding success of the 7 point program has been the wage stabilization plank, which has stabilized the earnings of the average American. The Little Steel formula, adopted by the War Labor Board on July 16, 1942, as supplemented by the President's stabilization order of October 3, 1942, and his hold-the-line-order of April 8, 1943, has resulted in general in the stabilization of wage rates at May, 1942 levels. The complete effectiveness of the wage stabilization policy in keeping wage scales down is reflected in War Labor Board Chairman Davis' statement that "The wage adjustments approved by the War Labor Board since October 3 have had a microscopic effect upon prices * * *. The * * * facts show that the Board has succeeded in so controlling wages and salary increases since September, 1942 that they have not added perceptibly, either, directly or indirectly, to the cost-of-living-burden of the American people."[1]

Where weekly pay envelopes, as distinguished from wage rates or wage scales, have substantially risen, the rise has been the result of added sweat and toil of the worker. They have come from long hours of overtime, from bonus payments for speedup production, from improved skills and shifts to higher paid industries and jobs. Increased work and increased production for the war and civilian fronts, in other words, not increased hourly pay scales, have been responsible for higher weekly pay envelopes.

In short, the average American has had his pay envelope stabilized—a crucially important contribution to the war effort.

(3) *The price control plank.*—While the average American's wages have been stabilized, the prices of the goods and services he buys have by and large not been kept under effective control. The Labor Department's index of the cost of living has risen more than 24 percent since January 1941, 9 percent above the 15-percent increase over the January 1941 wage levels, at which wages have been stabilized. The average American family is thus at least 9 percent in the red in the balance between prices and wage rates. Food prices have gone up 17 percent since May 1942 and 40 percent since January 1940. Indeed, the average family has undoubtedly suffered a far greater loss in income through the widespread

[1] First Monthly Report, National War Labor Board (May 10, 1943), pp. 1-2. For a more extended discussion of inflation and wage stabilization, see *Holding the Line Against Wages*, 8 Lawyers Guild Review 86 (May-June, 1943).

violations of ceiling prices, which are not adequately reflected in the published figures of price and cost-of-living rises. Office of Price Administration's belated attempt to roll back prices has thus far had only an insignificant effect on the cost of living.

(4) *The voluntary savings plank.*—The average American is contributing heavily, very heavily, to the purchase of War Savings bonds. Twenty-seven million workers are now buying bonds through pay-roll-deduction plans. The success of the pay-roll purchase plan is a tribute to the patriotism and sacrifices of the average American. Families with incomes under $2,500 saved $2.4 billion in 1942; those receiving from $1,500 to $2,000 a year, saved 10.9 percent of their incomes, and those with incomes from $2,000 to $2,500 a year saved 15.3 percent of their incomes. These savings, which were undoubtedly largely in War Savings bonds, constitute a phenomenal percentage of savings for such income groups, in the face of rising living costs.

* * * * * * *

The record thus unmistakably establishes that the average American family has sacrificed heavily in the fight against inflation.

AMERICAN CORPORATE BUSINESS IS REAPING ENORMOUS PROFITS OUT OF THE WAR

Corporate profits, before taxes, have nearly quadrupled since 1939; they rose from 5.3 billion dollars in 1939 to 20.1 billion dollars in 1942. Corporate profits, after taxes, have more than doubled since 1939, increasing from 3.3 billion dollars to 7.6 billion dollars in 1942. And they are still rising. For the first half of 1943, corporate profits, before taxes, rose from 8.9 billion dollars for the same period in 1942, to 11.2 billion dollars, an increase of 26 percent. After taxes, corporate profits were up 14 percent for the first half of 1943 over the first half of 1942. During the 3 war years, 1941–43, American corporations will have earned an estimated 24.2 billion dollars in profits, after taxes; they will have paid out 12.6 billion dollars in dividends, leaving 11.6 billion dollars in undistributed profits.[1]

It is apparent that our tax laws have not fulfilled the President's declaration to the American people, in 1940, that the tax burden must be "equitably distributed according to ability to pay so that a few do not gain from the sacrifices of the many." The few have indeed gained enormously from the heavy sacrifices of the many.

It is apparent that business has profited handsomely from the war; and that existing income and excess profits taxes, as well as renegotiation statutes, have thus far been ineffective in preventing the war from producing highly lucrative corporate earnings.

THE FIGHT AGAINST INFLATION REQUIRES ADDITIONAL TAXES ON BUSINESS AND ON THE COMFORTABLE AND THE RICH, NOT ON THE AVERAGE FAMILY

To combat inflation, new taxes must be directed at the most dangerously inflationary incomes. Those are the incomes of the 38 percent of the Nation's families receiving above $2,500 a year. And the way to siphon off these dangerously inflationary incomes is both to impose direct taxes on these above-average-income families, and to cut down a substantial part of their incomes at their source, through taxes on the corporations whose securities many of these families hold.

There is a widespread misconception that to combat inflation, it is necessary to siphon off a part of the incomes of the low-income groups; that these groups hold the "hot money," which is flooding the market place and causing price rises; and that taxes must be imposed on these, the low-income levels, to deal with inflation. This is a dangerous misconception, which has been energetically propagated by spokesmen for business and representatives of the higher income levels, in an effort to avoid the imposition of a fair share of the tax burden on the interests for which they speak.

(1) *Distribution of incomes and purchasing power.*—We have already noted that the 61.8 percent of our families with incomes under $2,500 received, in 1942, only 29.7 percent of the total family income—27.7 billion dollars out of 93.3 billion dollars. Obviously, the great mass of the people do not receive the mass incomes.

[1] The figures used throughout this memorandum as to corporate profits are taken from the testimony of Randolph E. Paul, General Counsel of the Treasury Department, in hearings before the House Committee on Ways and Means, Renegotiation of War Contracts, H. R. 2324, H. R. 2698, and H. R. 3018 (pt. 2, Sept. 10, 1943), pp. 204, et seq.

The facts also show that the masses of the people do not have the mass purchasing power. The 61.8 percent of our families with incomes under $2,500 in 1942 made less than 40 percent of the consumer expenditures of all families in the country. The three out of five families with incomes under $2,500 spent 25.5 billion dollars in 1942, whereas the remaining two out of five families with incomes above $2,500 spent, in 1942, approximately 40 billion dollars for consumers goods and services. The 12.7 million families with incomes above $2,500 thus spent 14.5 billion dollars more, for consumers goods and services, than all the 20.6 million families with incomes under $2,500.

(2) *Expenditures of average families.*—A consideration of the character of the goods and services purchased by the average family, as contrasted with the purchases made by the higher income levels, shows that the incomes which must be siphoned off are those of the latter group. The families receiving less than $2,500 in 1942 spent 34.9 percent of their incomes for food, whereas those with higher incomes spent only 15.2 percent of their incomes for food. The less than $2,500 group was obliged to spend 50 percent of their incomes for food, rent and household fuel, whereas the higher level groups required only 25 percent of their incomes for these essentials. Put otherwise in terms of total expenditures, after providing for food, housing and fuel, the 20.6 million families with incomes under $2,500 spent only 11.6 billion dollars for transportation, the doctor, the dentist, education recreation and all other goods and services, whereas the 12.7 million families with incomes above $2,500 spent nearly double that amount, or 21.4 billion dollars for such purposes.

(3) *Average family incomes and nation's health and productive capacity.*—Certainly, the sound way to combat inflation is not to cut down on the amounts available to the groups under $2,500 with which to buy food. A Bureau of Labor Statistics study has shown that the average city family, although spending more for food in 1942 than in 1941, obtained "less food or cheaper food in 1942 than in 1941" because of higher prices.[4] This reflects an ominous condition for the nation's health, and, indeed, contains a serious threat to the war effort, for workers cannot produce guns and tanks and airplanes—with accelerated production schedules, long hours of overtime and curtailed holidays—without a completely adequate diet.

The Office of Price Administration has warned the Nation of this danger to the health of our people and to the effective prosecution of the war. In a recent study of the Nation's spending and saving, it declared that the consumers with incomes under $1,500 a year in 1942 were "just barely able on the average to maintain even their usual low living standards out of current incomes,"[5] and that those with incomes from $1,500 to $3,000 "probably are not much above the levels which, under existing conditions, will adequately preserve the health, efficiency, and morale of civilian families."[6] That this is a highly conservative statement is shown by the authoritative studies of standard of living made by the Heller committee of the University of California.[7]

We cannot afford, therefore, further to cut down on the food basket of the average family. Nor can it be seriously argued that the average family should have the rent item in its budget cut. With rents at new highs, especially in war-plant areas, the Nation's problem is how to provide the average family with proper housing and with the funds to pay their rent—not how to cut down on the portion of incomes required to pay the landlord.

These items, food and rent, together with household fuel, account, as stated, for over 50 percent of the average family's income and percent of their expenditures for consumers' goods and services. They cannot be cut down if the Nation's health is to be preserved and if the production front is to keep the arsenal of democracy adequately supplied.

Nor can we safely cut down on other expenditures made by the average family. The increased dollar pay envelopes of the average family have not resulted in any "boom spending and 'silk shirt' prosperity."[8] The Department of Labor has found that the "only expenditures of the average [city] consumer that showed notable increases in average amount between 1941 and 1942 were food, fuel, and medical care." And, as already stated, in the case of food, the average consumer spent more money but carried home less or poorer food in his food basket.

[4] Income and Spending and Saving of City Families in Wartime, 55 Monthly Labor Review, Sept. 194, p. 419, at p. 477.
[5] See Civilian Spending and Saving, 1941 and 1942, note 1, supra, at p. 5.
[6] Idem, at p. 6.
[7] See Quantity and Cost Budget for Three Income Levels, Heller committee for research in social economics, University of California (1943).
[8] See note 4, supra.

In other words, it is not the families with incomes under $2,500 that receive the bulk of the Nation's incomes; they do not make the bulk of the Nation's spendings for consumer's goods and services; they spend the bulk of their incomes for food, rent and household operation; they are eating less, or poorer, food than in earlier years, despite larger expenditures; they have not gone on spending sprees with their increased dollar incomes; they are putting most of their increased dollar spendings into food, fuel and doctor's bills; and their standard of living is such that to reduce their expenditures through added taxation is to threaten the health of the Nation, as well as the effective prosecution of the war. The campaign to halt inflation does not require and cannot justify any cut in the incomes of the average family.

(4) *The basic necessities, rationing and price control.*—The instruments for dealing with shortages and with actual potential price rises in food, housing and other basic necessities is not taxation of the average family. The effective and democratic instruments for curbing inflation in these areas are rationing and price control.[9] Thereby, food and housing and clothing and the other necessities of life remain available to the entire community.

To use taxation as a device for curbing the purchases of life's necessities is to substitute the pocketbook for the ration book in allocating the community's supply of goods and services. The comfortable and the rich are still able, under a system of pocketbook rationing, to buy all the scarce goods and services they desire; only the average and the poor family has its purchases cut down. Moreover, by a scheme of pocketbook rationing, the average family is prevented from buying not only items, such as shoes, as to which there is a shortage, but in addition, milk and bread, and other necessities of life, as to which shortages may not exist. In other words, taxation, which imposes levies on the average family as a means of dealing with shortages and price rises, is a crude and undemocratic anti-inflationary device, which results in special privileges for the comfortable and higher income groups and discriminates against the average family.

(5) *Excess purchasing power of the higher income groups.*—There is idle and dangerous purchasing power which should be siphoned off in the fight against inflation, and which can be taxed and taxed heavily, without endangering either the health of the nation or the effective prosecution of the war. That purchasing power lies in the hands of the families with incomes above $2,500. The two out of five families which receive more than $7 out of every $10 of the national income, and which spend more than $6 out of every $10 of the nation's spendings have idle money, potentially dangerous money, which competes in the market place for goods and services not required for a more than decent standard of living.

The income of the higher income groups, i. e., those families and single consumers with incomes above $2,500 a year, increased by 16.8 billion dollars between 1941 and 1942. These incomes rose from 53.4 billion dollars in 1941 to 70.2 billion dollars in 1942. While their savings and taxes increased substantially in 1942, these higher level groups nevertheless spent 42.8 billion dollars in 1942.

These are the income groups which receive the bulk of the 4.1 billion dollars in dividends paid in 1942. These are the groups whose compensation was not subjected to governmental stabilization control until October 1942; during the three preceding war years, management, with booming business and soaring profits, sharply increased its own salaries, bonuses, and other compensation, without governmental restraint.

Moreover, it must be remembered that the higher income groups were in earlier years, responsible for the purchases of billions of dollars worth of goods which are no longer available, because of the war. They were the heavy spenders for cars, radios, washing machines, and other metal and rubber consumer's goods, which are largely no longer being made. These idle billions are pressing for new outlets of expenditures. These idle incomes—the incomes of the higher levels—constitute our greatest inflationary menace. And it should not be forgotten, as the Securities and Exchange Commission has repeatedly admonished us, that the increasingly large cash deposits in the Nation's banks, for which the higher income levels are largely responsible, present a constant potential inflationary danger.[10]

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[9] This is demonstrated by a recent report published by Office of Price Administration dealing with the rise in living costs in the first year of retail price control. Foods under ceilings at the beginning of that year advanced only 4.1 percent. Food brought under control during the year advanced 35.7 percent. Foods not controlled advanced in price 74.7 percent. Obviously the establishment of price control was the decisive factor in halting price rises.

[10] See Securities and Exchange Commission, Statistical Series, Release No. 731 (May 20, 1943).

Survey of Current Business (September 1943, p. 5), publication of the Department of Commerce, notes that although the large amounts of liquid funds saved by individuals out of their incomes were prevented from forcing up prices in 1942 and 1943, "they still constitute a potential threat to prices in the years ahead."

A sound anti-inflationary tax program thus requires that new taxes be levied, directly and indirectly, on the groups with incomes above $2,500. Heavy additional corporate taxes are a particularly effective instrument for siphoning off these incomes at the source, before rising corporate profits can be declared out as additional dividends to swell the purchasing power of stockholders. Increased individual income-tax rates, the closing of loopholes, the elimination of joint returns—these are the types of new taxes which should be levied to combat inflation. As stated in a recent Office of Price Administration study of spending and saving:

"With so large a proportion of consumption concentrated" in the consumers in the $3,000 to $5,000 area "economic developments and policies aimed at curtailment of expenditures are bound to have considerable impact in this area." And the group with incomes of $5,000 to $10,000 "is one which on the average appears to have a comfortable surplus with which to meet the demands for sacrifice imposed by the war. At the same time, measures which are aimed at control of inflationary demand pressure are likely to achieve substantial effect on this segment of the population".[11]

In short, progressive taxes—not regressive taxes—are required to combat inflation. Inflation control does not dictate cutting down the purchasing power of the average family. It does not require us to endanger the health or productive efficiency of the nation. It does require a tax program bearing down heavily on corporate profits and on the comfortable and higher incomes, a tax program based on ability to pay, a democratic tax program.[12]

The tax program set forth below is designed to aid in the fight against inflation, to raise additional revenues for the financing of the war, and to impose levies in accordance with the democratic principle of taxation according to ability to pay.

INDIVIDUAL INCOME TAX

(1) *Rate schedules.*—The individual income tax is the best available type of tax measured by ability to pay. Its rates and exemptions can be adjusted to the size of personal income and differing family responsibilities. It is a direct tax and therefore falls where Congress wants it to fall.

From the preceding analysis of income and purchasing power, it is clear that a sound anti-inflationary tax program requires that new taxes be levied on the higher incomes. Income-tax rates should be increased for such incomes but no additional taxes should be levied on families with incomes below $2,500.

In determining upon the increases to be made in income-tax rates, Congress should have in mind the fact that under the existing Federal Contributions Act, the employees' contribution is scheduled to rise from 1 to 2 percent in 1944, which will add several hundred million dollars to the tax bill of families with incomes under $2,500.

(2) *$25,000 ceiling on individual incomes.*—We believe that if Congress is to keep faith with the American people, it can no longer delay the enactment of the President's proposal that incomes, after taxes, be limited to $25,000 a year.

President Roosevelt, in presenting to Congress his seven-point program to check inflation, declared:

"* * * while the number of individual Americans affected is small, discrepancies between low personal incomes and very high personal incomes should be lessened; and I therefore believe that in time of this grave national danger, when all excess income should go to win the war, no American citizen ought to have a net income, after he has paid his taxes, of more than $25,000 a year."

What meaning can equality of sacrifice have if we fail to adopt the $25,000 ceiling? Nothing could be more calculated to stir the indignation of the millions of single people with incomes of $10 a week and married persons with incomes of $23 a week who are asked to pay income taxes at a rate of 19 percent, if the few thousand favored persons are allowed to retain hundreds of millions of dollars a year after taxes and beyond their $25,000 exemption. How can we ask John Q. citizen to put 10 percent of his income in War bonds or stamps, or to agree to stabilize his wages, while the few thousands at the top of the American economic scale retain their excess incomes?

The Office of Price Administration statistics (Civilian Spending and Saving, p. 17) reveal that 88.1 percent of the aggregate savings made by individuals in 1942 was made by families and single consumers above the $2,500 income level. These higher income groups saved $22.4 billion out of the total of $23.4 billion.

[11] See Civilian Spending and Saving, 1941 and 1942, note 1, supra, at pp. 7-8.

[12] For an extended presentation of this general point of view, see Helleristein, Inflation and Low Income Groups, 21 Taxes—The Tax Magazine 75 (February 1943).

The failure to adopt the President's $25,000 limitation would hinder the war effort by undermining morale, would breach an important sector in the battle against inflation, and would violate every principle of equality of sacrifice.

(3) *Personal exemptions.*—There can be no justification for any further lowering of the personal exemptions, which now begin at $500 a year for a single person and $1,200 for a married person, with a credit of $350 for each dependent. The exemptions were lowered in the 1940 Revenue Act; they were lowered again in the 1941 Revenue Act; and lowered still further in the 1942 Revenue Act. Moreover, their value to the taxpayer has been substantially reduced by the rise in the cost of living. In the face of a 24-percent wartime rise in living costs, the value of the $500 exemption is actually only $403 in pre-war purchasing power, while the value of the $1,200 exemption is in reality only $960. Such levels can hardly maintain even a minimum standard of living.

The lower income groups already pay a disproportionate part of their little incomes in indirect taxes of all kinds. Finally, as has previously been demonstrated, a further lowering of the exemptions cannot be justified as essential to the campaign to stave off inflation. Any lowering of present low levels of exemptions would deprive large segments of our population of the bare essentials of life, thereby undermining the health and morale of our people to the detriment of the war effort.

To enable the working population to retain its present share of the available basic goods necessary for life and productive efficiency, married couples in the lower income brackets should be allowed an exemption of $1,500, with an additional allowance of $400 for each dependent. In terms of pre-war purchasing power, the value of these exemptions is actually $1,210 and $323—in view of the 24-percent rise in living costs. The exemption for single persons should be restored to $750, the value of which is only $600 in terms of pre-war purchasing power.

(4) *Computation of personal exemptions.*—Under existing law, personal exemptions are allowed as a deduction from net income, and therefore serve to reduce the base subject to the normal tax, as well as the base subject to surtax. The amount of the exemption operates, in fact, to reduce the top bracket of the taxpayer's income. This method of computation gives the upper-bracket taxpayer a decidedly greater reduction in actual taxes paid, as a result of the personal exemption, than the lower-bracket taxpayer. Thus, the $1,200 personal exemption results in a tax saving of only $228 (the 6 percent normal tax rate plus the 13 percent surtax rate) to a married man in the lowest bracket. But to a taxpayer in the top bracket, the exemption means a tax saving of $1,056 (6 percent normal tax plus 82 percent surtax). The upper-bracket taxpayer, while possessing greater ability to pay, thus secures a far greater reduction in actual taxes paid than the low income taxpayer.

This discrimination in favor of the upper-bracket taxpayer should be eliminated by allowing personal exemptions (and the credit for dependents) as a credit against the tax, rather than against net income. The principle here proposed was endorsed by Colin F. Stam, chief of staff of the Joint Committee on Internal Revenue Taxation, in his testimony before the House Committee on Ways and Means in its hearings on the 1941 Revenue Act.[12] It has also been recommended by Dr. Dewey Anderson, executive secretary of the Temporary National Economic Committee, in his monograph, Taxation, Recovery, and Defense.

In line with the recommendations made for restoring personal exemptions to the 1941 levels, at existing tax rates the family status tax credit should be $150 for a single person with a net income of $750 or less, $300 for a married person with a net income of $1,500 or less, and $80 for each dependent. Thus under our proposal the tax would be computed on the amount of net income before exemption, and the credit would then be applied against the tax as a reduction in the tax, as so computed.

There is another change in the present personal-exemption provisions which we believe should be made. In order to accommodate exemptions to ability to pay, the amount of the tax credit should gradually diminish as net incomes increase, and should finally vanish altogether, at reasonably high income levels. For example, under our proposal, whereas a married man with a net income of $1,500 would obtain the full $300 tax credit, a married man with an income of $3,000 might obtain a credit of only $250, and a married man with a net income of $7,500 might obtain no tax credit whatever. In this way exemptions would be geared to ability to pay.

[12] See hearings before the House Committee on Ways and Means, Revenue Revision of 1941 (Apr. 24, 1941), pp. 84-85.

The basic reason for a personal exemption is to except from income taxation persons whose incomes are so small that they should not be subject to the income tax at all. Obviously, this reason has no application to taxpayers who are able to pay the progressive rates in the upper surtax brackets. In the high income groups, it is unnecessary to provide exemptions, since such incomes are adequate to provide for the taxpayer and his dependents without allowing exemptions. In order to preserve the basic principal on which the personal exemption is allowed, it is recommended that the personal exemption be allowed as a credit against the tax and be gradually reduced as the net income rises, until the credit vanishes entirely.

REPEAL OF THE VICTORY TAX

The Victory tax, levying a flat 5-percent tax on gross income above $12 weekly, with no regard to living costs, family status, or dependents, should be repealed. A camouflaged form of sales tax, it hits incomes below subsistence levels. It imposes crushing burdens on the millions of America's ill-fed, ill-clad, and ill-housed families fighting the vital battle of production on the home front.

Its flat exemption of $12 a week fails to take into account differing family responsibilities, and its imposition on gross earnings rather than net income, constitute the grossest violation of the ability to pay principle. This 5-percent levy taxes wages below the danger line and thereby taxes the health, the strength, and war production of those producing the weapons of war. The Victory tax must be eliminated as a basic threat to national health and morale.

Not only is the Victory tax unjust and inequitable, but it also introduces unnecessary complications in the determination of income tax liability. It involves extra computations requiring the taxpayer to calculate part of his taxes on the basis of one exemption and part of it on the basis of another exemption, and requiring different sets of deductions for each basis.

In eliminating the Victory tax, the oppressive burden on low incomes so removed should not be replaced by other levies on such income. The Victory tax is the most regressive and undemocratic tax measure in American history. It should be repealed.

CORPORATE TAXES

(1) *Excess-profits taxation.*—A substantial share of increased corporate taxes should fall on excess profits. Taxes paid from such profits have less disrupting effects on business than taxes which are generally applicable to all corporate earnings, irrespective of the rate of return. A tax which absorbs excess profits tends to leave the corporate taxpayer with a sufficient margin of income for dividends and safety. Increases in excess-profits taxes have the additional virtue of recapturing undue profits on war contracts.

Under the Revenue Act of 1942, a flat rate of 90 percent was imposed on net income subject to excess-profits taxation; however, the total of the normal tax and surtax and excess-profits tax may not exceed 80 percent of the corporation surtax income. A post-war credit of 10 percent of the excess-profits tax is also provided which may be currently used for debt retirement. The invested capital credit (amount exempted from excess-profits tax) was revised to allow 8 percent on the first $5,000,000, 7 percent on the next $5,000,000, 6 percent on the next $190,000,000, and 5 percent on the balance of invested capital. Finally, a large number of relief provisions designed to benefit corporate taxpayers were adopted, which mean a substantial reduction in the amount of excess-profits taxes payable or finally collectible.

High excess-profits-tax rates alone, however, will have comparatively little effect on those corporations which virtually escape the tax because of the large amounts exempted (called credit in the law) from the excess-profits tax. The existing law exempts from taxation (1) 95 percent of the average 1936-39 earnings, or (2) a 5 to 8 percent return on invested capital, whichever credit is higher—a "heads the corporation wins, tails the Government loses" proposition. Only the annual profits above the higher credit is subject to excess-profits taxation.

The average-earnings credit remains unchanged so that corporations with large pre-war earnings continue to avoid their fair share of the excess-profits tax. Borrowed capital is still treated as invested capital to the extent of 50 percent.

Because of the heavy capitalization of some corporations, and the prosperous pre-war earnings, of others, the unprecedented profits of some of the largest and most profitable corporations in America will not be substantially recaptured by the existing excess-profits-tax law. The record of corporation profits after taxes, referred to at pages 5-6, supra, proves this.

The President, in his seven-point anti-inflation message, said:

"We must tax heavily and in that process keep personal and corporate profits at a reasonable rate, the word 'reasonable' being defined at a low level."

In line with the tax plank of the President's seven-point program, we propose that the credit for equity invested capital be reduced to 5 percent for the first $10,000,000 of invested capital and 4 percent for the balance; that the credit for borrowed capital be eliminated, inasmuch as interest deductions provide a proper allowance for the cost of such capital.

We would impose a rate of 90 percent on all profits in excess of the 4- to 5-percent return on invested capital, without any post-war credit; and where a corporation's current profits exceed its average 1936–39 profits, we would tax the difference between such 1936–39 average earnings and the invested-capital credit, at the rate of 65 percent. By this plan, corporations increasing their earnings in wartime would pay an excess-profits tax on the increased war profits. The profits subject to the 90- and 65-percent excess-profits tax rates would not be subject to the corporate normal tax or surtax. Corporations with net incomes under $10,000 would be entirely exempt from the excess-profits taxes.

The profound importance of excess-profits taxation to the war effort has been strikingly described by Secretary Morgenthau in his testimony before the Senate Finance Committee in 1942:

"There is no easier way to stir the righteous anger of the American people than to let them hear constantly of excessive wartime profits that are not being recovered by adequate taxation * * * An effective excess-profits tax does more than produce badly needed revenue in time of war. It also reassures the masses of our farmers and factory workers that industry is not being rewarded unduly for its part in the winning of the war." [14]

(2) *Corporate income tax.*—It is recommended that additional corporate taxes be provided by increasing the present corporate surtax rate from 16 percent to at least 31 percent on corporations with incomes of more than $25,000. This was the surtax rate proposed by the Treasury in 1942, but which was reduced to 16 percent by Congress. Combined with the present 24-percent normal tax, the 31-percent surtax would bring the aggregate of corporate-income tax rate to at least 55 percent of corporate incomes above $25,000.

There can be no fair quarrel with the imposition upon corporations of a substantial portion of the increased load of taxation required by our national emergency, inasmuch as American corporate business will still wind up with aggregate profits far in excess of those enjoyed in pre-war years.

REMOVAL OF SPECIAL PRIVILEGES

(1) *Mandatory joint returns.*—There are in our tax system certain provisions which grant special privileges to the relatively few, at the expense of the great majority of our people who must bear additional tax burdens for the revenue thereby lost. At a time when the great mass of the taxpayers are called upon to pay billions of dollars in additional revenues, there is no justification for perpetuating these special privileges. As Secretary Morgenthau has said: "They are bad enough in time of peace—they are intolerable in time of war."

The privilege allowed married couples to file separate income-tax returns affords a means of tax escape for those with large incomes. This option has little or no value for most taxpayers since, at the present time, married couples with incomes of up to $3,200 (the amount is higher in the case of married couples with dependents) pay the same total tax whether they file joint returns or separate returns. However, it makes a great deal of difference in tax in the case of married couples with large incomes, particularly where the income is more or less evenly divided between husband and wife. Thus, if a $20,000 net income is divided evenly between husband and wife and separate returns are filed, each $10,000 is subjected to a surtax rate ranging from 13 to 28 percent; whereas if joint returns are required, the first $10,000 would be subjected to the 13 to 28 percent rates, but the second $10,000 would be subjected to surtax rates of 32 to 46 percent.

What is more—in the brackets above $3,200, the tax advantage is graduated in direct proportion to income—the ability-to-pay principle in reverse.

In the past, the Treasury has recommended that the "special favoritism" in the tax laws which grants to married couples the option of filing separate income tax returns be abolished. Under the compulsory joint return provision the tax liability of husband and wife would be computed upon their combined incomes.

[14] See hearings before the Senate Committee on Finance, Revenue Revision of 1942 (July 23, 1942), p. 7.

The actual tax burden, however, could be allocated between the spouses as they pleased so that neither would be obliged to pay the tax due from the other. The Treasury also proposed at that time a special allowance for a wife's earned income (a credit of 10 percent of her salary, up to $100 credit) so as to compensate for the additional household expense usually incurred. The mandatory joint return provision would yield hundreds of millions in additional revenue.

It is obvious, therefore, that the true basis for objections raised to the mandatory joint-return proposal is not the fact that family expenses may increase where a man and wife both work, for the bulk of the working population is not in the income classes which benefit from the separate-return privilege, and, what is more, the "working wife tax credit" proposal would give relief where the wife works outside the home.

The Ways and Means Committee advocated compulsory joint returns in the 1941 revenue bill. Although the arguments for mandatory joint returns marshaled by the committee in its report [18] have never been effectively refuted, the mandatory joint-return provision still remains to be enacted. The filing of joint returns by husband and wife is compulsory in Great Britain.

The ability of a man and his wife to pay taxes is measured by their joint incomes. The family rent or the real-estate taxes, junior's milk, and Mary's dress do not vary in price depending upon whether the family's income is derived from the earnings and property of the husband alone or of both spouses. Yet under the income-tax law as it now stands, the couple may pay a greater tax where the husband alone is the family breadwinner than if the wife contributes to the family income. Consider two couples without dependents each having net incomes of $8,000. In the one case, where the husband earns the entire income, the income tax will be $1,532 under existing rates. In the other, the husband and wife each have a net income of $4,000. By filing separate returns, each spouse will pay $664 (the top surtax rate is 16 percent). Their combined tax will be $1,328, a preference of $204 despite the fact that both families are in exactly the same income category.

The mandatory joint return requirement is particularly important in order to eliminate important loopholes. At the present time there are 9 so-called community property States in which one-half of the husband's earnings are attributed to the wife for income tax purposes. In the 39 noncommunity property States, on the other hand, the income is taxable to the spouse who earns it. The result is that married persons with high incomes in community property States pay lower taxes than married persons in the same income groups in noncommunity property States, despite the fact that in both cases the husband is the source of the entire family income. Thus, under the law as it now stands, a married man without dependents living in the noncommunity property States of Colorado or New York, and having a net income of $10,000 a year, would pay about $350 more than the man with the same income living in the community property States of California or Louisiana. There is no justification for such discrepancies in the application of the Federal income tax. This advantage would be removed if joint returns were made compulsory.

A second source of tax avoidance resulting from the special privilege of filing separate returns is the manipulation of incomes between husband and wife. For example, if a husband's only income were $20,000 from securities, he would pay a tax of $6,518 (under existing rates). But if he transfers half of his securities to his wife, by filing *a separate return* on her $10,000, she would pay $2,393 and he would pay the same on the $10,000 reported in his own separate return—thereby cutting the total tax by $1,722, or a 26 percent reduction.

Voices have been heard to say that mandatory joint returns will destroy the institution of marriage and send women back to marital slavery. This point of view seems fantastic in view of the fact that all that would happen would be that tax liability would be computed on family income, with the actual tax burden allocated between the spouses as they pleased. The husband would have no more right to his wife's income than he has under the existing law. If Henry earns $6,000 a year and Helen's earnings bring her $2,000 a year, their aggregate income tax under existing rates would be $1,257 if they remain single as against $1,297 if they married—an increase of $40 under the mandatory joint return requirement. If their marriage is to be prevented on account of $40 a year, it seems obvious that they ought to stay single. And if the additional $40 would lead to divorce, their marriage is probably on the rocks already.

[18] H. Rept. No. 1040, July 24, 1941.

At a time when we are levying heavy taxes on persons with small incomes, it is intolerable that comfortable and large incomes escape their fair share of the tax burden via the separate-return privilege—a privilege which should be abolished now.

(2) *Tax-exempt securities.*—The abolition of the tax shelter afforded recipients of tax-free interest from governmental securities is a vital war measure.

In this national emergency, every element in our population should bear its fair share of the financial burdens which war imposes. Through tax-exempt securities, however, persons with large taxpaying ability find themselves in a sheltered position. Obviously, they did not buy these securities at prices reflecting the great favor of escape from wartime burdens. The holders of tax-exempt securities are reaping windfall profits at a time of national sacrifice. Surely the holder of governmental securities is entitled to no greater tax immunity than the holder of a Victory baby bond—which is not tax-exempt. In Great Britain all interest from governmental securities is taxable.

There is a noticeable tendency for tax exempt securities to gravitate toward individuals with large incomes subject to high tax rates, at which they provide scandalous exemptions. The glaring unfairness of this exemption is evident from a case cited by the Treasury of an individual who had an income of $1,083,700 from tax-exempt securities, on which he did not pay a single penny in taxes.[1] Even under the Treasury's surtax rates proposed last year, which are higher than existing rates, this taxpayer would have a net income of $1,536,300 after all taxes were paid—more than 60 times the $25,000 limit urged by the President.

As income-tax rates increase, wealthy individuals are tempted more and more to shift their investments into the shelters of tax-exempts—considering that the net return after taxes of a 3 percent tax-exempt bond to a person with a net income of $100,000 is equivalent to the net return on a taxable bond yielding 20 percent.

The elimination of the tax exemption enjoyed by governmental securities, both outstanding and future issues, is long overdue. The law now provides for the taxation of all interest on Federal securities issued since March 1, 1941. We favor the taxation of the interest from all State and local securities, past and future issues, as well as of all outstanding Federal issues, so as to close the loophole through which many large taxpayers escape their just share of the tax burden.

State and local securities: The effort to eliminate the tax exemption of interest on State and local securities has met with substantial opposition from many State and municipal officials. Actually, it seems quite unlikely that States and municipalities would find this badly needed reform a serious obstacle to credit operations. It must be recalled that these governmental units managed quite well without this advantage before the income tax was adopted. In this earlier period, State and municipal bonds commanded an excellent market and enjoyed a considerable advantage over other bonds. Moreover, governmental units manage quite successfully to obtain credit in Canada, Australia, and many other countries, despite the absence of tax immunity.

It is generally conceded that the exemption may mean a difference in interest rates ranging up to one half of 1 percent. In recent years State and local bond issues have approximated $1,000,000,000 per year and if the volume should continue, extra interest payments would amount to $5,000,000 in the first year, and eventually this figure would increase. Against this loss would have to be offset the revenue which the States might derive if the States and municipalities were allowed to tax Federal bonds.

In resisting the taxation of tax-exempt securities, State and local officials are not concerned with protecting the patently unfair privileges of wealthy taxpayers. In urging the elimination of tax-exempt securities, it is unnecessary to deprive the States and municipalities of the fiscal advantages they now enjoy.

To resolve this dilemma, many suggestions have been made. These are most clearly set forth in the recent study made by the Committee on Intergovernmental Fiscal Relations:

"One proposal worth serious consideration is that the Federal Government might establish a Federal bank for States and municipalities. The lending operations of the Reconstruction Finance Corporation in recent years have been of substantial assistance to debtor States and municipalities, and such arrangements might be continued on a permanent basis. Another proposal worth considering is a crediting arrangement whereby the differential advantage in tax exemption of large income recipients would be wiped out. More promising

[1] Hearings before the House Committee on Ways and Means, Revenue Revision of 1942, at p. 3090.

politically, perhaps, is the suggestion that the Federal Government grant a direct subsidy to units which borrow in the future. The equivalent of one-half of 1 percent on the outstanding principal of new bond issues could be paid to the issuing units annually. This would have the effect of eliminating the inequities in the income tax created by tax exemption, and would convert a hidden and indirect subsidy into an open and direct one. If a compromise is necessary to secure action and promote better governmental relations, and such seems to be the case, this solution is recommended." [17]

Federal securities: The contention that existing issues of Federal securities should remain tax-free because they were issued as tax-free obligations ignores the all-important fact that we are a Nation at war fighting for our survival. At a time when men are giving their lives, when rationing, priorities, and price control produce marked changes in normal economic life, we are unimpressed by the plea that those who hold Government bonds should retain a rich avenue of escape from taxes because, in normal peace times, the securities were issued as tax-exempt. Nor do we believe there is any serious constitutional barrier to the taxation of interest on the billions of outstanding Federal, State, and municipal obligations.

Those who urge that the existing exemption for outstanding securities should not be disturbed should take heed of Secretary Morgenthau's statement, made before the Ways and Means Committee:

"In times of peace, when the strain on other elements in the population was not so heavy, there was much to be said for the gradual elimination of tax exemption through taxing future issues only. The national emergency of war makes this gradual approach unacceptable." [18]

(3) *Depletion allowances as to oil wells and mines.*—It is fair and proper that oil and mining companies be allowed the return of their capital free of tax and that is fully provided in the allowance for cost-depletion granted by law. However, percentage-depletion goes far beyond the point where it can be so justified. Oil and mining companies are no more entitled to these extra concessions than any other business involving the investment of capital.

The continuance of this provision which permits owners of oil and gas wells to deduct from their income 27½ percent of their gross receipts—a deduction allowed year in and year out, even after 100 percent of the cost of the property has been recovered—is a shocking violation of the basic principle of equity and cannot but adversely affect the morale of the American taxpayer. In the hearing, on the 1942 tax bill, Secretary Morgenthau called attention to a leading oil company owning oil properties costing $3,000,000, which had already taken percentage depletion allowances of 3.6 million dollars, although the properties still had three-fourths of the oil left. The persuasive testimony of Randolph Paul, then tax adviser to the Secretary of the Treasury, before the Ways and Means Committee in 1942 amply demonstrates that the elimination of percentage depletion will not endanger the supply of war materials needed for the war effort.

Finally, the existing option to capitalize or treat as an expense in tangible drilling and developing costs should be eliminated for both oil and gas wells and mines, and herefater such costs should be charged to capital account. Elemental justice and equity require the elimination of the percentage depletion allowance, thereby adding hundreds of millions in new revenue. The war makes it imperative that every special favor to one group of taxpayers should be eliminated.

(4) *Tax-exempt corporations engaged in business.*—Our revenue laws have been generous in exempting certain corporations from the income tax. Charitable or educational corporations are not subject to the income tax. Many exempt corporations, however, have so far departed from the purpose of the exemption as to engage in trades and business completely unrelated to their exempt activities, and yet the income of such business activities remains exempt from tax. Thus, if a college operates a hotel, the earnings of the hotel are exempt; if a charitable organization operates a bathing beach, the earnings of the beach are exempt. In this way sources of considerable tax revenue are withdrawn from the scope of the tax. At the same time privately owned businesses are forced to compete at a disadvantage with other businesses not subject to an income tax.

There is no justification for such distortion of the exemptions accorded to such organizations. We suggest that such corporations be taxed on the income derived from a trade or business not necessarily incident to their exempt activities. It might be desirable however to allow a flat exemption of $5,000 regardless of the nature of the business activity.

[17] Vol. 1, p. 34.
[18] See note 16, at p. 8.

DEDUCTIONS FOR TAXES PAID

Wartime rates make it imperative to eliminate, as far as possible, existing inequities which distort the tax burden of certain taxpayers. There is a striking unfairness in the deductions allowed under the income tax for taxes paid. In general, with certain exceptions such as Federal income taxes, taxes paid are deductible by the taxpayer in computing his net income for income-tax purposes. Because of the technical provisions of the statutes (which in form impose Federal excise taxes on the manufacturer, importer, or retailer), consumers are denied the deductions for excises imposed on gasoline, tobacco, liquor, cosmetics, furs, jewelry, etc. Yet, by and large, consumers pay these taxes, the retailers or manufacturers being merely tax-collecting agents. There is no warrant for this discrimination against the consumer; such taxes should be deductible by the consumer.

This principle was recognized in the 1942 Revenue Act, which allows a deduction to the ultimate consumer for State and local retail sales taxes, not imposed by law directly on the consumer, if the taxes are separately stated by the seller, and are based on the gross selling price of the article (sec. 23 (c) (3), Internal Revenue Code).

In addition, with respect to the employees' pay-roll tax under the Federal Insurance Contributions Act, the deduction by the employee, who is concededly the taxpayer, is disallowed. This discrimination against workers should likewise be abolished, and employees should be allowed to deduct the tax taken out of their pay envelopes.

ESTATE AND GIFT TAXES

(1) *Integration, exemptions, rates.*—Under existing law, an estate of $60,000 is entirely exempt from tax and an additional $30,000 may be transferred tax-free as a gift inter vivos. This means that $90,000 can still be transferred without paying a single penny in Federal estate or gift taxes. In addition, annual gifts of $3,000 to each donee may be made tax-free. Thus, the impact of estate taxes may be whittled away very substantially. It is no surprise, therefore, that the results of the existing estate tax system are fiscally disappointing. The estate and gift tax system needs thorough overhauling. If the job is done thoroughly, estate and gift taxes can be made to assume a place of prominence in the tax system, commensurate with their inherently progressive character.

Despite the very heavy increases in income-tax rates levied upon low incomes, estate and gift-tax rates have remained virtually unchanged during the national emergency. Even the comparatively mild increases proposed by the Treasury in 1942 were rejected. The net result of the amendments made in the estate-gift-tax system in the 1942 revision was that, instead of increasing estate and gift taxes in the amount of $309,000,000, as the Treasury had recommended, there will be an estimated loss of some $7,000,000.

We have noted that a principal avenue of estate-tax avoidance is through gifts made before death. What is required is an integration of the estate and gift taxes so that the rates shall be applicable to transfers in the aggregate, whether made before death or after death. In adopting an integrated estate and gift-tax system, a single set of drastically increased rates should be adopted with a single exemption of $20,000. Estate and gift-tax rates should be brought in line with the drastic reductions in income-tax exemptions and the drastic increases in income-tax rates which have been imposed upon the low-income groups. In England there is no specific exemption, but estates of less than $400 are not subject to tax. In Canada, the exemption varies from $20,000 for a widow to $1,000 per heir. No tax is levied if the estate is less than $5,000.

(2) *Annual gifts.*—Instead of permitting annual gifts of $3,000 to each donee to be tax-free, the annual exclusion should be limited to a maximum of $5,000 in all for each donor.

(3) *Estate tax deductions for contributions to controlled charitable or educational foundations.*—Existing provisions also enable decedents to perpetuate, through charitable or educational trusts and corporations, family or similar control over their wealth, without paying the estate tax. In the case of gigantic fortunes, such as those of John D. Rockefeller, Andrew Mellon, and Edsel Ford, it has been a familiar device to create family controlled tax-exempt foundations whereby vast sums are transferred tax-free but the wealth remains under the control of the donor's family. This device has cost the Federal government hundreds of millions of dollars in taxes, and constitutes a flagrant loophole in the estate tax law. Transfers to such controlled foundations should be taxable, for they are in substance a device for appearing to give away wealth, while perpetuating the control of the wealth in the decedent's family.

(4) *Contemplation of death.*—Congress should tighten up the provisions designed to tax the transfer of property in anticipation of death. The existing rebuttable presumption that a gift is in contemplation of death, if made within 2 years of death, has not been productive of substantial revenue, although it has been productive of litigation. It is therefore recommended that the provision be amended to provide that all transfers made by a donor over the age of 65, to the extent that such transfers to any one beneficiary exceed, in the aggregate, a specified sum, shall be subject to the estate tax.

(5) *Computation of credit for State taxes.*—The credit granted to a taxpayer against his Federal estate tax for death taxes paid to States consists of an amount up to 80 percent of the Federal tax paid under the 1926 Federal estate-tax statute. The Federal law has since been amended several times, with rates and exemptions revised, but the credit is still tied to the antiquated 1926 law. The credit should be adapted to the most recent estate-tax statute.

SPECIAL EXCISE TAXES

Heavy excise taxes on luxuries and nonessential items are desirable. In determining what are "luxuries," wartime definitions should be adopted, without taxing essentials. Considerable revenue can thus be raised. The Treasury has indicated that very substantial revenue can be raised by heavy excise taxes on luxuries.

The effects of special excise taxes are substantially different from the effects of a general sales tax. Such excise taxes help to conserve the materials needed for the war particularly, when they are imposed on commodities of which there is or will increasingly be a scarcity. Where excise taxes fall on goods which are of the luxury or semiluxury character, needed revenue may thus be obtained; and consumer purchasing power will thereby be tapped, without taxing consumers on necessaries of life. Such special excise taxes have the further advantage of not requiring any substantial expansion of administrative machinery.

FEDERAL SALES TAX

The drive is on again to foist a Federal sales tax upon the American people—on top of all of the heavy burdens already imposed on the low-income groups. The issue is clear—shall Congress adopt those proposals based upon the principle of ability-to-pay, or shall Congress resort to such devices as a general sales tax, which would fall with the greatest impact upon those least able to bear the burden?

We have already shown that inflation control does not require cutting down the purchasing power of the low-income groups. The families with incomes under $2,500 do not have excess purchasing power. A sales tax hitting as it does the low incomes cannot, therefore, be justified as essential to the program of curbing inflation.

The striking unfairness of a general sales tax, on any ground, is demonstrated by the fact that such a tax would hit the poorest people four times as hard as the wealthy. Treasury Department statistics demonstrate that the sales tax is the exact opposite of the ability-to-pay income tax. The income tax graduates upward from no tax on the lowest incomes to a top of 88 percent on the highest incomes. But a sales tax would graduate downward. For example a sales tax absorbing 10 percent of the income of persons earning less than $500 a year, would graduate downward so as to absorb 2.7 percent of the income of persons making more than $10,000 a year. According to the Treasury Department's data, a sales tax absorbing 10 percent of incomes of $500 or less would produce the following: [10]

Income class	Tax burden (food taxed)[1]	Tax burden (food exempt)[1]
	Percent	*Percent*
$500 or under	10	10
$1,000 to $1,250	7.1	8.7
$2,000 to $2,500	5.9	8.2
$4,000 to $5,000	4.9	7.7
$5,000 to $10,000	4.2	6.9
Over $10,000	2.7	4.9

[1] These figures show the relative percentages of income taken by a retail sales tax, according to income class, not the actual percentage of income absorbed by such a tax.

[10] See hearings before the House Committee on Ways and Means, Revenue Revision of 1942 (March 16 1942), p. 352.

The sales tax hits the poor people hardest because the lowest-income groups are obliged to spend all of their small incomes while the higher-income groups spend only a part of their incomes. In addition, a substantial part of the spending of higher-income groups goes for personal services which would escape sales taxes.

The Secretary of the Treasury, in his testimony before the Ways and Means Committee in 1942, forcefully presented to the Nation the vital reasons for opposition to a general sales tax.

1. "The general sales tax falls on scarce and plentiful commodities alike."
2. "It strikes at necessaries and luxuries alike."
3. "As compared with the taxes proposed in this (the Treasury's) program, it bears disproportionately on the low-income groups whose incomes are almost wholly spent on consumer goods. It is, therefore, regressive and encroaches harmfully upon the standard of living."
4. "It increases prices and makes price control more difficult. It stimulates demands for higher wages and adds to the parity prices of agricultural products."
5. "It is not, as many suppose, easily collected; on the contrary, its collection would require much additional administrative machinery at a time when manpower is limited." [30]

We should also add that the Treasury's statistics demonstrate that a sales tax that does not hit food would not raise much revenue. Even a stiff 10-percent retail tax, which excluded food, Government purchases, and those articles already subject to severe excise taxes, would raise only $1,691,000,000, based on 1942 estimates. If medicines, clothing, and fuel were also exempt, a 10-percent sales tax would raise only $780,000,000. In addition, a sales tax would considerably complicate our fiscal problems, for it would tend to increase substantially the cost of producing the sinews of war.

Nor can we too strongly warn of the grave effect on national morale if Congress were to adopt so unfair, inequitable, and regressive a measure as a general sales tax. A general sales tax would foster national disunity and seriously hamper the war effort—a worker without calories cannot efficiently produce war materials.

CONCLUSION

A grave responsibility rests on Congress, and particularly on this committee, to see that the new Revenue Act is fashioned so as to strengthen the unity of our people, to mobilize the maximum production of tanks, ships, and war material, not to retard such production—never forgetting that a production soldier, deprived of sufficient calories by oppressive taxation, cannot effectively produce war materials.

The time has, therefore, come to enact a war-tax program which will effectively recapture war profits.

The time has come to halt the piling of new tax burdens onto the shoulders of the average American family.

The time has come to require the comfortable and the rich to bear their fair share of the tax costs of financing the war.

The time has come to insist on progressive taxes and to resist all attempts to foist new regressive levies on the American people.

The time has come, in short, to enact a democratic wartime tax program for America.

The enactment of the Lawyers Guild's tax program would fit into the pattern of a democracy paying the tax costs of this people's war for survival. It would fit into the struggle against inflation and the battle to keep the Nation's morale at its highest peak. It would create a powerful instrument for victory.

NATIONAL COMMITTEE ON TAXATION, NATIONAL LAWYERS GUILD.
OCTOBER 5, 1942.

Mr. WOLFE. Formidable batteries of talent, especially retained or in their own interest, either for this occasion or continuously engaged in watching matters of this sort, have appeared and have spoken long and not without reason, in every case. But, there is a war being fought, men and women are dying for a cause—while here in this chamber men have appealed and have argued, for what? Profits—profits! while men are dying and Government needs revenue to support these

[30] Idem, p. 7 (March 3, 1942).

fighting men. Now gentlemen, there's no crime in being businessmen, and there's no crime in making profits. But, these are wartimes and Government revenues must come from profits. You can't take taxes out of our citizens' food, clothing and shelter; you can't take taxes out of their subsistence allowances while there are still profits over and above salary allowances to all concerned. Free enterprise needs a free country and there's a war being fought to preserve it. Gentlemen, I am a practicing attorney and certified public accountant. My appearance here and my service in the interest of the wage earner and small businessman may lose me some personal income. It certainly can't get me any. Now examine the interest of those who have testified. How many have had their country's interests at heart? And, who, pray, is the country but the great vast number, far exceeding a majority of our citizens, who are wage earners and small business men.

The enactment of the Lawyers Guild tax program would fit into the pattern of a democracy, paying the tax costs of this people's war for survival. It would create a powerful instrument for victory.

Senator WALSH. Thank you.

(The following statements were submitted for the record:)

JOINT STATEMENT OF PHILIP MURRAY, PRESIDENT, CONGRESS OF INDUSTRIAL ORGANIZATIONS; JAMES G. PATTON, PRESIDENT, NATIONAL FARMERS UNION; A. F. WHITNEY, PRESIDENT, BROTHERHOOD OF RAILROAD TRAINMEN; WILLIAM H. HASTIE, CHAIRMAN LEGAL COMMITTEE, NATIONAL ASSOCIATION FOR THE ADVANCEMENT OF COLORED PEOPLE; ELISABETH CHRISTMAN, SECRETARY-TREASURER, NATIONAL WOMEN'S TRADE UNION LEAGUE OF AMERICA; KATHERINE ARMATAGE, CHAIRMAN OF BOARD, LEAGUE OF WOMEN SHOPPERS; ARTHUR KALLET, DIRECTOR, CONSUMERS UNION; ROBERT W. KENNY, PRESIDENT, NATIONAL LAWYERS GUILD

STATEMENT ON TAX BILL VOTED BY HOUSE WAYS AND MEANS COMMITTEE

The tax bill tentatively agreed upon by the House Ways and Means Committee does not meet the basic requirements of a revenue act for America at war. It does not tax adequately high personal incomes, the unparalleled corporate profits, and the large inheritances, while continuing disproportionately heavy burdens on the common man with meager income.

The Ways and Means Committee would perpetuate the oppressive burden of the Victory tax on 9,000,000 hard-pressed families, although the Victory tax as such would be technically repealed. The committee has failed to provide adequate income-tax exemptions, retaining the present substandard levels of $500, $1,200, and $350, in the face of the steep rise in living costs. The committee has failed to impose increased income taxes on persons with large incomes who are well able to carry a heavier share. The committee would continue the unwarranted tax-exemption of governmental securities, the exorbitant percentage-depletion allowances for owners of oil and mining properties, and the special privilege of separate returns. The committee has refused to adopt the wartime principle that for the duration no American citizen ought to have a net income, after he has paid his taxes, of more than $25,000 a year. The committee has eliminated, however, the earned-income credit which favors those who toil rather than those who hold investments.

The committee has rejected the very moderate proposal to lower the estate tax exemption from $60,000 to $40,000, and increase estate and gift tax rates to yield an additional $400,000,000. The committee has rejected, too, the very moderate proposal to increase the income-tax rate on corporations with profits above $25,000 from 40 to 50 percent, which would have yielded $1,100,000,000 in new revenues. Although voting to increase the excess-profits tax rate from 90 to 95 percent, and to reduce the credit for invested capital, the committee has left unchanged the choice to compute excess profits on the average-earnings method, so that corporations with large pre-war earnings will continue to escape their fair share of excess-profits taxation. Thus, while corporate profits, after exist-

ing taxes, will be approximately $8,400,000,000 in 1943, as compared to $3,300,000,000 in the last pre-war year in 1939, the committee's proposal would recapture only $600,000,000 thereof.

A grave responsibility rest on Congress to see that the new tax bill is fashioned so as to meet the basic requirements of a wartime revenue measure. To achieve this objective, the tax bill should be amended so as to embody the following minimal provisions:

1. In eliminating the Victory tax, the oppressive burden on low incomes so removed should not be replaced by other levies on such incomes.
2. Personal exemptions should be restored to $750 for single persons, $1,500 for married couples, and $400 for each dependent.
3. Personal taxes on incomes above $3,000 a year should be increased, along with a $25,000 ceiling on net incomes, after taxes.
4. The rate on corporate taxes above $25,000 should be no less than 50 percent, instead of the existing 40 percent.
5. The option to compute excess profits on the average-earnings method should be eliminated.
6. Special privileges should be eliminated so as to provide for mandatory joint returns, the taxation of governmental securities and the elimination of percentage-depletion allowances for oil and mining properties.
7. Tax rates should be increased and exemptions lowered for estates and gifts.

Additional revenue should come, not from a sales tax which burdens the poor, but from increased taxation of comfortable and large incomes, unprecedented corporate profits and large estates. The adoption of the proposals here made will raise substantial revenues, aid in siphoning off the most dangerously inflationary incomes, and avoid cuts into the necessary subsistence of those who fight the battle of production on the farms and in the factories. The adoption of these proposals, through their fairness and adherence to democratic tax principles, will contribute immeasurably to victory on the battlefields and on the home front.

In previous years the tax bill reported to the floor of the House by the Ways and Means Committee has been subjected to a restricted rule that has largely foreclosed amendment. Certainly, in our democracy the people are entitled to know the views of their elected representatives in Congress in regard to each of the vital issues that are covered or not covered by the proposed tax legislation that is reported by the Ways and Means Committee. It is only fair that the tax bill be submitted to the floor of the House of Representatives under a rule which permits full amendment to the bill as reported, so as to permit the elected representatives of the people to vote on each of the vital provisions which have been here suggested.

NOVEMBER 1943.

STATEMENT OF PHILIP MURRAY, PRESIDENT OF THE CONGRESS OF INDUSTRIAL ORGANIZATIONS, WASHINGTON, D. C., SUBMITTED TO THE SENATE FINANCE COMMITTEE, DECEMBER 6, 1943, ON PENDING TAX BILL

When the tax bill first came before Congress over on the House side several months ago, the discussions were opened with a barrage of propaganda by high-income groups and representatives of large corporations. This propaganda had a double purpose. On the one hand, it was calculated to convey the impression that the present tax laws have already squeezed corporate profits dry and that there were no more high incomes or war profits or tax evasion loopholes from which any fair contribution could be secured to finance our war effort. At the same time and as a corollary, this propaganda was calculated to create the impression that the proper place from which to draw for the financing of this war was from the pockets of the lowest income brackets, even if that kind of taxation meant taking food off the tables and clothing off the backs of those people. This second proposition was used as a foundation for the suggestion that a sales tax, with its retrogressive effect, its excessive burdens on the poor and lighter burdens on the rich, should be adopted.

From the start the Congress of Industrial Organizations has challenged the truth of both parts of this deceiving propaganda.

The spokesmen for these wealthy and corporation groups have engaged in the sophistry of pointing out that the many in the lowest income brackets have, when added together, more total income than the few in the higher brackets. They have argued in effect that a hundred men earning $10 a week have, when added together more money than one man earning $500 a week. They argue, therefore,

that a sales tax is necessary in order to place the burden on the $10-a-week salaries because they total more than the $500 salary.

The Congress of Industrial Organizations has urged, as I shall indicate in greater detail below, that the tax program must recognize that in the interests of the war effort it cannot and must not reach into the pockets of those to whom such taxation means depriving them of the minimum amount necessary to purchase the necessities to maintain a standard of health and efficiency consistent with the needs of war production.

Even the existing tax burden, with its Victory tax placed on incomes of as little as $12 a week, contains that threat to American health and working efficiency. While the House in its consideration of this bill failed to take any steps to remedy that situation, nevertheless it is a fortunate fact for the welfare of the American Nation that the House side did not dare to yield to the unscrupulous pressure in favor of a sales tax.

But the action of the House does represent a substantial victory for the moneyed interests of this country and a substantial defeat for the national welfare and the war effort.

For the other side of the same coin, whose one face is the advocacy of the sales tax, is the contention that none but the poor and the hungry today have the funds to support our war effort. It is on the basis of that proposition that these large corporations to whose exorbitant profits I shall make reference shortly, have succeeded in avoiding any action in the House to place the corporate taxes at proper levels. It is on the basis of that proposition that the moneyed interests have succeeded in resisting this year as in the past any effort to plug certain tax evasion loopholes which have been a national scandal for years and which in wartime constitute a huge gap in our war finance ramparts.

It has been a convenient political dodge for the House to purport to please everybody by raising virtually no new taxes. But the people of the Nation know that huge amounts of money are needed to carry this war to a swift conclusion. They know that when the huge profits being accumulated by the large corporations in open and hidden forms on their books are left to go untaxed now in the midst of the conflict, those same corporations and their spokesmen will redouble their pressure next year and each year thereafter to place upon the lowest income groups the tax burden which those corporations avoided and evaded in these years. The people know that what is not collected from the levels of high corporate profits and higher incomes today will have to be paid and that the same groups which today are crying for taxes on the food and clothing of the poor will raise the same cry each year in the future.

The Congress of Industrial Organization does not subscribe to the fallacious notion so widely spread in our land that inflation comes because groups in our population who have never had enough to eat and keep them warm are today able to live a little less below the level of minimum subsistence and good health. The Congress of Industrial Organization does not subscribe to this notion that inflation comes because the poor can buy food and that the way to combat inflation is to tax money away from the poor so that they will not be able to buy food. The direct and sound defense against inflation is firm price control and over-all rationing.

In connection with this tax bill, however, the Congress of Industrial Organization and the people of the country do recognize that money is necessary and must and will be raised to fight this war. To whatever extent the profiteers and tax evaders succeed in escaping their just contribution to the needs of this war, a victory is won by the same groups which today and tomorrow will be urging that the money which they should have, but did not, contribute to our war effort be raised by a sales tax and other burdens on the poor.

That kind of a tax program is not a program which supports our war effort. It is not too late for this committee to act. There are sources from which the funds which are needed can be raised. I pointed out those sources in my testimony before the House Committee on Ways and Means. For the benefit of this committee I should like to insert into your record a copy of the material which I submitted to the House committee. It is as directly relevant today as it was then. With the advances that our armies have made since that testimony was given, it is even more vital today than it was then. I urge that this committee act to raise now the funds which are needed to fight this war by the corporate tax program proposed in my testimony, by the removal of special privileges, by the adjustment of the estate and gift tax levels, and in general by means which will advance our war effort and preserve the health, welfare and morale of an American people at war.

There is one collateral aspect to which I feel that reference must be made. It is a matter which has been injected by the House into the bill which they call a tax bill, but which has not one single solitary thing to do with the tax question. The injection of this extraneous matter into the tax bill indicates, I fear, the extent to which the tax bill was made in the House a forum for political maneuvering.

I refer to that portion of the bill passed by the House which attempts to sneak through under the guise of a tax measure a much disputed and ultimately defeated portion of the old Smith antilabor bill as it was debated in the House. I refer to that portion of section 101 which attempts to write into the tax measure the proposal to require labor oganizations to file, even for the benefit of interested employers, the details of their financial condition. I am prepared at any time to discuss this proposal on its merits. It is not a matter on which there is or ever has been anything secret.

The United Steelworkers of America, an organization three-quarters of a million strong, of which I have the honor to be president, renders every 6 months a financial statement which is delivered to its members and which I will be glad at any time to make available, as we have in the past, to each and every Member of Congress, of the Senate, and to anyone else, but we have repeatedly pointed out the dangers of a measure calling for compulsory publication by all labor organizations of the details of their financial condition. We have pointed out the uses which employers could and would make of such a measure. We have pointed out that in the case of a weaker, still struggling organization, full disclosure of its financial strength or weakness to an employer places the organization in a weakened collective bargaining position.

All these things we have pointed out. We have no objection at any time to discussing the merits of this kind of proposal, but the basic fact in the present connection is that no person has any warrant to inject a problem of that kind into the midst of the multitude of problems involved in a tax bill. Bills have been from time to time introduced in an effort to bring about the result which this rider seeks to accomplish. Those bills have been and should be discussed on their merits and in the appropriate committee. We urge, therefore, that this committee and every other committee in the Congress of the United States declare itself firmly against the tactic of legislation by parliamentary maneuver which has been resorted to with increasing frequency in recent months. There has been increasing tendency to make revenue bills, appropriation bills for example, the vehicle for undesirable changes in substantive law. By devices which make impossible any separate vote on these unrelated items, these maneuvers have brought about the passage of measures which could never have stood the light of separate and objective valuation on their own merits.

I fear that that is precisely what is being attempted in the present situation. The rider which the House bill proposes to attach to section 101 is on its merits undesirable, but under any circumstances has no proper place in this tax measure and should be eliminated in the interests of an open and fair consideration in accordance with the proper legislative procedures.

(Attachment.)

CONGRESS OF INDUSTRIAL ORGANIZATIONS
Washington, D. C.

For release on delivery, Friday, October 15, 1943

The following testimony on the 1944 tax bill was scheduled for presentation by President Philip Murray of the Congress of Industrial Organizations before the House Ways and Means Committee today.

Mr. Chairman, and members of the committee. You have under consideration a subject matter which leads directly to the vital issue of the successful prosecution of the war.

The amount of revenue that must be raised from taxes and the allocation of the burden among the various segments of our national life raise two fundamental questions:

(a) Are we permitting the wage earners—those who through their sweat and toil produce the munitions of war—to retain sufficient funds, after taxes, with which to purchase the necessities to maintain a standard of health and efficiency consistent with the war needs?

(b) At a time when every American is being called upon to sacrifice—including the supreme sacrifice which those in the armed forces are prepared to make—are we making certain that no individual or group shall avoid contributing to an equality of sacrifice or benefit or prosper as a result of the war?

I shall not endeavor to go into each of our proposals in detail. Instead, I believe it would be more beneficial to the members of this committee if I confined

my remarks this morning to a few of the outstanding problems which run directly to the issues which are in the minds and hearts of the millions of workers whom I am privileged to represent.

Further, when I am finished, I should like to introduce a steel worker who will endeavor to place before you, not indexes, not cold statistics, but the human equations which run directly to the vital question of producing steel.

I. Low income groups cannot be subjected to any further taxation without a devastating impact upon the morale, health, and efficiency of our war workers

Every right-minded citizen must concede that he cannot through a tax program drain away funds from families which will leave them with insufficient money to purchase the necessities of life to maintain a health and efficiency standard essential for the working members of these families. Any other policy is not merely foolish but actually endangers the entire war program.

We should therefore examine what makes up the cost of living for the average worker. What is it that workers today with a certain income can do—what can they purchase to meet their minimum needs?

The Heller committee of the University of California, which has made a scientific survey of this problem, recently calculated that a budget for a worker's family of four in San Francisco requires an annual income of $2,357.56.

This budget allows $17.63 for the week for food. This means 63 cents a day per person for each day throughout the year. It allows $257.67 for clothing. This would permit the father to get one overcoat in 8 years, one suit every 3 years, and one pair of shoes every year. He may buy one sweater every 3 years and one and a half dress shirts every year. He may have two suits cleaned and two shoe-repair jobs annually.

His wife can spend $75 a year, including the purchase of a winter and a summer coat every 4 years, a wool dress every 2 years, a rayon dress every one and a half years, two pairs of dress shoes each year, one sweater every 4 years. Her cleaning of clothes is restr! 'ed to one coat per year and two dresses twice a year.

The oldest boy may have a suit and a raincoat every 2 years; one school shirt each year, together with three pairs of corduroy trousers and 4 pairs of shoes, at a total cost of $69.14. A girl aged 8 may have a coat every 2 years, a sweater every 2 years, 3 cotton dresses a year, 4 pairs of shoes at a total cost of $47.09.

The family may live in a 4-room house with a maximum rent of $44 a month.

Only 70 cents is set aside each year for the total cost of school education.

For spending money the entire family is allowed 93 cents a week. The husband and wife can go to a concert or theater three times a year and to a movie once a month, taking only one child each time. Excursions and vacation trips are eliminated.

The budget sets aside $179.04 a year to cover all medical, dental and hospital care. If the family has no access to a group-practice clinic, this budget allowance falls about $100 short of an adequate amount.

Certainly no one can urge that this budget is other than a minimum maintenance budget.

The Office of Price Administration, in a study in the spring of this year, warned the Nation of the danger to the health of our people and to the effective prosecution of the war as a result of the burdens being borne by low-income families. In this study the Office of Price Administration declared that the consumers with incomes under $1,500 a year in 1942 were "just barely able on the average to maintain even their usual low living standards out of current incomes" and that those with incomes from $1,500 to $3,000 "probably are not much above the levels which, under existing conditions, will adequately preserve the health, efficiency, and morale of civilian families."

These studies don't tell the whole story. We know that since May 1942 wages have been stabilized by the National War Labor Board under the so-called hold-the-line order of the President. The complete effectiveness of the wage stabilization policy in keeping wage scales down is reflected in War Labor Board Chairman Davis' statement that—

"The wage adjustments approved by the War Labor Board since October 3 have had a microscopic effect upon prices * * *. The * * * facts show that the Board has succeeded in so controlling wage and salary increases since September 1942 that they have not added perceptively either directly or indirectly to the cost of living burden of the American people."

But, on the other hand, according to the Labor Department's index, the cost of living has risen more than 24 percent since January 1941—9 percent above the 15 percent increase over the January 1941 wage levels at which wages have been stabilized. The average American family is thus at least 9 percent in the red in

the balance between prices and wage rates. Of course the discrepancy between prices and wages, as disclosed by the official indexes, does not reflect the even far greater loss in real wages through the widespread violations in ceiling prices and prevailing black markets.

At this point may I say that the solemn obligation given by this Congress and the President of the United States to the people that wages and prices were to be stabilized at the September 1942 level has not yet been fulfilled.

There is another burden that the low-income groups must bear to which very little reference is made in the public press. Secretary Morgenthau stated on March 16, 1942, that the Treasury's studies had shown that a single person earning $750 a year paid direct and "hidden" indirect Federal, State, and local taxes of $130. This constituted 17.3 percent of his income and represented 8 weeks' pay. A married man with no dependents, said Secretary Morgenthau, earning $1,500 paid $250 in such taxes, 16.7 percent of his income, or an equivalent of 8 week's work.

Those were the figures at a time when personal income-tax exemptions were $1,500 for married persons and family heads, and $750 for single persons. Since then the exemptions have been lowered to $1,200 and $500, respectively.

Those were the figures at a time when there was no so-called Victory tax of 5 percent on all incomes above $12 a week.

Those were the figures at a time when the income tax return on the first $2,000 of taxable net income was 10 percent, not 19 percent, when the taxes on tobaccos, liquors, and admissions were substantially lower than at present.

In addition to all of the foregoing burdens, we should also bear in mind that the average American worker is contributing and contributing very heavily to the purchase of War Savings bonds. Secretary Morgenthau has already advised this committee that the study of the Treasury Department discloses that among the automobile plants 87.6 percent of the employees are on a pay-roll deduction basis, investing 10.3 percent of their wages in War bonds. The workers in the automobile plants in Detroit invested in the Third War Loan $100 per man in extra bonds. Seventy-five percent of the shipyard workers are on this same pay-roll plan investing 11.3 percent of their wages in War bonds. It is common knowledge that in all community war chest drives it is the workers in the local communities who contribute—gladly—but yet it means an added burden for those low-income groups.

One of the favorite arguments urged by spokesmen for business groups seeking to evade their tax responsibilities, is that low-income groups have the so-called excess money which furnishes the inflationary pressure on prices. Let us examine this contention.

In a report made by the Office of Price Administration on March 1, 1943, it is shown that there are 20.6 million families in this country with incomes under $2,500 or 61.8 percent of all the Nation's families. They received, in 1942, 29.7 percent of the aggregate income of all families and bought 38.8 percent of the country's consumer goods and services.

Thus the families receiving less than $2,500 a year constitute 6 out of every 10 families, they receive less than $3 out of every $10 of the national family income, and they spend less than $4 out of every $10 spent by consumers.

Further, the families receiving less than $2,500 in 1942 spent 34.9 percent of their incomes for food, whereas those with higher incomes spend only 15.2 percent of their incomes for food. The less than $2,500 group was obliged to spend 50 percent of their incomes for food, rent, and household fuel whereas the higher evel groups required only 25 percent of their incomes for these essentials.

Those families with incomes above $2,500 comprising only 38.2 percent of the Nation's families in 1942, or 12.7 million families, received 70.3 percent of the total income of all families and bought 61.2 percent of our national purchases of goods and services.

In terms of total expenditures, after providing for food, housing, and fuel, the 20.6 million families with incomes under $2,500 spent only 11.6 billion dollars for transportation, the doctor, the dentist, education, recreation, and all other goods and services. On the other hand, the 12.7 million families with incomes above $2,500 spent nearly double that amount, or 21.4 billions for such purposes.

Thus, if the surplus money is to be taxed, it is not to be found with the families receiving less than $2,500, but rather with the families enjoying incomes higher than that amount.

Further, the stabilization of our national economy originally urged by President Roosevelt was to be predicated upon effective price control, over-all and democratic rationing, as well as equitable taxation. Through price control and rationing we can actually assure the distribution on a fair basis of our available goods

and necessities of life among the entire community. If taxation is used as a means of depriving low-income groups of the wherewithal to buy their fair share, we are effectively rationing, but on the basis of ability to buy rather than on the basis of war need.

Mr. Chairman, the problem before your committee is very simple. Do you wish to impose taxes which cut down the food consumption of the families of war workers? Do you wish to impose taxes which will make war workers move because they could not afford to pay the low rent which they are now paying? Do you wish to impose taxes that will prevent the war workers from having even that minimum type of medical care that they now have? Do you wish to impose taxes that will prevent the war workers from buying even the minimum clothing that they now purchase? Do you wish to deny the war workers even that once-or-twice-a-month moving picture entertainment?

That is just what you will do if you impose additional taxes on the low-income groups. That is exactly the blow that will be struck against the war effort if we add to the already serious financial burdens now being borne by the war workers.

Our conclusion is simply this:

(1) There cannot and must not be imposed any further taxes upon those receiving $3,000 a year or less. To do so would reflect a callous disregard of the disastrous impact which such increased taxes would have upon the morale, health, and working efficiency of our war workers.

(2) To enable the war workers to really purchase the necessities that they require to maintain the health and efficiency essential for war work, the present tax exemptions must be increased to $750 for the single man, $1,500 for the married couple, and $400 for each dependent.

(3) The Victory tax—the most shameful and reprehensible tax that has ever been enacted, reaching down to the pocket of the man making $12 a week regardless of his obligations or dependents—must be repealed.

(4) We are absolutely and unalterably opposed to the imposition of any sales tax. The sales tax is directed at the low-income group. It is the worker and his family that spend practically all of their money just to keep themselves alive. They are to have their full income in effect taxed under this most vicious type of tax legislation. High-income groups that spend only a portion of their income for food, clothing, or other necessities are to have just that small percentage taxed, whereas the rest of their income may be continued to be amassed for further concentration of wealth in their hands. In peacetime a sales tax is vicious enough, but in wartime, when we are trying to assure our war workers of sufficient funds to maintain themselves, the proposed sales-tax levy would be the equivalent of a military defeat.

A sales tax is an imposition of a national wage bearing most heavily on the low-income groups. Such a tax would be a violation of the obligation given by this Government to the working people of America that wages and prices are to be stabilized as of their relationship which prevailed on September 15, 1942. Organized labor would be compelled, following the imposition of a national sales tax, to demand a proportionate increase in their wages to make up for this unjustified wage cut.

II. Individual income taxes on incomes above $5,000 a year should be increased to obtain whatever revenue the Government needs and which has not been obtained through other taxes

We submit that the basic principle of such direct taxes should be that no individual, after taxes, should retain any income in excess of $25,000 a year.

During this war period, when it is so essential that we establish equality of sacrifice, when extraordinary funds are required to prosecute our war program, what do you think happens to the morale of the millions of single people with incomes of $10 a week and to the married persons with incomes of $23 a week who are asked to pay income taxes at the rate of 19 percent when they read of others who are permitted to retain hundreds of millions of dollars each year after taxes and beyond the $25,000 exemption?

President Roosevelt has stated that "No American citizen ought to have a net income, after he has paid his taxes, of more than $25,000 a year." There is an obligation to those in the armed forces, to the production soldiers, to the Nation, that this objective be achieved in this tax program.

III. Taxes on Corporate profits must be drastically increased

I wish to cite the figures of a few corporations:

The American Locomotive Co. made a net profit of $1,462,000, after taxes, as an annual average over the period 1936 to 1939. Their net income, after taxes, for 1942 was $7,552,000. Taking the peacetime period of 1936 to 1939 as 100, this company increased their net profits more than five times. For the first half of 1943 this company made $7,018,000 or nine times the net profits which they made for a 6-month period during the peacetime years of 1936 to 1939.

The Bethlehem Steel Corporation made $19,269,000 after taxes, as an annual average over the period 1936 to 1939. For the year 1942 this corporation made $38,188,000, after taxes, or practically double their net profits during the peacetime period.

The Anaconda Copper Corporation made $19,503,000, as an annual average over the period 1936 to 1939. For 1942 this corporation made $40,785,000, or more than twice what they made during the peacetime era.

The United States Steel Corporation made $45,098,000, after taxes, as an annual average over the period 1936 to 1939. This corporation made $96,819,000 during 1942, after taxes, or more than twice their peacetime average of net profits.

The Worthington Pump Machine Corporation made $679,000, after taxes, as an annual average over the peacetime period of 1936 to 1939. It made $3,769,000, after taxes, for 1942, or about five and one-half times their peacetime average.

The United Aircraft Corporation made $5,161,000, after taxes, as an annual average over the period 1936 to 1939 and made $20,994,000 after taxes, for 1942, or more than four times their peacetime average earnings.

I ask each member of this committee, and also each member of Congress how they can justify to themselves and to the people of the Nation, a situation which permits corporations to show such increasing profits during the war. How can we justify this terrifying injustice, established by corporations through the sacrifices of those on the home front and the blood and lives of those on the military front?

How can anyone urge that the taxes on corporate profits should not be increased so as to prevent any company from reaping benefits out of the war? Mr. Chairman and members of the committee, I submit to you that this situation, if permitted to continue, furnishes the very material which the Axis agents yearn for to spread their propaganda to cause serious disaffection and a lowering of morale among the American people. It is your obligation to terminate this abuse which directly weakens the war effort.

Our proposals are that:

(1) The existing income and surtax rates on corporate incomes above $25,000 should be increased from the present level of 40 percent to at least 55 percent.

(2) An effective excess profits tax at the rate of 90 percent, without post-war credit, should be levied on profits above 4 to 5 percent of invested capital. Profits in excess of average 1936–39 profits, but below 4 to 5 percent of invested capital, should be taxed at the rate of 65 percent.

IV. Special privileges must be removed and Estate and Gift Taxes Increased

We have in our tax system certain provisions which permit a few to retain special privileges. These privileges are enjoyed at the expense of the great majority of our people who must bear additional tax burdens for the revenue thereby lost.

Briefly, these special privileges that should be removed are:

(1) Married couples should be compelled to file joint returns.

(2) Income derived from tax-exempt securities, whether Federal, State, or of local character, should be subjected to taxation. There is no justification for wealthy individuals to be permitted to retain large incomes completely free of taxation. I assure you this situation has continued only because the facts are not fully known to the American people. The unfairness of this continued abuse through special privilege is shocking.

There are other special privileges, of which this committee is completely aware, such as depletion allowances to oil wells and mines and tax-exempt corporations engaged in business, that should be eliminated as well.

Finally, estate and gift taxes should be increased. There should be an integrated estate- and gift-tax system with a single exemption of $20,000 and a single set of graduated rates drastically increased for all brackets. A maximum of $5,000 annually in gifts from each donor should be incorporated in our tax legislation.

V. Social-security program

The Congress of Industrial Organizations has endorsed the essential provisions of the Wagner-Murray-Dingell social security bill. This proposed legislation would extend both the coverage and the benefits for unemployment compensation, old-age security, disability, and health insurance. This subject matter is not one that should be relegated to some distant future date.

The American people are vitally concerned now with making provision both for the present and the future against the hazards of unemployment, old-age, and ill-health. We have unemployment today as a result of cut-backs which are beyond the control of the workers. We have today the problem of meeting medical expenses because of ill health.

We are therefore urging that Congress consider now this social security legislation. The workers appreciate that an enlarged social security program may entail additional expense. We do not concede that it is fair to the working population that for the benefits called for under the Wagner-Murray-Dingell bill the increased cost of approximately 5 percent should be allocated on the basis of 4 percent to be paid by the workers and only 1 percent to be paid by the employers. To the contrary, this seems to us a most unfair allocation.

VI. Debate on the floor of the House

In previous years the tax program reported to the floor of the House by this committee has been subjected to a restricted rule that has foreclosed full and free debate on the merits of the important provisions of the tax legislation. Certainly in our democracy the people are entitled to know the views of their elected Representatives in Congress in regard to each of the vital issues that are covered or not covered by the proposed tax legislation that may be reported by this committee. For this reason I suggest that the bill, as reported by this committee, be submitted to the floor of the House of Representatives in a manner as to permit full and free discussion on all of the basic problems. No one can take offense to a demand that democratic procedure and democratic discussion be permitted on so burning and vital a matter as the proposed tax program for 1944.

VII. Conclusion

Taxes in the past have been a field known to and considered by only a few. Today it is a problem that has come home to practically every American family. Today taxes cannot be considered simply as a means of deriving revenue. It is also a weapon to be used in aiding the prosecution of the war, or if improperly applied, may actually retard the war effort.

This Congress has a responsibility to see to it that those who produce the munitions of war do not have their income so drained off through additional tax burdens as to lower their health and working efficiency.

This Congress has a very deep obligation to every American to see to it that every individual and every group in our national life participate in the equality of sacrifice.

This Congress has an obligation to make the 1944 tax program one which will be a blow for victory. That can be done on the basis of the recommendations and proposals which we have submitted.

SUPPLEMENTARY STATEMENT ON NEED FOR CHANGE IN NATIONAL WAGE POLICY

At this point it is important for this committee to appreciate the fact that our national wage policy must be revised. When President Roosevelt enunciated his national economic policy in April 1942, the Congress of Industrial Organizations gave its immediate and wholehearted support. We recognized then, as we do now, the imperative need of avoiding inflation. We therefore are anxious to establish a stabilized national economy.

But while wages have been stabilized, the Government has not carried forward in regard to its commitment to stabilize the other factors in our national life. As I have already indicated, prices have soared. Effective price enforcement has

not been established and the relationship that was supposed to be maintained in accordance with the law of October 1942 has been flouted. Increased tax burdens have been imposed upon the wage earners.

The common labor rate for the steel workers, certainly a very important industry, is 78 cents per hour. The average steel worker today is working about 44 hours a week—that means he receives pay, including time and one-half, for 46 hours. His weekly pay is, therefore, $35.88.

Clearly this weekly wage does not permit a steelworker to maintain his family, to meet his fixed obligations, and to buy for himself the necessities of life that he requires to perform the arduous work demanded in a steel mill.

This fact is appreciated by members of the Cabinet of the President. I desire to present to this committee two letters that have recently been sent to the National War Labor Board by Secretary of the Interior Ickes and Under Secretaries of War and Navy, Patterson and Forrestal. These letters have to do with the pending coal case before the National War Labor Board. These letters clearly express the view, as espoused by the Congress of Industrial Organizations, that workers must have more money to meet their requirements and to function effectively at their work. [Here read letters.]

The time has come when we must stop dealing in terms of theory and get back to basic facts. The workers can't eat statistics nor policies nor theories. It takes hard, cold cash to buy the necessities of life. We want the steelworkers and the auto workers and the shipyard workers, the rubber workers, and all the other wage earners to maintain a standard that will give them the health and efficiency necessary for their work.

We must revise our national wage policy in order to grant them appropriate wage increases. This is a problem that I am presenting to you and to the executive branch of the Government as one which demands immediate attention and solution to assure the most effective prosecution of the war.

ARMY AND NAVY MUNITIONS BOARD,
Washington, D. C., October 9, 1943.

Mr. WILLIAM H. DAVIS,
Chairman, National War Labor Board,
Washington, D. C.

DEAR MR. DAVIS: Some war plants are having increasing difficulty obtaining sufficient coal. Although the Nation does have stocks of coal on hand, local shortages have begun to occur.

One large steel mill recently had less than 2 days' supply while another was reduced to 5 days' supply. These margins are dangerously small, and any further shrinkage would curtail war production. Shortages of metallurgical coal, which is especially necessary in war industries, have been particularly prevalent.

Local shortages have been eased thus far by rearranging and lengthening coal shipments, thereby adding to the burdens of our already hard-pressed transportation system. Amelioration by this method, however, will dwindle as coal stocks shrink.

Moreover, new war plants are scheduled to come into operation, requiring additional coal, and there seems to be some doubt about our ability to supply them. Total coal requirements for 1944 are estimated at 12.5 million tons a week, whereas current production remains in the neighborhood of 12 million tons weekly.

These facts prompt us to urge upon the War Labor Board the need for an early settlement of the labor problems in the coal-mining industry.

As you know, the present truce expires October 31. An interruption in mining at that time would jeopardize present and future production of weapons for the Army and Navy. We hope, therefore that before October 31 your Board will be able to bring the various factions together in a settlement which recognizes the Nation's paramount need for larger coal production.

Sincerely yours,

ROBERT P. PATTERSON,
Under Secretary of War.
JAMES FORRESTAL,
Under Secretary of the Navy.

DEPARTMENT OF THE INTERIOR,
COAL MINES ADMINISTRATION,
Washington 25, D. C., October 9, 1943.

Hon. WILLIAM H. DAVIS,
Chairman, National War Labor Board,
Washington, D. C.

MY DEAR MR. DAVIS: The situation with respect to coal is so critical that I am undertaking to call it to the attention of the War Labor Board and of yourself as its chairman.

In order to take care of anticipated demands for the present coal year, we set a goal of 600,000,000 tons of bituminous and 60,000,000 tons of anthracite. Although this was high, new and unexpected demands from the Army for coal to be delivered to Italy and other unanticipated requirements, now persuade us that our sights were too low. As to anthracite, our estimate is that, doing the best that we can, possibly we will be able to produce only 90 percent of the total of last year. This will explain the anxiety that is increasing among those who depend upon anthracite to heat their homes.

We are now some 30,000,000 tons below our bituminous goal and we are running behind at the rate of about 500,000 tons a week. Unless this trend is reversed the end of the road will be disaster. Some of our heavy war industries will have to discontinue operations and it is doubtful whether we can keep our railroads running uninterruptedly.

There are several reasons for our inability to produce more coal. There has been a crippling trend of men into the Army and into the other heavy industries where the pay is higher. It is estimated that somewhere between sixty and seventy-five thousand miners have been drawn away from the mines, either by higher wages and more attractive working conditions, or by the armed forces. Moreover, these are the best men physically, and among them are men trained to operate mining machinery. Older men called back to duty cannot produce on the same scale as those who have been drawn away.

Another impediment is the falling into disrepair of mining machinery and an insufficiency of supply of such machinery. Recently, upon representations made by this office to the War Production Board, a priority rating has been given to the manufacturers of mining machinery that will enable us to cope with this emergency, although it will be some time before necessary parts can be manufactured and the machinery repaired.

But by far the most important reason for the falling off of anticipated production is the uncertainty with respect to the wages and hours of the miners themselves. Men who are competent to speak tell me that if there were a wage-and-hour contract in existence the miners would be able to produce even the greatly increased amount of coal that we have asked for. Morale is an intangible of high importance. Frankly, there has been a lowering of the morale of the miners that is making itself felt increasingly every day. Unless industrial peace and the security that the miners feel when working under a contract are speedily brought about, we may as well face the certainty of a scarcity of coal for the rest of the year that will gravely, and perhaps even disastrously, affect our fortunes in the war and our mode of living at home.

The situation is additionally critical because of the nearness of the 31st day of October, beyond which we have no assurance that the miners will continue to work. My own feeling is that if we should reach midnight of the 31st of October without a contract between the operators and the miners, there almost inevitably would follow runaway strikes which might well spread to the entire industry. If that should occur, it would not only be a catastrophe of the first order, it would be worse than that—it would constitute a blunder of magnitude.

I am not presuming to suggest to the War Labor Board how it should decide the issue that has been pending before it for some 3 weeks now in the form of an agreement that has been signed by the Illinois operators and the officials of the miners. But in view of my official responsibility to produce coal I am satisfied that you will not consider me out of order in suggesting that whatever decision may be forthcoming be arrived at speedily. There is nothing so disorganizing as uncertainty and delay.

One may question whether there is a more important domestic issue pending at this time. Coal is basic to the war. Without coal we could not supply our troops in Italy. Without coal we could not run our railroads. Without coal we could not keep our war industries going. Without coal much of our shipping would be tied up. Without coal we could not operate our utilities, with all that

would mean. Without coal we could not transport oil, either by railroad or by pipe line.

There is nothing that I can do about this matter except to call your attention to it and, or so it seems to me, the imperative necessity for action. The grave issue whether we have no recourse except to produce coal in the faltering manner that we have produced it during the past few months is not one that I have the power to resolve.

Sincerely yours,

HAROLD L. ICKES,
Coal Mines Administrator.

STATEMENT BY GLENN SPEELMAN, MEMBER OF THE UNITED STEELWORKERS OF AMERICA

My name is Glenn Speelman. I reside at Mansfield, Ohio, and work at the plant of the Empire Sheet & Tin Plate Co. in that city and am a member of the United Steelworkers of America.

I and my fellow members at the steel plant where we are employed have been reading, during the past few weeks, a number of statements in the press about how necessary it is for the good of the Nation, and particularly for the workers, that heavier taxes should be imposed upon them. That is strange and bewildering material for us workers to read.

I should like today to submit to this committee a brief sketch of what I earn, what it costs me to maintain myself and my family, and then ask the members of this committee whether under such conditions you can still impose further tax burdens upon me and workers in my position and also at the same time ask us to continue increasing our steel production so necessary for our soldiers and seamen.

My family consists of my wife and two children—a boy 3½ years and a boy of 1 year. I am a high-school graduate, attended a trade school, and also served 3 years apprenticeship. My occupation is a blooming-mill motor inspector. At this task I have worked 8 years.

My average hourly earnings, including overtime, at the present time is $1.07. My annual income this year will be $2,573.11. My average weekly hours is 45.41.

My food expenses for this year will be $700. That is for the entire family. This figure is low because through the effects of our union lodge we have developed a community garden project from which our union members grow vegetables for canning purposes, etc. This has helped to reduce the food expenditures for my family. Certainly no one can contend that $700 for the entire year is excess spending for food purposes for a family of four.

I estimate the clothing expenses for my entire family at $225. This includes $50 for work clothes. I need such work clothes because I work in very unclean surroundings and perform very dangerous work. I therefore must purchase overalls, safety shoes, gloves, etc.

This clothing expenditure estimate does not include the purchase of any new suit of clothes or an overcoat or a winter coat for my wife. When I purchase a suit it must last me from 2 to 3 years.

I estimate my rent to be $336 for the year. That is $28 a month. My rent is this low because I have been forced to move to the outskirts of town in which might be termed an undesirable location, in order to keep my rent costs at a minimum. In a more desirable location in the city of Mansfield, I would be forced to pay $35 to $40 a month rent for the type of house which I have.

The fuel and light expenses will be $205. This includes 9 tons of coal at $9.06 per ton and gas and electricity of $5 per month.

It will cost me about $50 for replacement of household equipment. This does not include any new furniture other than a bed for the older boy. It only covers repairs on equipment which we have in the house and replacement of some cooking utensils.

I have estimated that it will cost my family about $140 for dental and medical care; about $35 for medical supplies; $30 for cigarettes; $19 for newspapers and magazines for the entire year; and $20 for telephone.

The medical expenses are what we have actually paid out for serious cases where we were compelled to go to the doctor. I have a 1940 Willys car and the item I have listed for car expenses as $60 is for licenses, insurance, gasoline, oil, etc. Certainly I must at least have the car with which to get to work.

I contribute about $36 to my church; $25 for the Red Cross, etc.; and spend about $50 on so-called recreation. That means one or two picnics and a moving picture about once every 2 weeks.

My union dues is $12 per year.

In addition I have insurance which costs me about $122.12. This includes social security.

I have paid in taxes in 1943, $55.80 for Victory tax, $94.80 withholding tax, and $43.43 on my 1942 income tax.

I have purchased $316.25 of war bonds under a 10-percent pay-roll deduction plan and during the War bond drives.

The total is $2,575.40.

That, gentlemen, is my income and my expenses. Outside of War bonds, I have not been able to save anything. Certainly it cannot be said that I and my family in our expenditures have been adding to the inflationary spiral. We have limited ourselves to a bare subsistence level, trying to maintain ourselves on a basis whereby we can merely live, and I have some food so that I can perform my work at the steel mill.

In terms of the war effort, it isn't further taxes that I need but rather an increase in wages. At the present time I must borrow occasionally from a finance company or otherwise to meet my current expenses that I have just set forth. Any serious illness in my family means that I go into a hole. If I am ill for 1 day and lose my pay, that means to that degree I go into the hole. In addition, bear in mind that my fellow steelworkers, thousands of them, are not even earning the pay that I do. What about them? How are they supposed to meet their expenses which are the same as mine? There are thousands of steelworkers that live in towns other than Mansfield where the cost of living is even higher than that which prevails in my community. How are those steelworkers supposed to meet their expenses? We absolutely need an increase in wages if we are to be in a position to carry on and produce the amount of steel that this country needs.

Do you believe that it would add to the war effort to impose further taxes on me either through a direct income tax or a 10 percent sales tax? Any such proposal would merely mean that I will have to buy less food or move, if I can find a place, to a house which requires less rent. I certainly can't buy less clothes because that means I don't go to work.

As against this picture you must realize that we steelworkers, in reading the newspapers, learn of the huge corporate profits that are being made, higher after taxes than ever before. We also read of the fancy salaries that are being given to the executives of these corporations and they are not being asked to make anywhere near the sacrifice that we steelworkers are now making.

We, the steelworkers, have produced and will continue to produce the steel that this Nation needs for its war program. We are anxious that this war be over as quickly as possible and we are only too glad to make our contribution toard that end.

We Americans simply ask that you in Congress see to it that the burden upon the workers not be increased which would actually tend to destroy our morale and our productive efficiency. We ask that Congress enact a tax program that will really obtain the revenue that the Government needs not from the wage earners in the low income groups, but from the other groups in our national life who to date have actually been benefiting from the sacrifices that are being made by the workers at home and the soldiers on the battle front.

STATEMENT OF EDGAR G. BROWN, DIRECTOR THE NATIONAL NEGRO COUNCIL, PRESIDENT UNITED GOVERNMENT EMPLOYEES

Mr. BROWN. Mr. Chairman and members of the committee, you doubtless recall in the 1942 tax bill that the late Senator W. Warren Barbour proposed an amendment on the floor of the Senate to discontinue the exclusion of domestic workers specifically from social-security benefits. The present law denies to them unemployment benefits and old age pensions.

Senator WALSH. Mr. Brown, we are not dealing with the social-security laws. It is contemplated in a bill how we will deal with that

subject. I wonder if you would confine yourself to the tax features of it.

Mr. BROWN. Mr. Chairman, if you please, I submit that in line with trying to stop the inflationary spiral that is so much talked about, and also from the standpoint of justice for all the people, since there are a million Negroes fighting now for democracy—we feel it is right, since the Negro domestic workers are the largest group outside of the Federal social-security benefits. Every year a recommendation is made to this committee and to the Congress by the respective social-security officials and the President, that they ought to be included, but they are never included. We are tired of promises and no performance. We desire equal benefits for these workers.

Senator WALSH. We have had pending a bill for 2 years, and I haven't been able to get action on it. They keep saying that they are preparing an addition to the present law, but it has not been forthcoming.

Mr. BROWN. That is just the situation I am protesting. We wish to appeal to this committee to insert now an amendment to this present bill, because this is the committee that has the power and full responsibility of the whole social-security program. It is particularly advisable at this time, because the employers sense today these workers are important and most essential. They are paying good wages, and they could well afford to make a contribution now to this program. The worker, the employer, and the Government making such an additional contribution would help to stop the inflationary spiral, and assure domestic workers their equal rights to social security benefits.

Senator WALSH. I am sure the members of the committee, when they come to consider social security, will give it consideration.

Mr. BROWN. I do not wish to press this matter upon you, but I wish to urgently appeal to your committee to take it up at this time, just as you are taking up these other vital matters. They are getting good salaries now, and there may be another depression, then they will not be getting good salaries. There ought to be a fund built up to take care of unemployment needs and their old age.

I just had a case of one of these domestic workers who worked for 20 years for a prominent Government official who heads Federal security. He got tired of this particular worker because she became ill for 6 weeks, she was cut off and put out in the street with no benefits as other workers in industry who lose their jobs.

I think it bears most definitely on the present legislation, and I hope this committee will do something about it now. We are going to have it reintroduced on the floor again unless you act. We do not wish to embarrass the committee, but we do think something ought to be done for these most disadvantaged workers—forgotten Americans, outside of social-security benefits, when all other workers are under it. They are mothers, many of them who have sons and daughters who are now all over the world fighting for democracy.

Secondly, on this matter of raising additional taxes.

Senator GUFFEY. It is not a lottery.

Mr. BROWN. Congressman Knutson proposed it over in the House. We are against the sales tax. People are wasting and throwing a lot of money away for gambling, as has been testified before this committee—the race horses and the dog tracks generally are running full

blast. One State has taken in over $86,000,000 under legalized racing. Why shouldn't the Federal Government get its take as well as the States? The F. B. I. is kept busy checking on income tax due from these people, to make them pay up to the Internal Revenue Department. They legalize it from that point of view, or they put them in the penitentiary, in Chicago. Why shouldn't the Government, when it wants money so badly, and as long as these are wartimes, and we are doing a lot of things, even to plans for recognizing powers higher than the Constitution—why can't they do business with these people who want to make voluntary contributions? Practically everybody is taking some kind of a chance today—why shouldn't the Government get the benefit of it if the people want to spend their money that way?

I hope the committee, rather than consider a sales tax or any increase in the income tax, or other additional tax at all—because our people are already burdened greatly by present taxes. We wouldn't mind giving all the money we have for War bonds if we had equal rights in the Navy, Army, and Air Corps, no segregation and discrimination. Senator Walsh, who is also the chairman of the Naval Affairs Committee, knows that a colored woman is barred from membership in the WAVES. We feel it is grossly unjust to pay any more taxes unless we are at least guaranteed equal benefits from the Federal Government for equal sacrifice and contribution, regardless of race, creed, or color.

So, in view of that fact, since we have those who would like to take a chance—what is the name of it?

Senator GUFFEY. Voluntary contribution.

Mr. BROWN. Voluntary contribution; why can't the Government get the benefit of that?

Senator GUFFEY. You represent what society?

Mr. BROWN. I am president of the United Government Employees and director of the National Negro Council.

Senator GUFFEY. How many members in that council?

Mr. BROWN. Several million. I speak here on this matter in my own behalf.

Senator GUFFEY. Where are they?

Mr. BROWN. All over the United States.

Senator GUFFEY. How are they organized; how many chapters have you; how many lodges? You can't have 4,000,000 members in one lodge or organization.

Mr. BROWN. I speak for them and myself in opposition to discriminatory legislation and administrative practices.

Senator GUFFEY. You come in here and say you represent these people, but to date, as long as I have been here, you have never furnished any statistics as to who you do represent and how they are organized. I think you should submit to this committee, or some other committee, how your organization is made up, and whom you represent.

Mr. BROWN. We appreciate your concern because of the election results. I can explain that to you now. I am authorized to speak against unequal and discriminatory acts for all colored Americans, as director of the National Negro Council and those organizations affiliated with us in the case of justice, to fight inequalities.

Senator GUFFEY. Give us the names of the organizations and where they are located.

Mr. BROWN. The National Negro Council locals. They are in every State of the Union. We speak for those millions, too, disfranchised and inarticulate in many Southern States.

Senator LUCAS. Where are the headquarters of the society?

Mr. BROWN. The National Negro Council headquarters are in Washington.

Senator LUCAS. Who is the president?

Mr. BROWN. The chairman is Dr. D. V. Jemison.

Senator LUCAS. Where does he live, in Washington?

Mr. BROWN. No, sir; in Selma, Ala.

Senator WALSH. All right, Mr. Brown.

Mr. Campbell.

STATEMENT OF ROLLA D. CAMPBELL, HUNTINGTON, W. VA.

Mr. CAMPBELL. I am Rolla D. Campbell of Huntington, W. Va., and I appear for Marianna Smokeless Coal Co., Princess Elkhorn Coal Co., Pond Creek Coal Co., Island Creek Coal Co., and other coal producers and coal lessors.

The proposals I shall make have the full support of the National Coal Association, which represents the bituminous coal industry, and of the American Mining Congress, which represents the mining industry generally.

Senator GUFFEY. Is the Island Creek Coal Co. asking for help?

Mr. CAMPBELL. The Island Creek Coal Co. is in favor of the proposals we make.

The proposals we make, as I said, have the full support and endorsement of the National Coal Association, and they are included in the program which was presented to you this morning by Mr. Crowder. They are also approved by the American Mining Congress, which represents the mining industry generally.

If you have a copy of the House bill before you and will turn to pages 61 and 63, you will have before you section 208, parts of which I shall speak to.

I urge that two changes be made in section 208 of the House bill.

First: that the credit for production from coal and iron mines and timber blocks, which were not in operation during the base period, be made applicable to tax years beginning after December 31, 1941, for both producers and lessors, instead of to taxable years beginning after December 31, 1943, as proposed by the House bill.

Second: that the credit for production from such new properties be one-half of the net income therefrom, instead of one-sixth, as proposed by the House bill.

On exhibit 1, I show the precise text of the two paragraphs as they would be if these changes were made. The changed language is in italics.

The existing law proposes a credit known as section 735 (b) (2) of the Internal Revenue Code, which was put into the code for the first time by the Revenue Act of 1942. The credit for coal and iron ore is one-half of the net income from the increased production over the base-period production.

I might remind the gentlemen of the committee that this credit is a credit against excess profits, not against normal net income. It does not mean that the credit escapes taxation. What happens is that the amount of the credit is transferred from the excess profits net income into the normal income, where it is subject to the normal and surtax rate of 40 percent.

Senator LUCAS. What is the advantage of that?

Mr. CAMPBELL. As the Senate Finance Committee said last year in proposing that change, it was a necessary encouragement to the production of these two vitally needed products, and during the course of the legislation on the Senate floor there was a similar provision put in for timber blocks, and that is known as section 735 (b) (3).

On page 761 of the House bill you will note that line 4 starts the paragraph entitled "Coal, iron mines and timber properties not in operation during the base period." That is the particular section to which I refer, and section 208 (f) as it appears on page 63, shows the taxable years to which the various amendments are made applicable.

Section 208 makes three major changes, as I see it, in the present statute. The first one is to give to lessors of mineral property the benefit of the excess production credit contained in section 735 of the Internal Revenue Code. The bill makes those provisions retroactive to the tax years 1942 and 1943 with respect to properties which were in operation during the base period, but not retroactive with respect to new mines which were opened up after the expiration of the bass period.

Natural gas companies are given a new credit for the first time. There is no provision in the present law for a credit for natural gas companies. The credit is considerably broader in scope than that available to the coal and iron, in that it applies to distribution and storage, as well as production, and also it is so written that a gas company increasing its production from new properties gets a credit at the rate of one-half of the net income from those new properties, whereas the coal provision has a lower rate of one-sixth of the income.

Senator GUFFEY. Isn't that enough for the Island Creek Coal Co.?

Mr. CAMPBELL. I am not speaking for the Island Creek.

Senator GUFFEY. Well, you are representing them all. I know of no company that has harder labor conditions and is demanding more favors from the Government than this company. I just want you to understand that I know the Island Creek Coal Co.

Senator DAVIS. Who is the president of the Marianna Coal Co. now?

Mr. CAMPBELL. James D. Francis.

Senator GUFFEY. Is he also president of Island Creek?

Mr. CAMPBELL. Yes, he is.

Senator GUFFEY. Is he president of all these companies?

Mr. CAMPBELL. That is correct. He is not president of the Princess Elkhorn Coal Co.

As I say, the credit for the gas companies is drawn so as to include both transportation, storage, and production, and it gives the full amount of one-half the net income from any production from new properties. Then there is this provision with respect to coal and iron-ore mines, and timber blocks, contained on page 61 of the bill.

The subject matter of these proposals has already been discussed before the Senate Finance Committee. Mr. Randolph Paul, the

General Counsel of the Treasury, has commented on this section 208, in appendix E of the statement which he filed here on November 29. I would like to quote his language:

> However, if the coal, iron, and timber rule is to be retained in section 735, the amendments introduced in the House bill are appropriate. In the case of coal mines and timber blocks, the distinction between old and new properties appears to be a tenuous one, which has resulted in some inequities. As to the other amendment, corporate lessors of coal, iron, and timber properties should be entitled to the same relief now granted by the law to the operators of such properties.

Note that in his remarks concerning extension of the coal and iron rule of section 735 to the natural gas industry, Mr. Paul says the Treasury would not be opposed to the amendment of section 735 to include producers of natural gas, but excluding pipe lines from the rule.

I shall not attempt to elaborate upon the argument except to mention the points we make.

The first main point is that the credit applicable to iron mines and timber blocks should be made retroactive to the taxable years beginning with December 31, 1941, instead of December 31, 1943, for both producers and lessors.

The first reason for that point is that the credit for new coal and iron mines and timber blocks is a necessary part of section 735 (b) and should have been included in the 1942 act.

Senator LUCAS. Did you present this argument before the Ways and Means Committee?

Mr. CAMPBELL. Yes, I did.

Senator LUCAS. What happened over there?

Mr. CAMPBELL. They gave the credit, as you see it on page 61 of the House bill, and made it applicable to the tax years commencing in 1944 and subsequent years.

Senator LUCAS. Are you asking us to do anything more than what the House did?

Mr. CAMPBELL. Yes, I am. The House bill, as I say, gave the credit applicable to the tax years beginning in 1944. I want to make it retroactive to 1942 and 1943. Then we asked before the House committee that the credit be applied to the entire production of a new mine, and the committee put in a rule which is the equivalent of applying it to one-third of the production of a new mine.

Senator LUCAS. You made the retroactive request before the Ways and Means Committee and they denied it; is that correct?

Mr. CAMPBELL. I would say that was the way it worked.

Senator DAVIS. Are you familiar with the cost of production of the Island Creek Co.?

Mr. CAMPBELL. Only in a general way.

Senator DAVIS. Do you know what it costs them to produce the coal?

Mr. CAMPBELL. I am not in the operating department of the company.

Mr. Paul has conceded that the distinction between new and old properties appears to be a tenuous one—I am quoting from his statement—which has resulted in some inequities. Mr. Paul is correct, and since the distinction is a tenuous one, it should not have been made

when section 735 was adopted last year and therefore the present credit should be made retroactive.

The next point is that there is no sound reason for discrimination against properties developed in the years 1940 to 1943, inclusive. The purpose of this credit, gentlemen, was to encourage production from these mines. I quote your own report made to the Senate last year. Our fundamental point is that the new production which comes from new mines is as important to the war effort as the increased production which comes from an old mine and should have similar treatment, that the mines which were opened up and developed after the close of the base period have contributed highly to the coal supplies of the Nation, and they should have the same credit for having done that as the old mines which have increased their production.

I think I can say that there were many properties developed in the years 1940 to 1943 which would not have been developed had the present excess-profits tax rate been known or anticipated by the producers who opened those mines. The present tax rates for a hazardous industry like coal are quite high.

The next point is that the credit, as I said, should be one-half the net income instead of one-sixth. As I have already said, the increased production, whether from base period properties or from new properties, should carry the same credit. After all, that is the underlying purpose of the credit, to stimulate production.

I would like to call attention to the fact that the development of new mines now requires an investment of adventure capital in fixed, nonliquid assets at a time when wages and prices are high for the development of properties which, compared to base period mines, would be considered marginal or submarginal, and only after the consent of the War Production Board has first been obtained on a showing that the new mine or attempted development is necessary to the successful prosecution of the war.

Compared to the mines which had base period experience, I would like to call your attention to the fact that most of them were developed when prices and wages were low, when better properties were available for lease or purchase on more reasonable terms than now prevail. Consequently, most of the base period properties have a lower invest cost, lower operating cost and higher realization per unit of output. They have some hope of surviving post-war competition, whereas it is entirely speculative whether most of the newly developed properties can survive such competition. In addition, the cost of expanding output from an existing mine is relatively low compared with developing new production at a new mine. If capital has to be borrowed during the war period in order to open a new mine, then the chance of repaying those loans under the present tax rates, and at the same time disbursing something to stockholders, is quite small.

I might say that under section 722, which was put into the law last year for the purpose of giving general relief in special cases, it appears very doubtful whether any relief can be given to a new company opening a new coal mine or iron mine, because of the fact that the only ground on which you can get relief for a new company, as I recall, is that the invested capital must be abnormally low or you must have assets which contribute to the earnings which are not represented in invested capital. It is very difficult to make that

showing for a new property which has been opened up in a period when both wages and materials are high in price.

Again, the new mines are at a disadvantage in comparison with the old mines in the contest for markets. The new mines, we might say, have to take the marginal demand, and when that dies off, they will be in trouble for markets.

Senator DAVIS. The mines you are referring to are all in West Virginia, aren't they?

Mr. CAMPBELL. No; the mines I refer to are not mines with which I am personally connected. They are located all over the United States. There are quite a number of new mines in your State, Senator Davis, and the operators, with whom I have talked, are entirely in support of the proposals I make.

Senator GUFFEY. I thought you represented certain companies which you mentioned at the beginning.

Mr. CAMPBELL. I gave you the companies with which I am identified.

Senator DAVIS. What I am referring to, the companies you refer to there are all in West Virginia?

Mr. CAMPBELL. The companies I am connected with?

Senator DAVIS. Up in the Bluefield district?

Mr. CAMPBELL. No—well, one of them is in the low-volatile district.

I might point out, too, that coal does not have any nontaxable bonus income permitted under the present statute. It is not entitled to any special excess-profits treatment as a strategic material, nor any other special excess-profits credit, except that provided by section 735, so I say it is obvious that proper encouragement of the development of entirely new coal and iron mines and timber blocks requires more favorable treatment than that necessary to encourage additional production from properties with base period experience, and that the credit of one-sixth should be increased to one-half, in order to put the added production from new mines on terms of equality with the added production from old mines.

The third point is that the present and proposed tax rates on normal and excess profits of coal corporations do not permit net earnings after taxes large enough properly to reflect the high risk factors inherent in the coal business, and some relief from such rates is an absolute necessity if production is to be maintained.

I think those of you who are familiar with the markets for coal securities know that they sell at a lower ratio of price to earnings than any other stocks quoted on the stock exchange, and that the present price of stocks is approximately from 3 to 10 times the annual earnings per share of the companies involved. The companies with the worst experience will produce earnings which in 3 years will equal the price of the stock, those with better earning records sell at a higher ratio.

We say that the amendment proposed by section 203 with respect to lessors of timber properties is a good one and should be made retroactive with respect to properties which were not in operation during the base period, as well as with respect to those which were in operation during the base period.

The Treasury has approved the extension of the benefits of section 735 I. R. C. to lessors, but effective beginning with the tax year 1944. It seems to me that the argument for inclusion likewise supports retroactive inclusion.

Now, as to existing legislation: The amendments proposed by section 208 of the House bill relate to section 735 of the Internal Revenue Code. Section 735 was first enacted as section 209 of the Revenue Act of 1942. It was originated by action of the Senate as an encouragement to production of minerals and timber by means of granting a credit against excess profits net income related to the quantity of production accelerated above the average annual base period production. Section 735 (b) (2) gives an optional credit to producers from coal and iron mines of an amount equal to the excess output multiplied by one-half of the unit net income from the mining property for the taxable year. Section 735 (b) (3) gives a similar credit to producers from timber blocks.

At this point, I wish to emphasize the fact that section 735 does not exempt from all taxation the "nontaxable income from exempt excess output," as the credit is named in the statute. What actually happens is that the amount of the credit is deducted from excess profits net income and is added to the normal net income, where it is subject to tax at the normal and surtax rate of 40 percent, instead of at the rate of 90 percent (or if the House bill rates become law, at the rate of 95 percent). Likewise, the credit, being applicable only to excess profits, does not apply to individuals, trusts, or partnerships, but applies only to corporations and to associations taxable as corporations.

As to the amendments to section 735 contained in section 208 of the House bill, section 208 makes three major changes in section 735, I. R. C. They are:

1. Lessors of mineral properties are given the benefit of excess output credit. It is proposed that this amendment shall become effective with respect to taxable years beginning after December 31, 1941, as to lessors of properties in operation during the base period, that is to say, it is retroactive to the same tax years to which section 735 originally applied.

2. Natural gas companies are given the benefit of a credit based upon a formula somewhat different from the formula applicable to coal and iron mines. This amendment with respect to natural gas companies is made retroactive to the same tax years to which section 735 originally applied, that is to say, to taxable years beginning after December 31, 1941. The formula is much broader in scope than that relating to coal and iron mines and timber blocks contained in the present law, in that the gas company credit applies to the entire production from new gas properties and also to distribution through new gas pipe lines (new properties and new pipe lines being those developed after the expiration of the base period), the only requirement for the credit being that the gas company must own during the taxable year some producing or distributing property, however small, which was in operation during the base period. Transportation properties are not included in the formula applicable to coal, iron ore, and timber and the market value of the product added by transportation is not included in the computation of net income from coal and iron mines and timber blocks. If the natural gas pipe lines should be excluded from this formula, there would be little difference

in substance between the treatment which would be accorded to producers of natural gas and the treatment which I urge should be accorded to new coal and iron mines and timber blocks.

3. A credit is also provided for production from new coal and iron mines and timber blocks which were not in operation during the base period. This credit is equal to one-sixth of the net income from the property for the taxable year. This fraction was arrived at on the assumption that one-third of the production from a new property will be increased production, this figure conforming roughly to increases in national annual production since the close of the base period. However, unlike the amendment above mentioned relating to lessors, and unlike the entire new amendment above mentioned relating to natural gas companies, the credit for new coal and iron mines and timber blocks is not made retroactive to the effective date of section 735—that is, to taxable years beginning after December 31, 1941—but is made effective prospectively; that is, it is applicable to tax years beginning after December 31, 1943. In other words, this credit for new coal and iron mines and timber blocks is not to be applicable to taxable years 1942 and 1943.

In addition to the above amendments to section 735, the bill also amends the definition of "timber blocks."

As to the Ways and Means Committee hearings, three appearances were made before the Ways and Means Committee in connection with amendments relating to lessors and to new coal and iron mines and timber blocks. Mr. J. M. B. Lewis of Bluefield, W. Va., and Mr. G. T. Howard, of Lexington, Ky., appeared to urge that section 735 be amended to apply to lessors. Their statements are found at pages 199 and 205 of the unrevised record of the Ways and Means hearings. I also appeared and urged a further amendment, namely, that, effective with taxable years beginning after December 31, 1941, the excess production credit be extended to all the production from coal and iron mines and timber blocks which were not in base-period operation. This is the same amendment I am now urging. My statement appears at page 719 of the unrevised record of the Ways and Means hearings. That amendment had the full support of Congressman A. W. Robertson, a member of the Ways and Means Committee. So far as I can find, no public statement was made at the hearings before the Ways and Means Committee in specific opposition to such amendment. The Treasury signified its approval to the amendment with respect to lessors proposed by Mr. Lewis.

As to the Treasury position with respect to section 208 of the House bill, Mr. Randolph Paul, general counsel for the Treasury, has commented on provisions of section 208 of the House bill in appendix E of his statement made before the Senate Finance Committee on November 29, 1943. Said appendix E is attached hereto as exhibit 2.

It will be noted that Mr. Paul, while expressing Treasury disagreement with the credit applicable particularly to coal and iron mines and timber blocks, says that if such credit is to be retained in section 735, the amendments contained in section 208 of the House bill applicable to lessors and to new coal and iron mines and timber blocks are appropriate. His precise language is:

> However, if the coal, iron, and timber rule is to be retained in section 735, the amendments introduced in the House bill are appropriate. In the case of coal

mines and timber blocks, the distinction between old and new properties appears to be a tenuous one which has resulted in some inequities. As to the other amendment, corporate lessors of coal, iron, and timber properties should be entitled to the same relief now granted by the law to the operators of such properties.

Note also that in his remarks concerning extension of the coal and iron rule of section 735 so the natural gas industry, Mr. Paul says that the Treasury would not be opposed to the amendment of section 735 to include producers of natural gas, but excluding pipe lines from the rule.

1. The credit applicable to new coal and iron mines and timber blocks should be made retroactive to taxable years beginning after December 31, 1941 (instead of December 31, 1943), for both producers and lessors.

At the outset, I should say that my business and professional experience has been principally with coal and only incidentally with timber, and that I have had no experience with iron ore mines. However, since Congress has applied the same optional formula to the three kinds of properties, it is my proposal that any credit to which coal mines are entitled ought likewise to be extended to iron mines and timber blocks.

The credit for new coal and iron mines and timber blocks is a necessary part of section 735 (b) and should have been included in the 1942 act.

This is properly recognized by Mr. Randolph Paul for the Treasury in appendix E above quoted, wherein he said that in the case of coal mines and timber blocks "the distinction between new and old properties appears to be a tenuous one, which has resulted in some inequities." Mr. Paul is correct. Since the distinction is a tenuous one, it should not have been made by section 735 when that section was adopted as a part of the 1942 Revenue Act, and, therefore, the present addition of a credit for new properties should logically be retroactive to the same taxable years to which section 735 is applied. Note that Mr. Paul has not made any objection to the retroactive application of the entire new credit for natural-gas companies, or to the retroactive application of the lessor amendment. It must be assumed that since he has not raised any objection to such retroactive applications, the Treasury cannot logically now object to making the credit for new coal and iron mines and timber blocks also retroactive.

And such retroactive treatment is entirely proper. Like other natural resource properties, coal and iron mines and timber blocks are wasting assets, and in time are exhausted. In order to maintain production, new properties must from time to time be developed. If production is to be increased, the two sources of increase are, first, existing properties and, second, newly developed properties. It is difficult, therefore, logically to account for the omission from section 735 (section 209, 1942 Revenue Act) of a credit designed to encourage production from new properties, that is, from properties which were brought into operation after the close of the base period. From the point of view of aiding the war effort, production from new properties is equally as valuable as increased production from properties which were in operation during the base period. The user cannot tell the difference between the products of old properties and the products of new properties but is equally grateful now for products from both old and new properties. The illogical omission of the credit for the

products of new properties should now be corrected retroactively to the originally effective date of section 735.

There is no sound reason for discrimination against properties developed in the years 1940–43, inclusive.

If the provisions of section 208 of House bill are adopted without change, the properties opened after the close of the base period and before January 1, 1944, would get no credit for production during the years 1942 and 1943; whereas those developed in 1944 and later years would get the credit for one-third of their production during the taxable year, and those which were in operation during the base period would get the credit for increased productoin in 1942 and subsequent years. This difference in treatment is, as Mr. Paul so well says, inequitable with respect to properties developed between the close of the base period and January 1, 1944.

In this connection, it should be remembered that the purpose of section 735 is to encourage wartime production and not to recapture excessive profits. Therefore, there is no purpose to be served by tying the relief to properties having a based period experience. The credit should be large enough to encourage new production of badly needed basic commodities and it should be fairly applied to the different segments of the effected industries.

Many properties developed in the years 1940–43, inclusive, would not have been developed if the present rates of corporate income taxes had been anticipated when such developments were planned.

The 40 percent normal and surtax rate and 90 percent excess profits tax rate were features of the 1942 Revenue Act which was not approved until October 21, 1942.

I represent three coal mines opened in these interim years—two in 1940 and one in 1941. The operators of these mines have striven for production and the production from these mines has contributed materially to the war effort. They are producing about 1,000,000 tons per year.

Yet under the House bill, the operators of such mines would not be entitled to any excess production credit for the tax years 1942 and 1943, although the production in these years was wholly new and increased production. Many similar examples can be found.

I can state emphatically that if the owners of these three mines had known in advance that the 1942 Revenue Act would carry a tax on normal income of 40 percent and a tax on excess profits of 90 percent (or 95 percent as now proposed), these mines would never have been installed. I think the same can be said of many other mines opened between the end of the base period and the present. As will be shown more fully later, such taxes give no recognition to the high risk factor applicable to investments in the coal mines.

All properties which have been developed since the approval of the 1942 Revenue Act were planned and were in process of development long before such approval, and they are justly and properly entitled to a credit for the new production which they brought to the war effort during the tax years 1942 and 1943.

2. The credit for production from new coal and iron mines and timber blocks should be one-half of the net income instead of one-sixth

As above explained, the Ways and Means Committee arrived at the one-sixth fraction on the assumption that one-third of the production during the tax year should be considered as increased production entitled to the excess output credit. Roughly, the committee

estimated that the increase in production of coal, iron ore, and timber since the base period has been 50 percent over the average of the base-period production. The credit for base-period properties is the number of units of increased production multiplied by one-half of the unit net income. One-third multiplied by one-half equals one-sixth.

All increased production, whether from base period properties or from new properties, should carry the same credit.

The credit equal to one-sixth of the net income from new properties, while helpful, dies not go nearly far enough. It assumes that the purpose of granting credit to new properties is to put them on terms of rough equality with base period properties.

It is always important, as already pointed out, that the credit should not discriminate in favor of base period properties. But it is more important to remember that the real underlying purpose of the credit is to encourage increased production, and to do this all production from new properties (i. e., not in operation during the base period) should be considered as increased production or as "exempt excess output," one-half of the net income from which may be credited against excess profits net income.

Such treatment will not discriminate against base period mines.

A careful consideration of the facts shows that such treatment will not discriminate against the base period mines. The new mines need and deserve more favorable treatment than the base period mines.

The development of new mines and timber blocks requires the investment of venture capital in fixed nonliquid assets, at a time when wages and prices are high, for the development of properties which compared to base period mines would be considered marginal or submarginal, and only after the consent of the War Production Board has first been obtained upon a showing that the new mine or timber development is necessary to the successful prosecution of the war.

Compared to wartime developments, it should be remembered that most base period properties were developed when prices and wages were low and when better properties were available for lease or purchase on more reasonable terms.

Consequently, most of the base-period properties have a much lower investment cost, a lower operating cost, and a higher realization per unit of output. They have some hope of surviving post-war competition, whereas it is entirely speculative whether most of the newly developed properties can survive such competition.

Moreover, the cost in capital outlay of expanding production from base period properties is small and often is offset entirely by reduction in overhead; whereas the development of new properties represents a much greater investment cost per unit of output.

If capital must be borrowed, there is no chance of repaying the loan and at the same time disbursing some earnings to the stockholders without a small measure of relief from excessively high excess-profits rates.

Taxpayers operating properties with base-period experience, who are entitled to general relief under section 722 (b) of the Internal Revenue Code, are entitled to have their base period incomes constructed and at the same time they may also establish constructive base period or normal output and a normal unit profit for the purposes of section 735 (see sec. 722 (f) I. R. C.).

It is very doubtful if a new company operating a new mine, which could qualify for general relief under section 722 (c), is entitled to establish a constructive base period or normal output. Also, it is doubtful if many such companies could make the showing necessary to get relief under section 722 (c) since it will be unusual to find a new mine with abnormally low invested capital.

Again the mines and properties with base period experience already had established before the war market connections with customers and were and are regarded as steady sources of supply during periods of normal operations.

The wartime developed mines which have recently been developed are supplying excess or marginal demand and the market connections they are making are purely temporary and will not continue after the termination of the war. In this respect, the wartime mines developed are at a distinct disadvantage compared to base period mines.

I should like to point out that coal is not entitled to any nontaxable bonus income; it is not entitled to special excess-profits treatment as a strategic mineral; and it is not entitled to any other excess profits credit outside of that provided in section 735.

Hence, it is obvious that proper encouragement of the development of entirely new coal and iron mines and timber blocks requires more favorable treatment than that necessary to encourage additional production from properties with base period experience; and that the credit of one-sixth of the net income for the taxable year, proposed by the House bill for production from such new properties, is utterly inadequate.

Logically and fairly, the credit shold be one-half of the net income.

By no stretch of the imagination can it be said that coal and iron mines should have less favorable treatment than that accorded to natural gas.

The present (and proposed) tax rates on normal and excess-profits net incomes of corporations do not permit net earnings after taxes large enough properly to reflect the high risk factor inherent in the coal business, and some relief from such rates is an absolute necessity if production is to be maintained.

Different kinds of business carry different investment risks. An investor when considering the start of a new enterprise takes into account the probable net earnings per dollar of sales, the probable stability of earnings, the probable growth during the future, the amount of new capital which will from time to time be required, and all other matters bearing upon the profitableness of the enterprise.

Hence, we find that on the stock market chemical stocks sell at a price which is 15 to 30 times net earnings per share, while coal stocks are at the same time selling at a price from 3 to 10 times net annual earnings per share.

The best coal stock with the longest record of earnings during good years and bad usually sells at a price which is 8 to 10 times the net annual earnings per share; whereas stocks of companies with less consistent earning records sell at prices which are from 3 to 5 times their net annual earnings per share.

In other words, coal stocks can be purchased at prices which reflect net annual earnings which are from 10 to 35 percent of their market prices, while the stocks of chemicals and so-called growth companies sell at prices which reflect net annual earnings which are 3 to 5 percent of their market prices.

Other stocks reflect risk factors which vary in between these two extremes.

Quite obviously, tax rates which will encourage investment in businesses with a promising future may utterly discourage investments in other businesses not considered to have a promising future.

If a corporation desires to invest during wartimes in the coal business, it can make more money on its investment by buying the stocks of companies operating base-period properties than by investing in physical facilities to operate a new property.

The stock market has already reflected the investment risks inherent in coal mining, and, therefore, share prices show a higher percent of net annual earnings per share to purchase price than can be obtained from operations of a physical property after payment of excess-profits tax.

Moreover, the investment in existing listed stocks is liquid and can be disposed of at a moment's notice; whereas the investment in physical facilities is nonliquid and semipermanent in character and can be recovered, if at all, only through profitable operation during the entire life of the property.

A corporation buying the stocks of coal companies operating base-period properties also misses all the work and worries inherent in the operation of mines, such as protracted wage negotiations each year or so, recurrent strikes, Government seizure and operation, tax uncertainties and inequities, manpower shortages, material shortages, priorities, limitation orders, maximum-price regulations, safety regulations, wage-hour regulations, and many other obstacles to the regular production and sale of coal.

The same remarks apply, so I am told, to the lumber and iron-ore industries.

The record of earnings for the years 1928 to 1941, inclusive, for the coal and lumber industries shows that for these industries, considered as a whole, profitable years are few and far between; and that in most years they operate at a loss. This being so, if these industries cannot make substantial net profits after taxes during occasional good years, their total operations will be at a loss.

Exhibit 3 attached hereto shows for the two industries the results of operations during the years mentioned.

No comparable figures are available for the iron-ore industry but it is understood that this industry has been characterized by wide fluctuations in rate of production; that during the depression many ore leases were abandoned and that the high-quality deposits of iron ore are being rapidly exhausted.

The amendment proposed by section 208 with respect to lessors of coal, iron ore, and timber properties is a good one and should be made retroactive with respect to properties which were not in operation during the base period, as well as with respect to those which were in operation during the base period.

The Treasury has approved the extension of the benefits of section 735 I. R. C. to lessors. Lessors should have been included in such benefits in section 735 when it was originally adopted in the 1942 Revenue Act.

There is no reason why the lessor amendment should not be retroactive with respect to coal and iron mines and timber blocks which were not in operation during the base period.

The text of the amendments herein proposed, if adopted, will extend to lessors the benefits of the credit with respect to coal and iron mines and timber blocks which were not in operation during the base period.

In conclusion, it is most respectfully submitted and urged that the changes herein proposed in section 208 of the House bill should be adopted by the Senate Finance Committee.

(The exhibits referred to in the foregoing are as follows:)

EXHIBIT 1

If changes proposed are made then section 208 (c) (4) on page 61 of the House bill (proposed to be added as section 735 (b) (4) of Internal Revenue Code) will read (new or changed matter is italicized):

"(4) COAL AND IRON MINES AND TIMBER PROPERTIES NOT IN OPERATION DURING BASE PERIOD.—For any taxable year, the nontaxable income from exempt excess output of a coal mining or iron mining property or a timber block, which was not in operation during the base period, shall be an amount equal to *one-half* of the net income for such taxable year (computed with the allowance for depletion) from the coal mining or iron mining property or from the timber block, as the case may be."

and section 208 (f) on page 63 will read:

(f) TAXABLE YEARS TO WHICH CERTAIN AMENDMENTS APPLICABLE.—The amendments made by this section with respect to lessors of mineral properties which were in operation during the base period, and with respect to lessors of timber blocks, as defined without regard to the amendments made by this section, which were in operation during the base period, and with respect to natural gas companies, *and with respect to lessors of, and producers from, coal and iron-ore mines and timber blocks which were not in operation during the base period*, shall be applicable with respect to taxable years beginning after December 31, 1941.

EXHIBIT 2

[From statement of Randolph Paul, General Counsel, Treasury Department, before the Senate Finance Committee on November 29, 1943]

APPENDIX E

SPECIAL EXCESS-PROFITS TAX TREATMENT WITH RESPECT TO THE ACCELERATED OUTPUT OF CERTAIN NATURAL RESOURCES

A. THE EXTENSION OF THE COAL AND IRON RULE OF SECTION 735 TO THE NATURAL GAS INDUSTRY

The House bill provides special excess-profits tax treatment for natural-gas companies with respect to income from the production, storage, and transportation by pipe lines of natural gas. The treatment given would be the same as that now granted under section 735 (b) (2) with respect to income from coal and iron mines.

The Treasury recognizes that natural gas is a depletable resource, the production of which has greatly increased since the beginning of the war. It would not be opposed to the amendment of section 735 to include producers of natural gas. However, the natural gas companies which will benefit most under the provisions of the House bill are primarily engaged in the operation of pipe lines. Some of these companies produce no natural gas and all of them buy a substantial percentage of the gas carried in their pipe lines. The Treasury believes it would be undesirable to extend the relief now afforded to depletable resource industries to these companies.

Our reasons are twofold. First, from an examination of the tax returns of a number of the representative companies in this industry it appears that the industry, as a whole, is now earning as much per unit of output after excess-profits taxes but before corporation income taxes as it earned during the base period years. It is our belief that the excess-profits tax cannot be said to be injuring an industry if this tax allows the industry to retain its normal unit profits.

Second, we believe that the problem faced by the natural-gas industry as a result of accelerated output is primarily a depreciation rather than a depletion problem. The relief given in the House bill does not appear to provide an appropriate remedy for the wartime problems of this industry. The Treasury is of the opinion that the position of the natural-gas industry is not so unique with respect to accelerated depreciation that it should be relieved of the wartime taxes which Congress has imposed upon industry as a whole.

B. EXTENSION OF THE COAL AND IRON RULE IN SECTION 735 TO NEW PROPERTIES AND TO CORPORATE LESSORS

The House bill extends the treatment accorded by section 735 to operators of coal and iron mines and of lumber tracts in two respects: (1) corporate lessors are given the same treatment as operators; and (2) new mines and timber properties are allowed to treat one-third of their output as excess output.

Last year, when the revenue bill of 1942, was being considered by your committee, the Treasury pointed out the undesirability of the special formula which was made applicable to producers of coal, iron, and timber. We believed then, as we believe today, that a measure which distributes tax relief without regard to need not only deprives the Government of much-needed revenues, but also results in an inequitable distribution of the wartime tax burden among business enterprises.

However, if the coal, iron, and timber rule is to be retained in section 735, the amendments introduced in the House bill are appropriate. In the case of coal mines and timber blocks, the distinction between new and old properties appears to be a tenuous one which has resulted in some inequities. As to the other amendment, corporate lessors of coal, iron, and timber properties should be entitled to the same relief now granted by the law to the operators of such properties.

EXHIBIT 3

Profit-and-loss statistics of the bituminous coal and lumber industries for the 14-year period 1928–41, inclusive, compiled from U. S. Treasury Department Statistics of Income records on active corporations

[Money figures in thousands]

	Bituminous coal		Lumber [1]	
	Number of returns	Net profit (+) or net loss (−)	Number of returns	Net profit (+) or net loss (−)
Calendar year:				
1928	2,705	−$27,950	3,831	−$17,496
1929	2,409	−15,822	3,522	+25,665
1930	2,239	−44,706	3,365	−74,399
1931	2,095	−45,784	3,000	−119,104
1932	1,864	−51,944	2,819	−194,151
1933	1,851	−48,579	2,834	−44,693
1934	2,017	−10,852	2,915	−39,011
1935	1,978	−18,326	2,939	−20,570
1936	1,945	−6,524	2,770	+9,736
1937	1,815	−3,965	2,790	+30,947
1938	1,887	−28,328	2,937	−13,440
1939	1,820	−9,012	2,849	+11,280
1940	1,746	+8,429	2,644	+42,896
1941	1,722	+23,586	2,641	+88,673
Total 14-year period	28,150	−282,838	41,456	−213,443
Returns with net profit	8,628	+272,638	16,824	+457,133
Returns with net loss	19,522	−556,476	25,132	−670,576
Total (as above)	28,150	−282,838	41,456	−213,443
Percent of returns with net profit	30.65		39.38	

[1] Years 1928 to 1937 cover "Sawmill and planing-mill products"; years 1938 to 1941 cover "Lumber and lumber basic products."

NOTE.—Comparable figures for the iron-ore industry are not available.

EXHIBIT 4

EXAMPLES SHOWING APPLICATION TO PRODUCERS AND LESSORS OF COAL (AND IRON ORE) OF THE EXCESS PRODUCTION CREDIT UNDER SECTION 735 (b) (2) OF INTERNAL REVENUE CODE; UNDER SECTION 208 OF THE HOUSE BILL; UNDER THE CHANGES PROPOSED TO BE MADE IN SECTION 208 OF THE HOUSE BILL

Corporation A operates a coal mine which was in operation during the base period and which produced an average of 100,000 tons per year during the base period. In 1942, 1943 and 1944, A increased its output from this mine by 300,000 tons so that its total production in each of these three years is 400,000 tons.

Under the present law, A would get an excess profits net income credit equal to ⅓ of its net income from the 300,000 tons of increased production during each of the three tax years, 1942, 1943 and 1944.

2. Corporation B operates a coal mine which was in operation during the base period. It is on retreat and so cannot increase production. During 1942, 1943, and 1944, however, it continues to produce 100,000 tons per year from such mine, this being the same as its average yearly base period production. In order to increase its output, it develops a new mine during 1940 and 1941 costing $1,000,000, and in 1942, 1943 and 1944 B produces 300,000 tons, annually, from its new mine.

Under the present law, B would get no credit for any of its income from any of the production from its new mine.

Under the House bill, it would get a credit for 1944 only, equal to one-sixth of the net income from the new mine (or one-half of the net income from 100,000 tons, only, of the 300,000 tons of new production), and it would get no credit for any of the 300,000 tons produced in each of the years 1942 and 1493.

Under the proposed changes in section 208 of the House bill, B would get a credit of one-half of its net income from the 300,000 tons of new production for each of the 3 years, 1942, 1943, and 1944.

3. Corporation C operates a natural gas property which was in operation during the base period and which produced during the base years an average of 1,000,000,000 cubic feet per year. In 1942, 1943, and 1944, it increases its production by 3,000,000,000 to 4,000,000,000 cubic feet per year.

Under the present law, it gets no credit for any of its increased production.

Under the House bill, it will get a credit equal to one-half of its net income from the 3,000,000,000 cubic feet of increased output, and this credit will be applicable not only to 1944 and subsequent years but also to 1942 and 1943.

Note that this will give natural gas companies the same treatment with respect to increases in production from base period properties as applies to coal and iron ore under the present law.

4. Corporation D operates a natural gas property which was in operation during the base period, producing during the base period an average of 1,000,000,000 cubic feet of gas per year. It expands in 1941 and 1942 by developing several new gas-producing properites and by building a new pipe line to the market, so that in 1942, 1943, and 1944, it produces each year 4,000,000,000 cubic feet of gas, of which 3,000,000,000 come from the new properties and 1,000,000,000 from the base period property; and, by transporting this gas to market, D raises the value of its gas from 10 cents per thousand cubic feet at the well to 30 cents per thousand cubic feet at the city gate.

Under the present law, D gets no credit for its increased production or transportation.

Under the House bill, D would get a credit for each of the years 1942, 1943, and 1944 equal to one-half of the net income from the 3,000,000,000 cubic feet of gas produced from the properties developed in 1940 and 1941; and the income on which the credit is computed is determined by sale of the gas after transportation to the market, instead of by sale of the gas at the point of production, as is the case with coal.

Note that this is much better treatment than that shown by the House bill to coal and iron under comparable circumstance in example 2.

Laying aside the pipe-line question, coal production should get equally favorable treatment as natural-gas producers,

(a) as to years to which the credit is applicable, and
(b) as to the amount of the credit.

The changes proposed in section 208 of the House bill, set forth in the foregoing statement, would put coal on an equality with natural-gas production (but not with natural-gas transporters or storers) (a) as to years to which the credit is applicable, and (b) as to the amount of credit.

5. Corporation E is the lessor of all the coal property operated by Corporation A.

Under the present law, E gets no credit for its increased royalty income, all of which comes from a base period property.

Under House bill, E would get a credit in 1944 and later tax years on one-half of its net income from the increased production of 300,000 tons, but would not get any credit for the increased production for 1942 and 1943.

Under the changes proposed in section 208 of the House bill, E would get this credit for 1942 and 1943 tax years also.

6. Corporation F is the lessor of all the coal property operated by Corporation B.

Under the present law, F gets no credit in 1942, 1943, and 1944 and subsequent years for the increased production from its property which was brought into operation in 1940 and 1941.

Under the House bill, F would get a credit in 1944 and subsequent years, but not in 1942 and 1943, for one-sixth of its income from the new property (i. e., it would get a credit of one-half of the net income from 100,000 of the additional production of 300,000 tons, annually).

Under the changes proposed in section 208 of the House bill, F would get a credit for 1942 and 1943, as well as for 1944 and subsequent years, equal to one-half of its net income from the entire production of the new mine (i. e., F would get a credit of one-half of the net income from the 300,000 tons of new production).

SUMMARY

It is believed that a careful study of the foregoing examples will show the necessity for, and the justice of, the amendments proposed to be made in section 208 of House bill, as more fully set forth in the preceding statement.

ROLLA D. CAMPBELL.

DECEMBER 3, 1943.

Senator WALSH. Mr. Stiles.

STATEMENT OF JAMES F. STILES, JR., REPRESENTING ABBOTT LABORATORIES AND PARKE, DAVIS & CO.

Mr. STILES. Mr. Chairman, my name is James F. Stiles, Jr., vice president and treasurer of Abbott Laboratories, North Chicago, Ill. I appear on their behalf as well as Parke, Davis & Co. of Detroit, Mich., who is represented here today by Mr. W. M. Hawkins; Eli Lilly & Co. of Indianapolis, Ind., who is represented by Mr. Carl F. Eveleigh; and the Upjohn Co. of Kalamazoo, Mich., who is represented by Mr. J. B. Vanderberg.

I would like to have the record show that they appear and I speak for all of them.

We desire to call your attention to certain provisions of the proposed revenue bill of 1943, as well as the present law pertaining to the tax on distilled spirits and draw-back features thereof, which present several serious problems to all of us, and to make certain definite recommendations with the hope that they will receive your favorable consideration.

(1) Manufacturers or producers of designated nonbeverage products:

IN GENERAL.—Any person using distilled spirits produced in a domestic registered distillery or industrial alcohol plant and fully tax-paid in the manufacture or production of medicines, medicinal preparations, food products, flavors, or flavoring extracts which are unfit for beverage purposes and are sold or otherwise transferred for use for other than beverage purposes upon payment of a special tax per annum, shall be eligible for draw-back as hereinafter provided for.

The present law prevents the manufacturer from claiming any draw-back until the product containing alcohol is actually sold or otherwise transferred for use. Compliance with this provision involves volumes of detailed record as well as a very substantial investment of funds for a considerable period, which ultimately will be refunded. Each time the amount of draw-back is changed these problems are multiplied. The proposed increase in tax from $11.40 per gallon to $17.10 per gallon on a commodity that has a commercial value of approximately 50 cents a gallon, necessitates a tremendous increase in funds for this purpose. For example, when the manufacturer of a product which is unfit for beverage purposes purchases an 8,000 gallon tank carload of alcohol for which he pays a producer approximately $4,000, he will under the proposed bill advance a tax of $136,800, with the hope that after he has sold or otherwise transferred for use his finished product, he may then file a claim for draw-back amounting to $76,000.

Senator LUCAS. Your point is, as I understand it, that the $76,000 which you call a draw-back would be withheld at the time you paid the $136,800, is that correct?

Mr. STILES. No, Senator Lucas. My suggestion would be that we be allowed the full draw-back, as will be brought out, at the time the alcohol is actually put in these medicinal products, instead of waiting a year later when these particular products, which run into the millions of packages, are sold or otherwise transferred for use.

Senator LUCAS. You pay for an 8,000-gallon tank of alcohol $4,000?

Mr. STILES. That is correct.

Senator LUCAS. And under this bill you would pay at that time, as I understand it, a tax of $136,400 on that 8,000 gallons?

Mr. STILES. That is right.

Senator LUCAS. Ultimately you will get back from the Treasury Department $76,000—at some time?

Mr. STILES. Yes, sir.

Senator LUCAS. What you are trying to do now is to get it back a little quicker?

Mr. STILES. And a little more accurately.

Senator LUCAS. Than what the Treasury does now?

Mr. STILES. That is right, and I bring that out on the next page.

There is no disposition on the part of the firms here represented to interfere in any way with or to restrict the authority of the Commissioner to investigate sales of the manufacturer's product, but on the contrary, we desire to make it possible for him to effect certain changes in the regulations which will result in the following advantages:

(a) Simplicity of records for both taxpayer and the Treasury Department with consequent manpower savings.

(b) Assured accuracy in determination of the amount of claim which is extremely difficult under the present complicated procedures. The present procedures do not assure an accurate determination of the amount of claim, with the result that the draw-back may be greater or less than it should be—most probably less. This certainly was not the intention of Congress. Most of the tax-paid alcohol used by the firms represented eventually is placed upon the market in preparations running into millions of packages. The unsold packages of our products generally have to be inventoried quarterly in

connection with the preparation of the draw-back claims, so you can imagine the number of items that have to be dealt with to establish each claim. The volume of supporting data, consisting of approximately 20,000 invoices daily by the four companies here represented, makes confirmation by the Internal Revenue Department almost impossible.

Senator DANAHER. How many transactions are in this?

Mr. STILES. We have that many right along.

Senator DANAHER. All it does is settle the amount of the draw-back, isn't that it?

Mr. STILES. We are not arguing about the amount of the draw-back.

Senator DANAHER. The transactions are identical in either case?

Mr. STILES. Oh, yes. We are making the suggestion so that we don't have to go through all this. As a matter of fact, Mr. Berkshire and Mr. Kennedy have been very cooperative in trying to work out a simple formula, and I will say this: Our own company has not received its first draw-back yet.

2. At the time that the original draw-back provisions became law, the net tax cost of alcohol used in nonbeverage products was reduced from $7.60 to $4.25 per gallon. No draw-back provision was made applicable to the tax which had been paid on the alcohol in finished products or work in process. However, as a result of the draw-back, appropriate reductions in selling prices were made, notwithstanding the fact that the tax-paid alcohol at the rate of $7.60 per gallon not subject to draw-back was still in inventory.

3. As now worded, subsections B and C, section 309, of the pending bill, H. R. 3687, when considered together with section 302, title III, and the provisions of section 1650 of chapter 9A, again will produce exactly the same situation as I have just described, by reducing the net tax cost of alcohol from $7.60 to $4.275 per gallon, so that 6 months after the termination of hostilities the manufacturer will again be forced to take the substantial loss of $3.325 per gallon on all alcohol then in finished goods, work in process, and raw material inventory. In other words, our understanding of this construction of the language in these subsections is that the $3.75 draw-back beginning on the date referred to will be applied against alcohol in inventory on which the $9 tax was paid.

I don't think that is your intention or the intention of Congress, and I don't believe it was the intention of the Ways and Means Committee, because I read the article that went along with it. But we have been advised by our attorneys that that is the fact.

We feel that the present net tax cost of $4.275 per gallon, on a 50-cent commodity is quite sufficient. If this committee, however, finds it necessary to recommend any change in either the tax or the draw-back from that now in effect, than because of the added complications which will necessarily be added to an already burdensome system, we desire to make the following recommendations.

I just want to give one illustration. We buy alcohol—and I will use the proof-gallon rate for simplicity. It is practically double. A proof gallon refers to whisky, but we buy alcohol 190 proof, so it is 1.9 times. But we bought alcohol at $3, then we bought it at $4, then they raised it to $6, with $2.75 draw-back. Now you propose to raise it to $9, with a $5 draw-back. It takes about a year and a half

for our inventory to turn over from the time we get it until the time it is actually sold or otherwise transferred, so we have within our organization not only four different kinds of alcohol, at four different kinds of draw-backs, but four different alcohols blended in four different mixtures, which you can multiply and divide and get about 16 different draw-backs which now apply to our finished goods in the various branches.

Senator LUCAS. Under your recommendation you would eliminate those 16 draw-backs?

Mr. STILES. Absolutely. You would get down to the point where the alcohol would be a product used for beverage purposes.

Senator LUCAS. It would be almost impossible to determine what you are really entitled to as a result of the examples you have used here.

Mr. STILES. That is right, Senator.

Recommendations: 1. That section 3250 (L) (I) of the Internal Revenue Code be amended to read as follows:

(I) IN GENERAL.—Any person using distilled spirits produced in a domestic registered distillery or industrial alcohol plant and fully tax-paid in the manufacture or production of medicines, medicinal preparations, food products, flavors, or flavoring extracts which are unfit for beverage purposes upon payment of a special tax per annum, shall be eligible for draw-back at the time when such alcohol is used in the manufacture of such products and as hereinafter provided for.

2. We also recommend that subsection (c) of section 309, of the pending bill, H. R. 3687, be eliminated, and that the wording of subsection (b) of the same section be changed as follows:

In lieu of the rate of draw-back specified in section 3250 (L) (I) of the Internal Revenue Code, the rate applicable with respect to alcohol on which a tax of $9 per gallon—$17.10 per wine gallon as purchased—has been paid under title III of the Revenue Act of 1943 shall be $——— (the amount of draw-back finally determined to be effective).

This change of wording seems to us to be more in accordance with the intent of the House Ways and Means Committee as explained in their report to Congress regarding subsection C, section 309.

All firms here represented are members of the American Drug Manufacturers Association and with us is Mr. Carson P. Frailey, executive vice president of that association, who is prepared to state that in his opinion other members of the association affected concur wholeheartedly in this statement.

Senator WALSH. You are asking to have the tax remain as it is?

Mr. STILES. Naturally.

Senator WALSH. What does the Treasury say about their proposal, that they will unshackle you from this difficulty?

Mr. STILES. I rather imagine when they get working along with the situation, judging by comments received from men in the field, that they would be very happy to adopt this suggestion.

Senator DANAHER. Would you be willing to deposit as a sort of revolving fund the amount of the draw-back already in the hands of the collector?

Mr. STILES. Certainly. We would put up a bond or do it any other way.

Senator DANAHER. Why isn't that a far more satisfactory way than your suggestion?

Mr. STILES. Senator, I did say something about that, under the terms of the licensing arrangement, but I understand that the committee, and Mr. Kennedy, thought that would work practically satisfactory, as I have explained, by bringing that suggestion here.

Senator DANAHER. It seems to me that that would be a more satisfactory arrangement.

Senator LUCAS. Under this arrangement, what is your situation as to liquid assets?

Mr. STILES. We have tied up right now over $260,000 of prepaid taxes, which we ultimately will get back under this situation, and when the new tax goes into effect it will approximately double it, so we will have $500,000 involved, and unless Mr. Berkshire and Mr. Kennedy over there get this thing working a little faster than it is, we can look for that to further increase over a period of time, but I think we will get together on that and get that revolving a little faster than it has before.

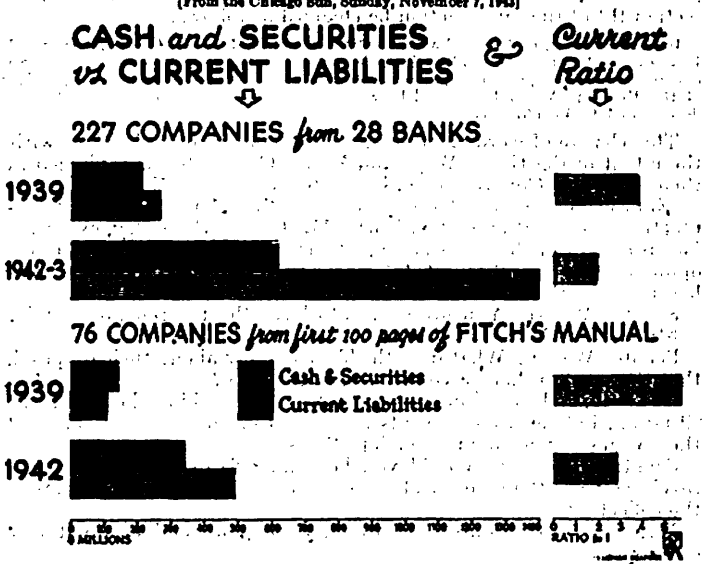
Senator DANAHER. Has the present system discouraged any new ventures into this field?

Mr. STILES. I wouldn't say it has. We are a very courageous people.

Senator WALSH. Thank you.

(Clipping from the Chicago Sun is inserted in the record at the request of Senator Lucas, as follows:)

(From the Chicago Sun, Sunday, November 7, 1943)



Prepared from data compiled by James F. Stiles Jr. Details in Business of the Nation.

BUSINESS OF THE NATION

MANY CORPORATIONS MUST SOON BORROW TO PAY THEIR TAXES, STILES SURVEY SHOWS

(By Phil S. Hanna)

Mr. J. F. Stiles, Jr., vice president and treasurer of Abbott Laboratories, North Chicago, calls attention in a most impressive way to the growing nonliquidity of American business corporations. The logical deduction from his study is that many corporations must soon borrow money to pay taxes.

His graphic portrayal (see chart in adjacent columns) of the manner in which the rise in taxes is trimming down corporations' ability to pay all their current debts and have sufficient working capital remaining for either ordinary or extraordinary needs is deserving of examination.

Mr. Stiles plotted the relation between liquid assets and current liabilities for 227 companies, being representative of industry in each of 28 banks' trade territories. While net working capital of these companies in the 3½-year period from December 31, 1939, to June 30, 1943, increased $650,000,000, current assets to current liabilities declined from 3.72 to 1.87.

In order to get a double check on the matter Mr. Stiles requested Fitch's Investors Service to submit comparative current assets and current liabilities at the end of 1939 and for the end of 1942 for the companies listed on the first hundred pages of its manual. This data, also shown on the chart, covers 76 companies. It shows that at the end of 1939, prior to having any war business, these 76 companies could have paid off all their liabilities out of cash and have had $38,000,000 left.

However, in spite of wartime expansion taxes have increased so much faster than profits that if these same companies had attempted to pay off their liabilities at the end of 1942 they would have had to borrow $158,000,000. Assuming a continuation of this trend it means, says Mr. Stiles, that by next year practically every growing company will have to resort to borrowing money to pay its taxes.

BETTER YARDSTICK NEEDED

Mr. Stiles declares that these data "clearly demonstrate that some yardstick other than simply the increased-capital method should be established for measuring normal profits of growing companies." He renews his suggestion that payrolls subject to social security taxes be made the yardstick for determining the base credit for normal profits.

His formula is as follows: "Determine the average ratio during the base period of payroll (subject to social security taxes) to net profit (net income after deduction of normal tax) and use such ratio to determine the base credit for normal profits in each subsequent year."

Writing to Chairman Doughton, of the House Ways and Means Committee, Mr. Stiles says in part:

"Let us assume that the stockholders of a certain company (whose base credit and specific exemption was $3,000,000 and whose total earnings were $5,000,000) decide that because of the increase in volume of business it is necessary to secure a million dollars additional capital. The company has never had a bonded debt and it decides that the most satisfactory method for securing this additional capital is the sale of $1,000,000 of 4½-percent preferred stock.

"As a result of this additional capital the company makes an additional $200,000 profit before tax. This certainly would be a liberal profit to expect on an increase of a million dollars.

"However, as a result of this change in capital, the base credit for normal tax would be increased to $3,080,000 on which the total normal and surtax would be, under the present law, $1,232,000, or an increase of $32,000.

NET-PROFIT INCREASE SLIGHT

"The profit subject to excess-profits tax would be increased to $2,120,000 which would increase the excess-profits tax by $97,200 after post-war credit. The total increase in taxes, if the company was fortunate enough to make 20 percent on its increased capital, would result in a net increase in profits after tax of $70,800.

"If the company paid 4½ percent on preferred stock this would have to come out of the increased earnings and leave a net profit of only $25,800 to be distributed to the common stockholders as a result of their willingness to accept a deferred position with respect to their equity and earnings.

"Furthermore, it would probably cost the company at least twice the profit of $25,800 in brokerage fees and legal expenses in preparing the securities for sale under the present federal regulations. So, really the common stockholder has accomplished nothing by permitting his company to secure the additional capital necessary to provide for its normal growth."

Senator WALSH. Mr. Todd.

STATEMENT OF VICTOR H. TODD, REPRESENTING THE COLD CATHODE LIGHTING INDUSTRY

Mr. TODD. Mr. Chairman, I appear in the interests of the cold cathode lighting industry. I am president of the Fluorescent Lighting Association.

Cold cathode lighting is a comparatively new and highly efficient form of lighting whose development was just getting under way as the war started.

I do not want to take your time by going into the details of restrictions and limitations imposed by the War Production Board and other Government agencies which hit this particular branch of the lighting industry, but they were outlined rather forcefully in a speech before the Senate by Senator Stewart, of Tennessee on February 22 of this year, and appeared in the Congressional Record of that date.

Briefly, it is a story of many small independents throughout the country seeking only to compete in the lighting industry under the principles of free enterprise, seeking to do war-plant lighting in open competition with the big companies who have virtually controlled the lighting industry for many years, but asking no favors or finances from any branch of the Government.

Today, I would like to protest against the 25-percent excise tax on lamps on two grounds.

First is that I think it is wrong in principle to impose an excise tax upon good lighting and good seeing. There are two bills that practically every poor man in the country has to pay each month; i. e., lighting and gas. Without regard to the selfish interests of the big lighting companies, it has been pretty generally conceded that all America needs better lighting, and that better lighting will be one of the biggest post-war businesses because in homes, schools, stores, factories, and everywhere artificial lighting levels of the past have been found to be insufficient.

I think that is pretty well proven by the fact that the Government, in spite of all restrictions, has nevertheless permitted all war plants to improve their lighting to overcome absenteeism from headaches and sickness due to poor seeing, and also to improve the efficiency and output from those plants.

I cannot see why, with all of the wild spending going on in such places as the theatrical and night club district in the city of New York, and probably in all other big cities, it should be necessary to take something so fundamental to good health as lighting and put it in the excise tax class. If, as Secretary Morgenthau has recently stated, one of the main purposes of the present tax bill is to prevent inflationary spending, why pick on something so fundamental as lighting. Nobody in the world ever went on a lamp-buying spree.

I would like to call your attention to news articles current this week, that a number of the blast furnaces of the Republic Steel Co. in Youngstown, Ohio, have been shut down due to lack of orders, and a demand by the C. I. O. that the Government order the reopening of those blast furnaces, demanding that they be kept in continuous operation for the duration of the war.

Yet, only last month we were told in the Lighting and Fixtures Section of the W. P. B. that there was no sign of any easing up on steel for lamp reflectors, either for homes, commercial establishments, or anything but war plants, and here are thousands of commercial firms, and for that matter, homes, who have been virtually denied any improvements in lighting during the duration of the war, anxious to make improvements in their lighting, being denied steel for reflectors while steel mills are shutting down for lack of orders, and the Congress is imposing an excise tax on lamps.

I submit, gentlemen, that if the public has excess money to spend it might better be spending that money for home, factory, and commercial improvement in an investment like better lighting, than for liquor and night clubs.

We do not want one pound of material, steel, or anything else that is needed in the war effort, but some of these sections just do not fit into the jigsaw puzzle in Washington.

If the Secretary of the Treasury is really interested in stopping inflationary spending, or if the Senate is so interested, I would like to recommend that one of these Senate groups that investigate matters right on the ground be sent to Broadway and Forty-second Street, New York City, and find out where the inflationary spending is going on before they impose an excise tax on something that affects the eyesight of every individual in America.

My second point reminds me of the old saw about the farmer who shot at the crow and killed the hired man, in this respect. If an excise tax must be imposed on tubes and lamps for lighting, I urge that it be mandatory that the tax be passed on to the consumer, as otherwise that excise tax will simply serve to warm the heart of the big corporations who have held a death grip on lighting for many years.

Those big companies are making plenty of money on war contracts in all kinds of electrical devices and equipment, and they can well afford to absorb the excise tax and, if necessary, take a complete loss in their entire lamp department as a heaven-sent means of writing off some of their excess profits in other departments, and at the same time wiping out of existence forever the competition from the small man, particularly in the new cold cathode branch of the industry which is already "punch drunk" from various war limitations favoring the big interests.

I do not want to pick on any individual competitors, but I would respectfully call to your attention the fact that there are now pending and held off merely for the duration of the war, various suits against important interests in the lamp industry charged with monopoly and also charged under separate suits with conspiracy to hold back the development of fluorescent lighting.

I cannot believe that the United States Senate would want to impose any tax in such a manner as to make a complete windfall for these big

interests at the expense of the small businessman, and thereby deal a death blow to a new form of lighting which is forging ahead on sheer merit in spite of terrific handicaps and pressure from many directions.

Cold cathode fluorescent lighting has virtually no patent control possibilities. It brings hundreds of small independent companies into the lighting business. If that be treason, this 25 percent excise tax would serve as a fit punishment if it becomes a law without the mandatory provision sought.

Senator WALSH. What is the present tax on lamps?

Mr. TODD. A 5 percent excise tax.

Senator WALSH. And the House bill increases it to what?

Mr. TODD. To 25 percent, 5 percent higher than jewelry.

Mr. WALSH. Does that apply to all lamps no matter what the price?

Mr. TODD. Yes, sir.

Senator WALSH. Thank you.

STATEMENT OF CHARLES POLLAK

Mr. POLLAK. I represent the neon lighting sign industry. Before the war, there were some 3,500 sign manufacturers in the United States; today we are a group of 2,000 existing concerns, most of whom are just barely existing, about 100 fully existing concerns, the remaining 1,900 concerns operating at nights, being one-man shops that cannot possibly, under the limitation L17 order, continue to operate a full business establishment, but who are keeping their name alive by still having a place of business, and a method of operating outside of working hours.

These signs consist of a transformer supplying the proper electrical energy to one or more gaseous discharge tubes. The tubes are bent to form letters and symbols and as such are called signs. If the tubes were straightened out and the letters and symbols eliminated, a cold cathode lamp would result.

During the time when section 3406 (A) (5) of the revenue act was in effect, to economically collect taxes from the multitude of sign manufacturers throughout the country was found utterly impossible. This is because the sign shop is essentially a small business. Most shops consist of the proprietor and one or two workers at the most.

At the time of Pearl Harbor, no industry was more drastically curtailed than the neon sign industry. War Production Board Order L-17 put the sign shop out of business. No relief has been offered since. Every sign man had displayed ingenuity—the ingenuity we expect from an American businessman under all situations of pressure. They have shifted some of their sales from signs to lighting.

Under the current revenue bill before the Senate Finance Committee, the sign manufacturer is required to pay a 25-percent tax on all tubes that he fabricates for lighting use. This is the death knell for the entire business.

The cost of cold cathode lighting is high—it is a hand-made, custom-built job. It is not too high at the present time if the cost is amortized over the life of the tube because of the tremendous life of a gaseous tube of this nature. With the huge tax of 25 percent placed on this tube, the sign manufacturer once again is placed in a position where he

cannot hope to compete and is, in effect, being legislated out of business. He must choose either to go out of business or to forego paying taxes.

Past experience showed that the tax on neon signs was uneconomical to collect. Taxes on cold-cathode tubes for neon-sign manufacturers will be equally uncollectible and uneconomical. This is especially true when you consider volume.

There are approximately 2,000 neon shops in existence in the United States, and with the average of 2 lighting jobs each month being handled per shop, there are 4,000 installations per month being made for illumination purposes throughout the United States by neon-sign shops.

The average footage per job is somewhat under 64 feet. This consists of an average of eight tubes or less per job.

At the present time prices given to a customer for the complete installation by the various sign shops have been made without any attempt to segregate the cost of the tube from the cost of the complete installation, because the tube is built in as an integral part of the installation of transformer, transformer box, and tube connectors.

The price of the tube is never billed separately, but if a price of 35 cents per foot were placed on the tube as an average fair price, the entire cost of the tubes per job would amount to $22.40, or an average gross business per shop of $44.80.

The tax return on such business would be $11.20 per month. The cost of collection and audit would probably be greater than $25,000 per month income which would be derived from the cold-cathode sign industry.

At the same time the small sign shops are eking out a living from these few cold-cathode jobs per month, plus the repair and maintenance work which they are doing.

After the war the sign industry anticipates a tremendous expansion when signs are once more built and placed into service. At that time the industry can be expected to take at least 100,000 to 150,000 more employees on their pay rolls.

The tax placed now on this industry would serve to collect less than $300,000 per year revenue if all tax bills were paid. It would probably serve to put half the industry out of business. It will be of little use to the Treasury Department as a revenue producer now, and certainly would be destructive to a long-range planned program.

Furthermore, the tax is discriminatory as far as the sign industry is concerned, since it will certainly throw it out of the lighting field, and cause the complete disintegration of this small national industry.

We ask that if this tax must be put on, that it be made a consumer tax to be passed on, if possible, so that this industry which is just growing and which you have no thought, I am sure, and the Ways and Means Committee had no thought, I am sure, of putting out of business, may be preserved. If possible, there should be some method to exempt us from this tax.

Senator DANAHER. You don't sell this cold cathode light to homes, do you?

Mr. POLLAK. No, sir; stores and factories.

Senator DANAHER. Displays?

Mr. POLLAK. Commercial purposes.

Senator DANAHER. The fluorescent light, what percentage of that goes to homes?

Mr. TODD. Our branch of the fluorescent lighting, the standard fluorescent lighting fixtures, which are made by the General Electric and Westinghouse, a good share of that goes into homes. None of ours has gone into homes, though. It has all gone into war plants and industrial plants.

Senator DANAHER. So that whatever tax you two gentlemen are talking about is passed on, it would be absorbed by the business companies, by some commercial venture, would it not?

Mr. TODD. If this tax is put on, this 25-percent excise tax, I think the same thing will happen to it as happened to the 5-percent tax, namely, that the big companies, and I am advised that the incandescent group, the General Electric and its licensees, control 90 percent—if they absorb that tax and write it off against their excess-profits tax, there won't be any tax paid at all, because I think our group will be automatically put out of business.

We are not in this field; we are just trying to get in, because we were really pushed out of the sign industry as being a nonessential industry for the duration. We admitted it was. They said, "What can you do?" We said, "We can do war-plant lighting." That is what we are trying to do now.

Senator WALSH. Have these industries which you claim will absorb the tax appeared in opposition to the 25-percent tax?

Mr. TODD. I don't know. I haven't heard of any opposition.

Senator WALSH. You think if they do help the tax, it will help reduce their excess-profits taxes and it will put you out of business, both of you?

Mr. TODD. That is what I think.

Mr. POLLAK. It will be a decided advantage to them.

Mr. TODD. I think that will be the main result of the tax.

Senator WALSH. Thank you.

Mr. TODD. I am submitting for the record a telegram to the chairman of the Ways and Means Committee, sent by the Incandescent Lamp Manufacturers' Association, and also copy of a letter to the Antitrust Division.

Senator WALSH. They may be inserted in the record.

(The papers referred to are as follows:)

(Telegram)

NEW YORK CITY, *November 1, 1943.*

Hon. ROBERT L. DOUGHTON,
Chairman, Ways and Means Committee,
House of Representatives, Washington, D. C.

This association of independent electric light bulb manufacturers respectfully requests a hearing on the proposed increase in manufacturers' excise taxes contemplated in the new revenue act now being considered by your committee. We wish to submit facts showing that such an increase will not result in substantial additional revenue for the Government because it will probably be absorbed the same as the present 5 percent excise tax by the General Electric Co. and its licensees who control about 90 percent of the business, thereby reducing their manufacturers' sales price and likewise their excess profits taxes. Present economic conditions and increased costs of production make it impossible for this group of small independent manufacturers to absorb any increase in taxes which results in reducing the manufacturers' sales price. It will drive them out of business, leaving to General Electric and its licensees a complete

monopoly of the lighting field. The electric light bulb situation is the subject of an antitrust suit now being prosecuted by the Department of Justice and we therefore urge upon you to grant us a hearing before incorporating the contemplated increase in manufacturers' excise taxes on electric light bulbs in your report.

INCANDESCENT LAMP MANUFACTURERS' ASSOCIATION,
By LOUIS KLEIN, *Secretary.*

OCTOBER 27, 1943.

MR. WENDEL BERGE,
Assistant Attorney General Antitrust Division,
Department of Justice, Washington, D. C.

DEAR SIR: On behalf of the Incandescent Lamp Manufacturers' Association and the various manufacturers admitted to membership in that association, I wish to direct your attention to the new Revenue Act which is pending in Congress. I particularly refer to the provision for increase in the manufacturers' excise tax upon incandescent lamps. The present excise tax rate is 5 percent and it is proposed to increase this to 15 percent.

You are fully aware of the various conflicts between the General Electric Co. and its licensees, and the independent manufacturers represented by the Incandescent Lamp Manufacturers' Association and the conspiracy of the former group which is the subject of the antitrust litigation now pending in the Trenton courts.

When the 5 percent manufacturers' excise tax first came into effect, the General Electric Co. did not pass it on to its jobbers, dealers or consumers, but itself absorbed it. This had the effect equivalent to a 5 percent reduction in the sales price. The independent manufacturers tell me that they have every reason to believe that the proposed 10 percent increase in this excise tax will likewise be absorbed by the General Electric Co., which would similarly have the effect of a further reduction in the price of the commodity.

I have previously submitted charts to your Department graphically portraying a static price structure during the years preceding 1932, when competition from the independent manufacturers was negligible. As the volume of business of the independent manufacturers commenced to grow, the General Electric Co. instituted successive price cuts and my clients have contended that these were designed to reduce the competition of the independent manufacturers and, if unchecked, would result in driving them out of business.

Price cuts at the present time are not justified by economic conditions. The cost of raw materials and of labor has increased substantially and the general trend is toward higher prices. The General Electric Co., through its dominant position, controls the price structure and if the independent manufacturers, in order to compete with the General Electric Co., were required to reduce their prices by an additional 10 percent, the product could not be sold except at a loss.

The earnings of the General Electric Co. are so great as to place it in the highest excess-profits-tax bracket, and any additional manufacturers' excise tax that it might absorb would almost in toto constitute a deduction from its income and excess-profits taxes. This would not be the case with respect to the independent manufacturers whose earnings are substantially lower.

Therefore, unless the proposed increase in manufacturers' tax is either canceled, or unless it is compulsory for the manufacturer to pass along the tax to the ultimate consumer, the General Electric Co. will become possessed of the means of accomplishing its purpose of throttling the competition of the independent manufacturers, and the objectives of the antitrust suit will be completely defeated.

I cannot believe that the legislators charged with the framing of the new revenue act are aware of the foregoing and I hope that you will call this to their attention before there is any further progress toward enactment. I should like to again repeat that unless this is done all of the steps taken by your Department to protect the independent manufacturers will have been in vain.

Very truly yours,

ARTHUR J. BROTHERS.

Senator WALSH. Mr. Hussey.

STATEMENT OF LUTHER N. HUSSEY, REPRESENTING NATIONAL EXECUTIVE COMMITTEE OF THE MILITARY ORDER OF THE LIBERTY BELL

Mr. HUSSEY. Mr. Chairman, my name is Luther N. Hussey. I am a practicing attorney of the city and a member of the national executive committee of the Military Order of the Liberty Bell, which is an organization of men who have served or are serving honorably in the armed forces of the United States. The slogan of our organization is equality always, and because of apparent inequalities in the proposed bill I ask for a few minutes of your time so that I may speak for yesterday's heroes who are today denied the privilege of coming here to speak for themselves.

Mr. Chairman, you may be surprised to learn that the constitutional rights of citizens, each of whom have given 30 years or more to the defense of our form of government, and all of whom are veterans of from 2 to 5 wars, have been so infringed upon that they are today denied the privilege of appearing here to speak for themselves. There has been a very serious chipping away at the cornerstones of democracy when executive decree forbids a citizen to petition the Congress. And when that decree is directed solely and exclusively at men who have honorably served their Government for more than 30 years, the discrimination is felt very keenly.

Mr. Chairman, I speak of the retired men of our armed forces. Men who know but one political creed. Men who have devoted their lives to the service of their country. These men, Mr. Chairman, are prohibited by a War Department order from exercising the fundamental right of petition. They may not consult with you gentlemen despite the fact that you, and you alone, are charged with the duty of raising and maintaining an Army and Navy.

Mr. Chairman, in the midst of all this talk about billions, it may seem an imposition upon your time for me to come here and talk about a few dollars, but I ask you to bear with me a few moments while I explain that the few dollars of which I speak mean the difference between food or no food on the tables of the retired men of our armed forces.

There is much talk about the need of high taxes to offset inflation and to make the Treasury a reservoir of surplus funds in the hands of people who have too much money. Now that may be true with respect to a few citizens, but I say to you that the retired men of our armed forces, who are the truly forgotten men of this country, have no surplus funds. The proposed bill would tax the food off their tables.

Mr. Chairman, in line with our policy of equality always, we seek the same income-tax exemption for retired men of the armed forces that is now accorded to those who are on active service and to those who are disabled.

Aged, disabled, retired veterans of the armed forces are today the only veterans who are not granted income-tax exemption. Are they to be penalized by Congress because they served 30 years, while veterans who served only 90 days and were disabled in service are granted exemption on their disability allowance?

There are approximately 11,000 enlisted men retired from the Army, Navy, Marine Corps, and Coast Guard who served 30 years actual time. All these men who are physically fit are again back on active service. Only those who are aged and disabled, or over 60 years of age, are not again back in the service.

The official records will show that over 50 percent of the retired enlisted men of our armed service have not received 1 cent of increase in retired pay since 1922. Some few Navy and Marine Corps enlisted men received $1.74 per month increase since 1922.

While over 50 percent of the retired enlisted men have not received an increase in pay since 1922, the Congress in 1926, and again last year, has twice increased the pay of civil-service employees, many of whom receive pension, or compensation, plus their civil-service remuneration, and they are income tax exempt on the pension, or disability compensation which they receive.

These individuals with two incomes are thus income tax exempt on one, whereas the aged, disabled, retired enlisted men with only one income—his small retired pay—must pay income tax on that.

The plight of the aged, disabled, retired enlisted men is becoming increasingly desperate because of the ever-increasing cost of living plus the ever-increasing tax burden. Organized labor has been receiving increases to supplement the increased cost of living but the retired enlisted men of our armed service must rely upon your sense of justice to extend to them the same consideration which your committee has heretofore extended to all other veterans.

Madam Perkins, Secretary of Labor, is authority for the statement that the cost of living has risen 23 percent since the Little Steel formula was announced in 1941. This statement is conclusive proof that the retired enlisted men are the chief sufferers from our increased cost of living, for their retired pay buys ever and ever less, and unless they are exempt from income taxes on parity with other veterans this bill will amount to a further reduction in their meager pay.

Congress has recently enacted legislation that will provide 15 percent increase in compensation to World War veterans and their widows, thus recognizing the need of some form of relief to meet the high cost of living. A similar increase was not accorded retired men, yet the proposed bill would amount to a reduction in their retirement pay despite the ever-increasing cost of living.

The foreign veterans of any war residing in the United States—this could include German, Italian, or Japanese veterans—are income-tax exempt on the benefits which they receive from their home government. While these foreigners are income-tax exempt, disabled, retired enlisted men of the Army, Navy, Marine Corps, and Coast Guard of the United States are forced to pay income taxes.

To amplify more specifically, we cite the case of Julius Heinze—twice decorated for bravery—once wounded. He served 30 years to retire. Yet today he receives less retired pay than approximately 25,000 Spanish-American War veterans who served only 90 days, and who never left a training camp here at home. Many of these veterans, personally known to us, are receiving $100 per month pension, all of which is tax exempt, while the lower retired pay of Julius Heinze is subject to income tax.

We could continue by citing hundreds of similar cases but shall not impose upon your time where the proposition involved is so simple.

Retired railroad employees, thousands of whom never contributed a single penny, or only a few cents, to the railroad-retirement fund, are also income-tax exempt. Many of these men—unlike the low-paid retired enlisted men—earned high monthly salaries throughout their lifetime, and many of them are well fixed financially. Yet they are exempt from paying income taxes on their retired pay, while the low-grade retired enlisted man is not.

Even pistol-packin' General Patton, who is reputed to be the wealthiest man in the Army, enjoys an income tax exemption on a substantial portion of his income and we are sure that he and the other boys who are so bravely holding the lines throughout the world would want this committee to extend the same exemptions to their comrades of yesterday.

Mr. Chairman, in behalf of the Military Order of the Liberty Bell, I wish to thank you for the privilege of appearing here and to ask that this committee amend the proposed bill to provide income-tax exemption on the first $1,500 of income for all retired personnel of our armed forces.

Senator WALSH. Mr. Cowdin.

STATEMENT OF J. CHEEVER COWDIN, CHAIRMAN, COMMITTEE ON GOVERNMENT FINANCE, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. COWDIN. Mr. Chairman, the effect of the pending legislation is of vital concern to every American.

It was my privilege some weeks ago to present the association's recommendations to the Ways and Means Committee of the House of Representatives. The suggestions made were based on careful and extensive studies. They were guided by the factual results of one of the most exhaustive surveys of current business conditions ever undertaken and they were supported by 8 months of meetings and conferences with businessmen from every one of the 48 States.

Our Nation-wide survey was conducted in cooperation with 90 national, State, local, and trade associations in the country and the facts and figures collected represent a comprehensive and accurate cross section of American business. A copy of our recommendations, this survey, and the complete testimony presented at the House hearings on this bill is attached to this statement for your examination.

Briefly, we recommend that there be no increase in present taxes or new taxes imposed at this time for three important reasons.

1. Additional income taxes would seriously impair national morale and would work particular hardship on 25,000,000 white collar individuals.

2. Corporation business now has so little left after payment of taxes that its ability to reconvert promptly and be in a position to give post-war jobs is threatened. Small businesses, particularly, are suffering from the impact of higher costs and sharply increased taxes.

3. In our opinion the existing Federal taxes will raise $44,500,000,000 on the next calendar year's estimated national income and in addition there will be substantial savings in estimated expenditures to greatly improve the budget situation.

Industry has always expressed its complete willingness to pay taxes to the limit of safety. This was evidenced when the National Association of Manufacturers last year was the first to recommend a combined normal and surtax rate of 40 percent on corporations and a 90 percent excess-profits rate.

Our recent compilation of figures on companies in war production shows the margin of profits on war business, even before taxes, has been declining over the past 3 years and now is no greater than companies in civilian business.

Projection of the figures from our Nation-wide survey indicates that all corporations will have left after taxes about $6,000,000,000 in 1943 and only about $2,000,000,000 after dividend distributions to stockholders. For the 3 years 1941, 1942, and 1943, taxes and dividends will leave only 6.5 billion dollars of retained income in American business to offset the huge business losses during the depression years and to support our present tremendous expansion of production.

It is important to understand that these retained earnings are not a cash accumulation but are largely in bookkeeping assets such as expanded inventories, receivables, plant, and equipment.

Industry will need funds in much greater amounts than it now has if it is to reconvert quickly and furnish its full share of jobs promptly in the post-war period.

A great section of American business has been caught in a net of rising taxes, rising costs and dwindling earnings. This white collar class of business has been hard hit. A survey by the Department of Commerce shows that from June 1940 to June 1942 there were 273,000 firms—mostly small businesses—which went out of business—about 450 each working day.

Small business has been the heart and soul of American industry and a great supplier of jobs for our people. Thousands have been forced to close their doors and others are just managing to hold on. Materials are scarce. Labor costs have soared. Many of their employees have gone into the services or into war work. Their solvency must be maintained for they represent the core of peacetime business and are counted on to give millions of peacetime jobs.

Too little consideration is given to the fact that more than half of our corporate units lose money every year. In 1941, the last year for which official data is available, out of the total of over 500,000 corporations there were 246,000 which did not operate at a profit.

Eleven million of our people own stock in corporations. The income tax returns show that at least 57 percent of dividends are paid to those with incomes under $10,000. Many persons of modest means have invested their savings in the larger corporations in the belief that in this way they would secure the margin of safety they need. Stockholders have become our forgotten class.

While every other segment of our national income has expanded greatly, dividend payments continue to decline. For example, wages and salaries this year will be 90 percent above 1929. Dividend payments will be 32 percent less.

Corporation enterprises now provide jobs for 30,000,000 people out of our 54,000,000 working population. Excluding those in Government and farming, corporations are supplying about 95 percent

of business employment. They must be given every opportunity to continue this job giving.

The revenue bill before you shows painstaking care and due consideration of the manifold problems the Government and our people now face. We do, however, desire to present to you our views and conclusions with respect to three extremely important sections of the pending legislation.

Regarding excess profits rate, the proposed increase in the excess profits tax from 90 percent to 95 percent is an increase beyond the point of sound and effective taxation.

We want to repeat our disapproval of excessive profits, but in our opinion an increase to 95 percent would be destructive to many companies and harmful to the entire economy. It would kill incentive. It would encourage and stimulate waste and eventually cause severe unemployment.

The excess-profits tax at best is an imperfect instrument. In thousands upon thousands of companies the earnings which are being taxed as excess profits are actually only normal earnings. A 95-percent rate on these companies is extremely unfair and works hardship which can seriously interfere with the ability to meet financial obligations and continue in business.

Over a period of time the effect of a 95-percent rate will be to defeat its own purposes by producing less, rather than more revenue.

It must be repeated again that much of the profits which are computed are not in cash but in inventory, plant, and receivables. But taxes must be paid in cash—the tax collector is not satisfied to accept inventories, receivables, and equipment.

We urge your committee to retain an excess-profits rate of not more than 90 percent, the limit for corporations faced with a monumental task of production.

As to reduction of invested-capital credits, the provision in the pending bill which reduces the credits of companies with more than $5,000,000 of invested capital is inequitable and unsound.

1. This provision unjustly penalizes many companies and particularly discriminates against millions of American citizens who are their owners.

We are aware of the views that some companies may have increased their invested capital as an expedient to lighten their tax load but this is not true certainly of the vast majority of companies. Isolated cases can be treated more properly through corrective provisions of law rather than through a discriminatory tax which hits such a broad segment of our economy.

2. The provision violates the basic principle of excess-profits taxation. The Congress and this committee have worked diligently to establish in prior tax laws a credit base to serve as a yardstick of normal earnings and to be segregated from excess profits.

For example, in enacting the relief provisions last year your committee recognized this principle and in its report to accompany the revenue bill of 1942 stated:

> This credit will be predicated upon an amount which is a fair and just reflection of the normal earnings capacity of the business and which it is entitled to retain before the imposition of an excess profits tax.

This new provision seriously infringes upon this sound principle by arbitrarily reducing the credit base and by this device it would subject a substantially greater proportion of normal earnings to the severe excess-profits rate.

3. This provision discriminates against many millions of our citizens who are corporate stockholders.

Within the past few days we have received information on the effects of this proposed provision from 175 corporations and their affiliated companies.

Compilation of this data from this small segment of corporate enterprise alone reveals the following sharp reduction in the excess-profits credit base of these companies would result:

Combined base under present schedule of credits	$938,742,000
Combined base under proposed schedule	792,285,000
Amount of reduction in credits base	146,457,000
Percentage of reduction, 15 percent.	

Significantly, these comparatively few companies have a total of 2,592,818 stockholders. Obviously the greatest portion of these are small stockholders of modest means. They are the ones who are directly affected by this arbitrary reduction in the base credits of these companies in which they have invested their savings.

Multiply this situation many times and the serious effect of such a discriminatory measure on the financial position of companies using the invested capital method may be realized.

If this legislation is enacted it will be the third arbitary reduction made in the invested capital credits in 3 years, and might easily result in additional requests to also reduce arbitrarily the credit base of the average earnings method.

In regard to post-war reserves and jobs, if there are going to be enough jobs to go around after the war ends, we must begin preparing for them today. If we wait until hostilities cease it will be too late.

It is a matter of paramount self-interest to every working-man and to every farmer in the United States that industry be in a position to provide jobs promptly. Their well-being depends upon the ability of industry to undertake peacetime production promptly.

The only guaranty that industry will be able to continue maximum employment is financial strength.

To achieve maximum post-war employment, industry must have adequate funds. We must get our factories off to a rapid start in the production of the myriad products America has done without during the war years. Only by production and more production can we hope to create jobs for all our people.

It is going to take time and it is going to cost a great deal of money to remove hundreds of thousands of machines producing war material, reinstall the necessary machines and make the jigs, tools, and dies to produce the goods of peace. Raw material will have to be purchased, selling organizations built, labor must be paid and other costs met before millions of peacetime products can be sent to market.

The accompanying survey gives the detailed conversion figures for 2,072 companies now engaged in war work. They estimate it will cost $2,289,000,000, without taking into consideration renegotiation repayments to get back to peacetime production. This is $570 for each employee.

These companies employ 3,987,536 people. It is obvious that they will not be able to meet tremendous reconversion costs and promptly begin peacetime production and employment unless they have the necessary funds available immediately upon the termination of the war. We call your attention to the fact that these companies' net current asset position will not allow the continuation of such employment unless additional funds are made available for this purpose.

We in industry are particularly concerned with the reemployment of our people who are in the armed forces as well as the maintenance of our present employees and the employment of the millions of our youths who are constantly expanding the working force. Our plans and hopes for their future welfare must not be jeopardized by short-sighted taxation policies.

The complete cost of reconversion and reemployment will call for vast outlays of funds. When the war ends, the amount of funds immediately available to industry will measure the ability of America to continue its forward progress and the employment of our people.

After the last war industry had extreme difficulties in making post-war readjustments, even though its financial strength was not impaired by years of depression and the drain of taxes as heavy as at present.

The readjustments to follow this war are going to be many more times severe. The Nation's welfare demands we prepare for them.

Industry completely endorses the principle that it must pay taxes to the limit during this war period. We feel it is no contradiction to this principle to ask the Congress to make provisions which will enable companies to make a more rapid transition to peacetime business.

We recommend you give serious consideration to allowing corporations to set up reserve funds in the form of a special issue of Government bonds. Corporations should be permitted to purchase such Government bonds as they deem desirable but should be limited in the amount of credit against taxable net income to a maximum of 10 percent.

At the termination of the war, these bonds would become redeemable and the proceeds would be used for post-war needs such as the encouragement of maximum employment through reconversion and rehabilitation, for accelerated depreciation, deferred maintenance, inventory adjustments, and other business needs. Such funds should not be permitted to be used for the payment of dividends.

With such reserves set up in Government bonds the Treasury would have the use of the money now, when the Government needs it most. In the post-war period these funds would be available to industry to help create the jobs which all segments of our people agree will be our most serious problem.

The recommendations made here are presented in the interest of the entire economy, and to assist in laying the foundation for maximum employment in post-war America.

We fully appreciate that the task of drafting a tax bill at this time is a most difficult one. Your committee has industry's complete confidence and respect.

We will, of course, gladly accept your final judgment on these matters, and we sincerely trust that the factual information we have been able to bring you will aid in your deliberations.

Senator WALSH. Mr. Batter.

STATEMENT OF CARL J. BATTER, REPRESENTING THE FAIR GROUNDS BREEDERS AND RACING ASSOCIATION OF NEW ORLEANS, LA.

Mr. BATTER. Mr. Chairman, my name is Carl J. Batter. I am an attorney at law representing the Fair Grounds Breeders and Racing Association of New Orleans, La.

We believe that a tax on pari-mutuel wagering is most unwise and sincerely hope that the said provision will be deleted from the bill. In the alternative, we believe that such wagering should be exempted from taxation when conducted by organizations not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

We feel that we can advise your committee with reference to this contemplated provision of law for the reason that we have succeeded in placing horse racing in the State of Louisiana on a high plane; eliminated the private profit element, and benefited the State, city and citizenry by conducting our track as a civic, nonprofit institution.

Prior to the advent of this organization, the State of Louisiana had no racing law. Racing lacked public confidence; betting was done without a totalizator, and racing finally was abandoned. Following the closing of the track, and the passage of a State law controlling racing—as the track was about to be subdivided into building lots—a group of public-spirited businessmen created the present, nonprofit organization; acquired the track; installed a totalizator, and conducted racing under State supervision for the purpose of promoting the tourist trade of New Orleans.

Racing has been revived, public confidence acquired, and the State and city have received substantial revenues.

Pari-mutuel wagering has, during recent years, been a means of substantial State revenue. It is a field of taxation so far reserved to the States. The advent of the Federal Government into this field, we believe, will deprive the States of much needed revenue.

In our case, we would probably have to change to the bookmaking form of betting—if we operated at all—and the direct loss in taxes to the State and city would amount to several hundred thousand dollars per year.

In addition, there would be the indirect loss to the community resulting from the reduced patronage and tourist trade. Other States would, in most instances, likewise suffer a loss in revenue.

We believe the proposed legislation to be fundamentally unsound for the reasons that—

It discourages pari-mutuel wagering which is conceded to be the fairest means of betting.

It discourages the use of the totalizator, a mechanical device, that insures honest control of pari-mutuel betting.

It encourages bookmaking, both at and off the track. Bookmaking, off the track, is an evil that we and others have endeavored to stamp out.

It invades a field of taxation heretofore reserved to the States, and the proposed legislation will probably yield very little tax.

By encouraging bookmaking off the track, the Government encourages the loss of admission taxes.

The proposed legislation will encourage bookmaking at the track, in lieu of pari-mutuel betting, with the result that the tax yield to the Federal Government will be negligible; State and city government will suffer a loss in revenue, and all the improvement gradually attained in racing over the past two decades will be seriously jeopardized.

The amount that can be extracted from the wagering without discouraging such wagering—for the purpose of the State and the track operator—in other words, the "kitty"—has already been brought to a high degree of efficiency. It has already attained the maximum and in some communities runs as high as 21 percent.

Any further tax would have to be borne by the State or the operator.

If the State is deprived of such revenue, other State taxes will require increasing or new sources of taxation will need be found. The State renders a service in controlling racing and should not be deprived of the revenue.

If the operator is deprived of that much revenue, the loss to the Federal Government in corporate taxes will most likely more than offset the excise now sought to be imposed.

Since the advent of the war the various race tracks have contributed millions of dollars to the war and other charities. These contributions were made without increasing the "kitty"—the extraction from the wagering—so that the contributions were not made at the expense of the public or the States. Such donations were solely at the expense of the operators who devoted the tracks to charitable purposes for given periods of time.

Finally, all the controls invoked by taxation, Federal and State, to insure an open, honest and full accounting will be lost. A bookmaker cannot be controlled in the same manner as a legitimate business, and some of the sad experiences of the past are likely to be repeated.

If the Congress concludes that parimutuel wagering should be taxed, we sincerely hope that the proposed section 1653 (a) be amended by adding to the end thereof the following language:

Provided: that this section shall not apply to such wagering when conducted by an organization not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

The proposed alternative, even though it does not meet the objections set forth above, will be in keeping with the policy of Congress to encourage, by relief from taxation, orgnaizations that have for their purpose the welfare of mankind.

Senator WALSH. Mr. Gillette.

STATEMENT OF S. L. GILLETTE, TOOELE, UTAH

Mr. GILLETTE. Mr. Chairman, I am Sam Gillette, small theater owner, from Tooele, Utah, a town of about 5,000 population with two small theaters. I am president of the Intermountain Theater Association. This is an association of theater owners in the States of Utah, Idaho, Montana, Wyoming, and Nevada. The large majority of our members are small independent operators of theaters, with a seating capacity of less than 500, in rural communities that average slightly under 5,000 population. Approximately 85 percent of the communities which I represent have no war industries whatsoever. The

communities have suffered a loss of population both from men going into the military service and others leaving to go to areas containing war industries.

We are small merchants in the field of motion-picture exhibition, and in our communities our people think of us in the same terms as they do their grocer, doctor, or druggist. Of course, we realize that you think of the motion-picture industry in terms of these large theaters which you see in Washington, D. C., which is entirely new to me except what I have seen in the last few days. You never see lines of people waiting to get into theaters in our towns like you do here. All the glamour there is in our operation is on the screen. Our doormen and ushers are sons of our neighbors who come and work in their ordinary street clothes. We would not think of dressing them up to look like admirals or generals in our theaters, and we serve a definite need in our communities to provide entertainment.

It is easy to understand the low waiting lines which I have seen in Washington because it appears that all the people pour out of the Government offices at one time, and as soon as they have succeeded in cleaning up and being fed, they all dash madly to the theater at approximately the same time.

In other words, your Washington theaters are, to a great degree, deserted except at the peak hour, around 8 p. m. The rest of the time there are seats available at all times.

On behalf of the owners and operators of the theaters in our territory, and I believe I can speak in this matter for all men in the field of motion-picture exhibition when I say that theaters are willing to carry their fair share of the tax burden.

We are already carrying a 10 percent tax of our gross in addition to income taxes and corporate taxes that are carried by our fellow merchants in other businesses adjacent to us, and now it is proposed that the tax on admissions be doubled.

In other words, 20 percent of our gross.

We feel that this constitutes unfair discrimination and that is the reason I am here to talk to you today. In addition to all the taxes which we have carried, we have acted as a propaganda agent for the Government. The large part of our running time is devoted to propaganda reels. Our pictures are slanted to convey the message that the Government has to the people, and by the combination of sight and sound we have been able to do an outstanding job which no other medium can do. The Treasury Department, War Department, and Manpower Commission all have come to the screens to get their message to the people.

There seems to be a prevailing opinion among those that drafted this proposed tax that the theater business constitutes a luxury, and, therefore, should be taxed as such.

While the Treasury Department proposed such a drastic increase in these tax rates on the hypothesis that theaters are a luxury, in many of their other endeavors they know and look to theaters as being vital in the community. The Treasury Department looks to the theaters to sponsor the sale of War bonds and to act as an issuing agent; to use the screen for carrying important messages in regard to the sale of bonds and the collection and payment of taxes.

The Government recognizes the theater as being important and vital to Army and civilian morale, and has definitely proven this by

the fact that they have installed a theater in every Army camp, every battleship, and every other installation they have built for service and supplies.

The theater owner, in his own community, is providing the same morale builder to the civilian front as the Government is in the operation of its own theaters.

The tax on general admission constitutes a tax on the low-bracket income class rather than the high-bracket income class. For many of the new families that have come into the intermountain territory the theater comprises the only means of escape from inadequate, poor housing, and, therefore, you must think of the cost of theater entertainment as a cost-of-living expense to many people if we are to maintain their morale and keep the job going on the home front.

There are many communities in the intermountain area that have never benefited from the war boom whatsoever. As a matter of fact, there has been a large loss of population, and, to the theaters in each and every one of these towns, this increase in tax will probably be the final consideration in closing the theater entirely.

This will have a bad effect on the morale of our farm population, as in many farming communities this is one of the few methods of relaxation available.

Some of the Treasury Department tax experts have estimated that this increased tax rate will yield an additional $165,000,000 a year, and as a matter of actual fact, they have obtained this already due to increased theater attendance, which definitely reflects the increased needs of the people for theater relaxation.

This proposed tax does not, apparently, bear in mind all the tax factors which make up the entire picture. The hypothesis on which they appeared to work is that theaters have enjoyed an abnormally large business and, therefore, have profited to a great extent.

They therefore look to the theaters for an increased share of theater receipts. The fallacy lies in the fact that they do not reconcile the tax returns of the various theater owners and then draw a picture as a whole.

As I have pointed out previously, the small theater owner in the small town may be forced to close, and in all probability, the return from him will be lost.

Insofar as the theaters in the boom areas are concerned, there is an equally large tax fallacy here. In practically all cases, these theaters are corporations. In most cases, the towns were over-seated and theaters were having a hand-to-mouth existence prior to the war boom.

For the years 1936 to 1939, which constituted the base for the computation of normal taxes, at the point of which excess profits taxes were computed, most of these theaters enjoyed a very slight profit, and, therefore, the tax base for normal purposes is very low as compared with their present income.

Therefore, if the theater owner is now forced to absorb the increased 10 percent in admission taxes out of his share of the total admission price, this will be taken off his profits.

In other words, the 10 percent removed from the theater profits will be remitted to the Federal Government as admission tax and will be taken off the net return for income tax and excess profits tax purposes.

This means that in this case these so-called "profits," of which the Government receives a minimum of 80 percent, and in many cases as much as 90 percent of the increase, would be merely a transferring of the funds from the pocket labeled "Income taxes" to the pocket labeled "Admission taxes." It would not constitute any appreciable return as anticipated by these proponents of the measure, and it would merely constitute an added burden on the tax structure of the theater.

Moreover, it might cause an actual reduction of attendance, and, therefore, reduce the return of tax dollars, as the theater owner, in absorbing this tax, finds it necessary to reduce the quality of his attractions, and, therefore, reduce the drawing power.

It must be apparent to you that if any increase in taxes is to be obtained, it must be from these large boom areas, and this increase has already been taken in the form of excess profits and corporate taxes.

A true interpretation of the entire measure is that this proposed tax is at best a 2 percent increase to the theater owner in the large boom areas, and a 10 percent death tax to the small theater owner in the nonboom areas.

There are only two ways to handle this tax: Either the theater owner must assume the tax and reduce his net established price, or the tax must be passed on to the patron.

While in theory this tax is supposedly absorbed by the patron, in actual fact, when the 10 percent tax was reduced from the 40-cent to the 10-cent level, in most cases the theater owner reduced his net established price to absorb the tax. This was universally true at the time the admission tax was imposed on the general admission price from 10 cents to 40 cents.

In determining whether the theater owner will absorb the tax himself or pass it on to the patron, he must first determine what effect this change of price will have on the volume of his attendance. You must realize that this is a business based as much on volume as on price, and if we are to secure the maximum returns, we must arrive at the point at which the factor of maximum attendance plus price equals the greatest gross.

This is also important in regard to the amount of tax dollars which the Government will collect from us.

In drawing up this proposed bill, there is a great fallacy in assuming that increased tax rates will yield increased tax dollars. It is true in the amount of revenue which will be obtained by the Government as admission taxes that the volume of attendance is more important than the tax rate.

Insofar as the small theaters in the small towns that have not obtained any of the defense industries are concerned, this increased tax will bear very heavily upon the small theater owner. If he absorbs the tax himself it will reduce his profits and proportionately reduce the amount the Government will receive from him in income taxes.

Of course, in theory the theater acts as a Government agent in collecting this tax, but, gentlemen, this is only a theory. In actual fact, the patron is only concerned with the total amount he pays for admission to the theatre. He does not concern himself with the proportion that goes to the Government and the proportion that goes to the theater owner.

Therefore, if we pass on this additional tax to the patron, to him it merely means that we are increasing the cost of admission, and if we increase the cost of admission, it definitely will have a bad effect on the volume of attendance.

We have observed that increases do have a definite effect on the volume of attendance, and we are fearful of the effect of increased admission price due to the 20 percent tax.

There may be an impression in your mind, due to these large standing lines which you notice in Washington theaters, that in spite of price the theater will continue to enjoy the same volume of attendance. May I point out to you a very significant fact in the volume of attendance today. It is true that we have an abnormal attendance in a lot of theaters in many towns, but this abnormal attendance today is due to one big important factor, and that, gentlemen, is gas rationing.

With the restriction of the use of automobiles and the fact that people cannot travel for outside activity, the participation in sports such as hunting, fishing, picnicking and so forth, has been greatly curtailed.

This has thrown large numbers of people into the theaters as the only recreation left. This has greatly increased the attendance factors in theaters throughout the United States and has given an increased return to the Treasury Department far out of proportion to what they had expected.

Without considering the fact that this is an abnormality and an unusual situation, tax experts look upon us as the "goose that laid the golden egg." However, as soon as gas rationing is relieved or dropped, the natural response of the people to this freedom which will be granted to them, and the opportunities to find entertainment elsewhere, will result in a precipitous decline in theater attendance.

Many of us may be able to take this tax under the abnormal attendance factor which we have today, but when you release our patrons and make it possible for them to enjoy all the other forms of entertainment which depend on automobile transportation, you have provided us no way of relief from a tax in which gas rationing is a large factor, though you do not recognize it as such.

Loss of attendance in theaters is comparative to a run on the bank in financial circles, and in a short period of time even the strongest of us will have been ruined. When this loss of attendance comes, when we fully expect, you gentlemen may not be in session and there may not be any tax bills being considered, and by the time relief would probably be considered and passed, many of the theater owners will be casualties of this ill-considered tax measure.

In the discussions which I have had with members of our association, all of them are fearful of raising the admission price. Most of them feel that they will have to absorb the tax.

I am, therefore, making this appearance before you in the hopes that the tax on the admission price will be allowed to remain at its present level.

Regardless of what the tax theorists say, taxes on admissions are never considered by the public at all. They consider the fact that we obtain all this money as the cost of admission. The small man on the street considers theater admission as a necessary part of his

budget; it is a cost of living expense to him, and he will not look kindly on an increase in it.

In a large sense, he reacts to the theater as you do. In other words, he comes at peak hours, he sees large waiting lines, but he probably does not know that seats have been empty for as much as three-quarters of the operating time of the theater. We cannot go to each and every patron and explain the economics of theater operation, but I have attempted to bring these problems to the members of the committee, and I feel that you will give our problem good consideration.

If it is necessary to put an additional tax on our patrons, please consider the schedule set up by the tax experts of the House, though not adopted. On a basis of 2 cents for each 15-cent unit of admission, or major fraction thereof—briefly:

Net admission:	Tax, cents
10 to 22 cents, inclusive	2
23 to 37 cents, inclusive	4
38 to 45 cents, inclusive	6

This will help the small operator and obtain the increase from higher prices.

We are ready and willing to do our part, and more as the records of theatre operation will show. However, the tax of 2 cents on each 10 cents of admission makes it impossible to have our present 25 cents admission in small theatres, if our base price is 20 cents, the 4-cent tax brings it to 24 cents; if we raise the base to 21 cents it makes the tax 6 cents, bringing 27 cents, which leaves us less money for operation and uses so many pennies, which are almost impossible to obtain or handle.

Thank you sincerely for the cordial treatment I have received from this committee and Members of the Senate.

Senator WALSH. Mr. Murchison.

STATEMENT OF CHARLES H. MURCHISON, JACKSONVILLE, FLA.

Mr. MURCHISON. Mr. Chairman, my name is Charles H. Murchison, of Jacksonville, Fla. I present this statement to the Senate Finance Committee on behalf of the following clients: International Paper Co., New York, N. Y.; The Chesapeake Corporation of Virginia, West Point, Va.; West Virginia Pulp & Paper Co., New York, N. Y.; Union Bag & Paper Corporation, New York, N. Y.; Hummel-Ross Fibre Corporation, Hopewell, Va.; St. Joe Paper Co., Port St. Joe, Fla.; National Container Corporation, Jacksonville, Fla.; Brown Paper Co., Munroe, La.

These clients manufacture paper, paper board and paper products of all kinds. The vast majority of their products constitute standard commercial articles as defined in the bill now before you. These standard commercial articles are all sold under ceiling prices. We are, therefore, vitally interested in having standard commercial articles exempted from the renegotiation provisions of the bill. We urge you to unqualifiedly exempt standard commercial articles from the provisions of the renegotiation portion of the bill. We believe that the reasons upon which we base our request are sound, are in the interest of the war effort and, in the main, are common to all other manufacturers of standard commercial articles.

In order for O. P. A. to establish and maintain a price ceiling, it makes countless investigations of the books and operations covering the product in question. O. P. A. calls for the submission of endless economic data and supporting information by the manufacturer of the article. Over the course of 2 years, experience has taught us that time consuming conferences and investigations have had to be borne by industry and that in most cases the ceiling price eventually established, in the opinion of the manufacturer, is inequitable and highly unsatisfactory.

It would be a tragedy if the renegotiation bill now permitted another department of Government to repeat these investigations and these time-consuming conferences, reports, arguments, and so forth. If the price ceiling established is a fair price ceiling, or if it is below a price which the manufacturer thinks is a fair price ceiling (and this is more often than not the case) the repetition of these investigations by the renegotiation board would not end in the recapture of any appreciable excess profits. They would only serve the purpose of consuming the time and manpower and efforts of industry and of Government employees, both of which it is fair to assume are exceedingly vital to the war effort. If this is true, and it is our considered judgment that it is true, then this committee should see to it that standard commercial articles are unqualifiedly exempted from the renegotiation provisions of the bill and thus give us and other manufacturers of standard commercial articles an opportunity to carry on our vital war work without being subjected to endless and useless demands for the furnishing of reports and statistics and economic data by another department of Government.

Furthermore, and almost equally important, the bill as now drafted provides drastic penalties for contractors and subcontractors who do not conform to its provisions. It is utterly impossible for those of us who manufacture standard commercial articles to determine whether these articles are eventually utilized in such a way as to bring us within the description of being a subcontractor with the Government. Time and effort and useless worry is expended undertaking to determine whether we and other manufacturers of standard commercial articles do come within the purview of the renegotiation law. By unqualifiedly exempting standard commercial articles we will be properly relieved of this uncertainty and effort, and will thus be further freed to devote our undivided time to vitally essential war work.

We therefore respectfully urge upon the members of the Senate Finance Committee that they unqualifiedly exempt standard commercial articles from the provisions of the renegotiation bill and do not leave such exemption to the discretion of the Board as now provided for therein.

We respectfully suggest the amendments submitted herewith.

(The above-mentioned amendments will appear in the revised print.)

Senator WALSH. Mr. Fernald.

STATEMENT OF HENRY B. FERNALD, CHAIRMAN, TAX COMMITTEE, AMERICAN MINING CONGRESS

Mr. FERNALD. Mr. Chairman, on behalf of the mining industry we submit the following statement regarding certain features to which we urge your attention in connection with the pending tax bill.

Some of these are subjects peculiar to the mining industry; others may affect industry generally but are also important to mining. Some bear directly on present tax impositions; others are no less important as they bear on the future of the mining industry, its ability to meet the continuing war demands and the needs of the post-war period.

The mining industry cannot meet the demands upon it for production of needed minerals, for employment of our people and for contributing to the fiscal needs of the Government, unless it can preserve its capital and have available needed funds from capital realization, or can obtain needed funds from new investment sources. If present taxes leave mining enterprises without available funds, if tax rates and bases for imposing taxes are so burdensome as to leave no incentive for future investment and effort, the mining industry cannot continue the part it should fill in industrial life. The continuance and prosperity of the mining industry is not a matter in which the mining companies alone are interested; the welfare of great sections of the country depends upon the prosperity of their mines, for this affects general employment and general business, State and local revenues, and revenues of the Federal Government in the mining sections.

The mining industry has been doing its utmost to meet war demands; its accomplishments in production have been beyond anything heretofore anticipated it could do. It will continue striving to meet the requirements for war. In doing this its capital resources of previously developed mineral reserves are being rapidly exhausted and the mining industry is faced with the problem of making good such exhaustion, restoring needed development of previously developed ore bodies, and discovering and developing new reserves, if it is to survive. To the extent that a tax may take 90 percent of present realizations, the remaining 10 cents on the dollar will not be sufficient for deferred development, deferred maintenance, accelerated depreciation and wastage of assets. The proposed 95-percent tax cuts to 5 cents on the dollar the amount which mines can retain out of any earnings subject to such tax to make good any wastage, undermaintenance and under-development of the war period. Even the 40-percent normal and surtax rate materially curtails the funds which can be retained to make up for present wastage and to provide for postwar survival.

Mines may be subject to the excess-profits tax even though they do not have any true excess profits. Ceiling prices for their products generally were early fixed on a pre-war basis. Fixed prices with rising costs yield them less than a normal unit profit. If they are subject to the excess profits tax it is because of increased output, exhausting their capital resources at an abnormal rate.

We believe Congress has intended to recognize fully the need for capital allowances for mines so that there should be taxed as income or as excess profits only that which remains after full capital allowances. In the framing of our laws and their application by the Treasury that intent is not being fully observed. This is not a quibble over particular words or phrases and their interpretation, but it is a matter of substance and practical application. So we call to your attention certain points where amendment of the law seems necessary to express what we believe was the congressional intent that the exceedingly

high rates imposed on taxable income should not be applied to capital realization:

1. Gross income from the property: The allowances for percentage depletion and the excess-profits tax exemptions of strategic minerals, of above-quota bonus and of excess output, all depend to a considerable extent on the definition of "gross income from the property." There is immediate need for writing into the law a definition which will express the congressional intent. This has been the subject of special presentation to you by Dr. Donald H. McLaughlin in which he has explained to you why we so strongly urge the adoption of the amendment which Senator Johnson has proposed.

2. Nontaxable bonus income: Section 735 (c) of present law added by the 1942 act, provided exemption from excess-profits tax for the premium, or "bonus," which an agency of the Government may pay on account of production in excess of specified quotas of mineral products or timber.

To stimulate the production of zinc, lead, and copper the War Production Board and the Office of Price Administration have arranged since February 1942 for the payment by Metals Reserve Company of certain premium prices, in excess of the ceiling price, for production in excess of specified established quotas of such metals.

Since any stimulating effect thereof would be virtually lost if the premium, or "bonus," was subjected to the excess-profits tax, the Revenue Act of 1942 included in section 735 (with appropriate wording in sec. 711 to make it effective) provisions to exempt "nontaxable bonus income" from excess-profits tax (but leaving it subject to normal tax and surtax).

The Treasury approved the exemption but urged a limitation so that the exemption thus given on account of the net income from a particular property might not be applied to reduce excess-profits net income from other mining properties or from other operations not related to mining. The mining industry fully agrees to such a limitation.

However, the wording which was written into the law to express this limitation is being interpreted by Treasury regulations in a way which will greatly reduce, if not eliminate, the exemption in many cases to which it was intended to apply. This results because the Treasury regulations as now written would in effect attribute the bonus to the total metal production, although it is received only on the production which is above the quota. It seems doubtful that the Treasury, under present wording of the law, can work out any practical plans to give the bonus exemption which was really intended by Congress. We accordingly urge that the limitation clause of the law be amended to express simply the original intent that the exemption granted should not be in excess of the net income from the particular property from which the bonus metal was produced.

3. Bonus income from slags and residues: The nontaxable bonus income exemption from excess-profits tax under section 735 (c) of the code, above referred to, as it was written into the law by the 1942 act was applicable only to production on which depletion was allowable. The failure of this wording to cover bonus payments for production from mine tailings in certain cases was remedied by the Disney Act (H. R. 2888, approved Oct. 26, 1943). It appears, however, that recoveries from smelter slags and residues technically are not covered

by the wording "mine tailings," although such recoveries similarly receive above-quota bonus payments which should be equally exempt. Appropriate amendment is urged to include "smelter slags and residues," as well as mine tailings in section 735 (c) (2).

4. Development expenditures for mines: There is need for clearer expression in the law as to the allowance for development expenditures for mines which are simply advance costs of mining, as distinguished from expenditures during the development period for exploration which results in initial discovery.

The mining industry has agreed that those expenditures which result in initial discovery of a mining property should be recovered through depletion. There are, however, many expenditures sometimes referred to as development expenditures which are simply a part of the operating costs necessary for extraction of the mineral or to provide the facilities therefor. These should be recognized as operating costs even though the expenditures may be made before actual extraction of the mineral; they should not be treated as recoverable through depletion allowances.

This question as to mines does not exist with respect to oil and gas properties because the Treasury Regulations have been specific as to oil and gas, and have allowed options to those taxpayers under which they may fairly charge development expenditures to operations as distinguished from charges to be recovered through depletion. No similar standards have been set up for mines. It is recognized that the regulations for oil and gas which are appropriate for that industry, would not be applicable to mines. The present regulations for mines, however, as interpreted and applied by the Bureau, result in denying to mines in many cases the deduction for the real operating costs for extraction of the mineral.

We accordingly urge amendment in the law to express the intent of Congress, that the depletion allowances granted shall be exclusive of and in addition to the return of costs of development incurred subsequent to exploration resulting in initial discovery, whether such costs be charged to expense in the taxable year or be deferred subject to extinguishment when the mineral benefited is recovered.

5. Net income from the property: In addition to a definition of gross income from the property as above referred to, there should also be appropriate definition of "net income from the property" which affects the limitation of percentage depletion allowances and possibly affects the excess-profits-tax exemption of strategic minerals, bonus exemption and excess-output exemption. The original intention as expressed in Treasury Regulations and applied by the Bureau in practice, was that the net income should be that from the operation of the particular property involved regardless of deductions with respect to other properties, regardless of its particular form of ownership by a corporation, a partnership or an individual and regardless of whether financed by capital furnished by the owner of the property or by borrowed money.

Progressively over many years there have been additional deductions made by the Bureau in computing net income from the property, many of them items which had no relation to the production of that particular property. Since the law contained no definition, but left the entire matter to the Commissioner's discretion, the courts have generally sustained the Commissioner's determinations as to the deductions to be made.

We accordingly urge that appropriate amendment be written into the law to express the congressional intent as to the meaning of this limitation.

6. Definition of "mineral property": The law gives no definition of "mineral property" as that term would be applied to percentage depletion, but this is left to be covered under the regulations. However, as to excess output, the law in section 735 (a) (6) contains a definition of "mineral property," which is substantially the same as that included in the regulations for such term applied to percentage depletion; but this still leaves undetermined certain questions which should be covered by definition. There is at present considerable uncertainty as to whether a "mineral property" must represent each separate acquisition of interest, or whether several separate acquisitions now operated as a single operating unit can be treated as representing a single property. This should be clarified by definition in the law which would be applicable both to percentage depletion and to excess output.

We accordingly urge that the law should contain a provision applicable to section 114 (b) (4) and to section 735, that the taxpayer shall have the option either (*a*) to treat each separate mineral interest as a separate property, or (*b*) to treat as a single property any combination of separate mineral interests which normally or reasonably may constitute an operating unit or project and is so treated by the taxpayer, whether such interests are included in a single tract or parcel of land or within two or more contiguous or noncontinguous tracts or parcels; and that as so used the term "mineral interest" means each separately acquired interest of the taxpayer in a single mineral deposit, or, if such deposit is included in more than one tract or parcel of land, the portion thereof in each.

7. Undermaintenance and underdevelopment: The shortage of labor, materials, and machine parts during the war period have made it impossible in many cases to keep maintenance and repair of plants and equipment up to normal standards. This is a general situation throughout industry as has been extensively presented to this committee by others.

Mines have this same feature of undermaintenance of plant and equipment and also have the companion feature of underdevelopment of mines. The endeavor to employ all labor so far as possible on immediate production has often meant the sacrifice of current development work in favor of current production. In some future year, if the mine is to be kept going, this sacrificed development will have to be made good. To do this, the company will need to have in reserve the funds required for such work. It will not have these funds if they are taken by taxation.

We join others in urging that some such plans as have been suggested to you for allowance of reserves for undermaintenance for the railroads and for general industry should be adopted, and that they should also be made applicable to underdevelopment of mines.

8. Accelerated depreciation: The subject of increased depreciation allowances (accelerated depreciation) to cover the more rapid depreciation of plants and equipment which occurs under war demands has been also presented by others, and we join them in urging such amendment as may be needed in the law to insure that allowance for accelerated depreciation, where merited, will be granted.

9. Tax-benefit rule for depreciation and depletion: Section 113 (b) (1) (B) provides a rule for the adjustments to be made to the basis for property in computing gain or loss on its sale. This general rule (first introduced by the Revenue Act of 1932) is that the adjustment shall be for exhaustion, and so forth, "to the extent allowed (but not less than the amount allowable) under this chapter or prior income-tax laws." Treasury rulings, sustained by the courts, interpret this provision to mean that depreciation or depletion is to be considered as "allowed" or "allowable" even when the taxpayer for a loss year did not and could not obtain any tax benefit as a result of the deduction. Furthermore the Treasury holds that the greater amount "allowed" or "allowable" for each year is to be taken into account and so arrives at the conclusion, set forth in an example in section 19.113 (b) (1)—1 of the regulations, that where depreciation "allowed" over a series of years aggregated $39,500. and the depreciation now determined as "allowable" aggregated $42,000, the amount "allowed, but not less than the amount allowable" is $44,000, which is greater than either the total allowed or the total allowable. Even though the Commissioner might in his audits have reduced or denied depreciation then claimed by the taxpayer, the Bureau claims the right now to assert that such allowances were too low and to reduce the taxpayer's remaining basis for current depreciation as if greater allowances had been made in the prior years, notwithstanding that tax refunds for such years may now be barred by the statute of limitations.

The "tax benefit" rule has been recognized as applicable to bad-debt recoveries, and should be recognized as applicable to depreciation and depletion. Investments are not recovered out of losses but only out of profits. Depreciation or depletion should not be considered for the purpose of these adjustments as having been "allowed" or "allowable" except to the extent that it was actually allowed or allowable for tax purposes—that is, that there was net income against which the deduction could be made.

Section 113 (b) (1) (B) should accordingly be amended so that the adjustment should be for the aggregate allowed (or aggregate allowable) to the date of the adjustment, but only to the extent that such allowances have or would have resulted in tax reductions for the prior years.

10. Basis for inadmissible asset adjustment: When the provisions for computing invested capital were first formulated under the 1940 act, it was recognized that the adjustments prescribed by section 113 (b) for computing gain or loss on sale of property would not in all cases be the proper adjustments to make in computing earnings and profits for invested capital; so that act made specific provision that in computing earnings and profits the adjustments proper for that purpose should be used. However, that act—wholly through oversight, we believe—in section 718 (a) (2) and in section 720 (b) referred to the adjustments determined under section 113. Correction was made in the 1942 act in the wording of section 718 (a) (2) so that the adjustments there specified should be those "proper under section 115 (l) for determining earnings and profits." This, we believe, was undoubtedly the original intent of that section and also of section 720 (b).

However, the 1942 act did not by its terms introduce the corresponding wording in section 720; perhaps because it seemed so

manifest as not to require specific provision that the same basis for adjustments which were to be made in the computations of invested capital under section 718 would naturally be the basis for adjustments to apply in computations of admissibles and inadmissibles under section 720.

To avoid question, however, the amendment should be made to section 720 (b) so that it will similarly prescribe—

the adjustments proper under section 115 (l) for determining earnings and profits—

and such amendment should be retroactive as expressing the original intent of the law.

As to certain provisions of the pending bill, H. R. 3687:

11. Excess-profits exemption for production from new mines: The bill includes provisions for exemption from excess-profits tax of certain production from new coal and iron mines and timber properties. This is otherwise discussed before you.

We subscribe to the fairness and need of such an allowance for properties not in operation during the base period, and this allowance should be retroactive. We believe it should be enacted as to coal and iron mines, and to timber, and we believe it should be extended to cover other mines as well.

12. Excess output allowance for lessors: Provisions for excess-profits tax exemption for excess output, as written into the law by the 1942 act, did not cover certain lessor interests which the Treasury agrees should have been provided for. This amendment is included in the House bill, section 208 (b), amending section 735 (a) (1).

This amendment should be adopted with retroactive effect.

13. Section 114 (d), termination of percentage depletion for certain minerals: The bill would terminate the percentage depletion allowances for certain minerals—fluorspar, flake graphite, vermiculite, beryl, feldspar, mica, lepidolite, spodumene, ball and sagger clay, rock asphalt, and potash—on the termination of hostilities. There is no necessity for such a termination clause. In fact, the answer is a practical one. To the extent that the newly added minerals are strategic minerals which will be produced solely during the period of the war, then upon the cessation of hostilities their production will stop, and, of course, depletion will stop. However, no one now knows what the situation will be on the termination of hostilities. To the extent that production continues, percentage depletion should remain applicable as a simple and proper method for determining their depletion allowances. We, accordingly, urge the adoption of the amendment proposed by Senator Thomas, of Oklahoma.

14. Section 205, reduction in excess-profits credit based on invested capital: The bill proposes to reduce the credit allowed on invested capital from the present percentages of 8, 7, 6, and 5 percent to percentages of 8, 6, 5, and 4 percent.

Such percentages are not fair standards for determining excess profits. The amount of the excess profits credit is subject to normal and surtaxes of 40 percent; and dividends distributed to individual stockholders are further taxable at high rates. For example, under

the bill the combined normal and surtax rate on surtax net income in the $4,000–$6,000 bracket will be 30 percent; in the $14,000–$16,000 bracket will be 50 percent; in the $26,000–$32,000 bracket will be 65 percent.

The following tabulation shows the practical effect on credit percentages after deduction of a 40 percent corporate income tax and a 50 percent individual income tax:

1. Percentage on invested capital, 8, 6, 5, 4 percent.
2. Net to corporation after a 40-percent income tax, 4.8, 3.6, 3, 2.4 percent.
3. Net to stockholder after a 50-percent tax, 2.4, 1.8, 1.5, 1.2 percent.

Such rates are entirely too low to be fair credits on invested capital for determining excess profits. The credit percentages allowed under existing law are already so low that they should not be further reduced.

15. Section 202, increase in excess-profits rate: We urge that the excess-profits-tax rate should not be increased to 95 percent as proposed in the bill; at least that this be not done unless adequate provision is made for reserves for undermaintenance of plant and equipment and underdevelopment of mines, and for other requirements of the post-war period.

16. Section 110, denial of deduction of Federal excise taxes: This section 110 of the bill is intended to deny deduction of Federal import duties, excises and stamp taxes which are not deductible under section 23 (a). This would be applicable to capital stock tax—unless and until it is repealed—and a wide range of other taxes or duties. It is of much concern to corporations, partnerships, and individuals engaged in mining that such deductions which are for business purposes should not be denied to them. The bill should carry a positive provision that such duties and taxes shall be deductible under section 23 (a) if for or related to business or income purposes.

17. Section 115, acquisitions to avoid income or excess-profits tax: This section of the bill is intended to bar certain tax-avoidance schemes as referred to in the committee report. The mining industry, as others, subscribes to the objective of preventing such tax avoidance schemes from being effective. We are, however, apprehensive that the indefiniteness of the wording and the great power granted the Commissioner may result in disallowances not intended by Congress and may bar or penalize transactions which have been for quite proper business purposes and have been made in a quite legal and appropriate manner. We join others in urging that this section should receive further consideration and should not be enacted without further assurance that it will not subject transactions for normal business objectives to arbitrary penalties or disallowances.

These matters which we have set forth and the needed action we have urged for each of them have become of great importance at the present and proposed high tax rates. Because of their importance to the mining industry and to all those whose well-being is affected by mining, we present them for your consideration and urge such action upon them as we have here recommended.

Senator WALSH. Thank you.

Mr. FERNALD. Thank you, gentlemen.

Senator WALSH. Mr. Brach.

STATEMENT OF HENRY BRACH, REPRESENTING APPEL & BRACH

Mr. BRACH. Mr. Chairman, I represent my firm, Appel & Brach, and various clients of our office. I appear on an amendment to section 500 of the Internal Revenue Code, imposing a penalty tax on personal holding companies.

Senator DANAHER. What did the House do on that this year?

Mr. BRACH. It is not in the House bill.

Senator DANAHER. It didn't do anything.

Mr. BRACH. No, sir.

Senator DANAHER. Did you appear over there?

Mr. BRACH. No, they called off my hearing and said they didn't want to consider it.

Senator DANAHER. They didn't go into the subject at all?

Mr. BRACH. No, sir.

Senator WALSH. Is it assumed to be administrative?

Senator DANAHER. Yes. And I think that is what it is here.

Senator WALSH. You may go ahead, but it is doubtful if the committee will take up any administrative matters.

Mr. BRACH. I asked to have the law amended retroactively.

The injustice results either from poor draftsmanship of the various acts, or from a particularly narrow court decision. Let me explain what the point is.

Senator WALSH. Very well.

Mr. BRACH. Section 5 imposes a penalty tax at rates ranging from 75 to 85 percent on the undistributed income of personal holding companies. It is a penalty intended to force a distribution of profits. That section lays down two tests of what constitutes a personal holding company. One is that there be a limited group of stockholders and the second is that 80 percent or more of its gross income—"its gross income" are the words used in the statute—be personal holding company income, that is, interest, dividends, profits on the sale of securities.

With that wording in the act, I don't think that Congress ever intended that that section should result in imposing a tax on a corporation which had $100,000 of operating income, $10,000 of investment income, and actually lost money for the year, and yet, The Tax Court, which was then the Board of Tax Appeals, and the United States Circuit Court of Appeals for the Second Circuit, have so held in the case of the Puerto Rico Coal Co., a citation of which is given in my statement.

They did that by a poor tortuous reasoning, at the very end of the section, imposing a personal holding company tax, is the statement that—

> the terms used in this chapter (chapter 2 of the Internal Revenue Code) shall have the same meaning as in chapter 1—

and in chapter 1 there are two places, one in relation to foreign corporations and the other in relation to corporations entitled to the benefits of section 251; that is, corporations doing business in the possessions of the United States, where it is said that the term "gross income" in the case of a foreign corporation, or in the case of a corporation entitled to benefits of section 251, shall mean gross income from sources within the United States.

The court then turns around and says, "therefore, in the case of a foreign corporation, or in the case of a corporation entitled to the benefits of section 251, in determining whether or not it is a personal holding company, we shall look into the nature of its gross income from sources within the United States."

We are dealing here with a penalty tax, and said the circuit court of appeals:

It is apparent that the decision of the Board has brought about a harsh result by imposing a surtax, to say nothing of the peanlty for failure to file a return, upon a corporation which had no net income to distribute; but if it finds itself, because of the way it was organized and did its business, within the scope of the statute primarily designed to make the failure to distribute actual net income too expensive to be worth while and was, therefore, taxed when it did not in fact do what the statute was aimed to discourage, it must endure its misfortune as best it may.

We are here appealing on behalf of companies who find themselves in that situation, to ask you to change the law retroactively so that it shall clearly say what we believe you intended to say.

Senator WALSH. Are there many such companies?

Mr. BRACH. We have three companies in our office that are affected. I believe there are maybe two or three hundred companies similarly affected throughout the country.

Senator WALSH. Have you been able to persuade the Treasury of the justification of your contention?

Mr. BRACH. I can say this; both Mr. Paul, counsel of the Treasury, and Mr. Surrey, legislative counsel, agree that the law should be changed.

Senator WALSH. If you will get them to tell us so, we will change it.

Mr. BRACH. So far they have said this, they do not oppose the change. They have authorized me to say that. I haven't been able to get them to specifically ask you, but I shall try to do so.

Senator DANAHER. Why, then, did they contest the Puerto Rico case if that is their view of the law?

Mr. BRACH. Because they felt that law a proper application of the law, required that, and that it was up to Congress to make that change. As a matter of fact, at one time I had the Income Tax Unit of the Bureau of Internal Revenue ready to change its regulations and concede that the law meant what I think Congress intended to enact, but there are always officials—shall we call them comma chasers—who insist that the law be interpreted exactly as it is written, and that if it produces a harsh result, the people who are affected should go to Congress.

Now, I just want to say this, I am asking for it retroactively because I think, if you never intended to propose it——

Senator WALSH. Otherwise you get no relief?

Mr. BRACH. That is right. The proposed change is set forth in my statement.

Senator WALSH. Thank you.

(The statement referred to follows:)

BRIEF OF HENRY BRACH BEFORE SENATE FINANCE COMMITTEE ON THE REVENUE BILL OF 1943

A. *Identification.*—My name is Henry Brach. I am a member of the firm of Appel & Brach, tax consultants, 19 Rector Street, New York, N. Y.

B. *Purpose of appearance.*—I appear before this committee to advocate a technical change in the Internal Revenue Code and in prior revenue acts.

C. The change which I propose is not in any way controversial and seeks to correct a situation where, due to an error in draftsmanship or an unduly narrow interpretation by the courts, the particular section of the code and of the prior revenue acts have operated to produce an inequitable tax situation.

D. *Nature of change recommended.*—Change in classification of certain foreign corporations and corporations subject to tax under section 251 of the code.

Section 500 of subchapter A of chapter 2 of the Internal Revenue Code and corresponding provisions of the revenue acts of 1934, 1936, and 1938 [1] impose a heavy tax on the undistributed income of personal holding companies. A corporation is classified as a personal holding company if in addition to meeting certain tests as to stock ownership at least 80 percent of its gross income is "personal holding company income" such as interest, dividends, profits on sale of securities. One would therefore not expect this tax to be applied to a corporation the greater part of whose gross income is derived from the operation of a business having nothing to do with interest dividends or profits on sale of securities. Yet, either because of error in draftsmanship or because of an unnecessarily literal interpretation of the statutes, corporations of this kind have been classified as personal holding companies and held subject to the tax.[2]

This situation arises because of the seemingly innocent statement in section 507 (a) of the code that "The terms used in this subchapter shall have the same meaning as when used in chapter 1." [3]

Chapter 1 of the code relates to the normal income tax and surtax. Foreign corporations and certain domestic corporations which fall within the provisions of section 251 of the code by reason of having the requisite percentage of their gross income derived from sources within a possession of the United States are subject to normal income tax and surtax only on their income from sources within the United States.

Therefore, section 231 (a) of the code provides that "In the case of a foreign corporation, gross income includes only the gross income from sources within the United States." [4] Likewise, section 251 (a) contains the statement in the case of citizens of the United States or domestic corporations satisfying the following conditions (conditions relating to the percentage of gross income from sources within a possession of the United States) gross income means only gross income from sources within the United States.[5]

Because of these definitions of gross income as applied to foreign corporations and corporations deriving income from sources within a possession of the United States, it has been held that as to such corporations the term "gross income" as used in the personal holding company tax section likewise means only gross income from sources within the United States. With this premise, it has been held that a foreign corporation or a section 251 domestic corporation which meets the stock-holding test is a personal holding corporation if more than 80 percent of its gross income from sources within the United States is personal holding company income. This produces the absurd result that in the case of *Porto Rico Coal Company*,[6] the United States Circuit Court of Appeals for the Second Circuit held that a foreign corporation deriving a gross income of $40,000 from the operation of a business in Puerto Rico and a gross income of $6,000 from personal holding company income within the United States, but sustaining a loss on its entire business, was subject to the heavy personal holding company tax on its income from sources within the United States. In its decision in the *Porto Rico Coal Company case*, the court stated that "It is apparent that the decision of the Board has brought about a harsh result by imposing a surtax, to say nothing of the penalty for failure to file a return, upon a corporation which had no net income to distribute; but if it finds itself, because of the way it was organized and did its business, within the scope of a statute primarily designed to make the failure to distribute actual net income too expensive to be worthwhile and was, therefore, taxed when it did not in fact do what the statute was aimed to discourage it must endure its misfortune as best it may."

This anomalous situation can be cured by stating clearly that for the purpose of determining whether or not a corporation is a personal holding company, refer-

[1] Sec. 351 (a) of the Revenue Act of 1934, Sec. 351 (a) of the Revenue Act of 1936, Sec. 401 of the Revenue Act of 1938.
[2] See *Porto Rico Coal Co. v. Commissioner*, 126 F. (2d) 212.
[3] Sec. 351 (b) (4) of the Revenue Act of 1934, Sec. 351 (b) (4) of the Revenue Act of 1936, Sec. 408 of the Revenue Act of 1938 contain almost identical provisions.
[4] The same statement appears in sec. 231 (a) of the Revenue Act of 1934, sec. 231 (d) of the Revenue Act of 1936, and sec. 231 (c) of the Revenue Act of 1938.
[5] The same statement appears in sec. 251 (a) of the Revenue Act of 1934, sec. 251 (a) of the Revenue Act of 1936, and sec. 251 (a) of the Revenue Act of 1938.
[6] Decided March 3, 1942.

ence should be had to its entire gross income, including income from sources without the United States, as well as sources within the United States.

This proposed change will not permit any corporation which reasonably should be subject to the personal holding company tax provisions from being classified as a personal holding company. On the other hand, it will prevent certain corporations which derive more than 80 percent of their income from personal holding company income sources from escaping classification as personal holding companies by deriving a small amount of non-personal-holding-company income from sources within the United States. The specific changes recommended are as follows:

REVENUE ACT OF 1934

Section 351 (b) (4) of the Revenue Act of 1934 should be amended to read as follows (the amendment being italicized):

"The terms used in this section shall have the same meaning as when used in title I: *Provided, however, That in the case of a foreign corporation and in the case of a corporation entitled to the benefits of section 251 the term 'gross income' as used in subdivision 1 of this subsection means gross income from sources both within and without the United States.*"

REVENUE ACT OF 1936

Section 351 (b) (4) of the Revenue Act of 1936 should be amended to read as follows (the amendment being italicized):

"The terms used in this section shall have the same meaning as when used in title I: *Provided, however, That in the case of a foreign corporation and in the case of a corporation entitled to the benefits of section 251 the term 'gross income' as used in subdivision 1 of this subsection means gross income from sources both within and without the United States.*"

REVENUE ACT OF 1938

Section 408 of the Revenue Act of 1938 should be amended to read as follows (the amendment being italicized):

"The terms used in this title shall have the same meaning as when used in title I: *Provided, however, That in the case of a foreign corporation and in the case of a corporation entitled to the benefits of section 251 the term 'gross income' as used in section 402 (a) (1) means gross income from sources both within and without the United States.*"

INTERNAL REVENUE CODE

Subdivision (a) of section 507 is amended to read as follows (the amendment being italicized):

"GENERAL RULE.—The terms used in this subchapter shall have the same meaning as when used in chapter 1: *Provided, however, That in the case of a foreign corporation and in the case of a corporation entitled to the benefits of section 251 the term 'gross income' as used in section 501 (a) (1) means gross income from sources both within and without the United States.*"

These amendments should be made effective as of the dates of the enactment of the laws amended.

As an alternative to the changes suggested above, the purposes thereof might be accomplished by adding to the end of section 507 of the Internal Revenue Code and to the corresponding sections of the earlier revenue acts, a new subsection reading as follows:

"(c) FOREIGN AND CERTAIN DOMESTIC CORPORATIONS.—Notwithstanding subsection (a), the term 'gross income,' as used in this subchapter, means, in the case of a foreign corporation or a domestic corporation entitled to the benefits of section 251, gross income from sources, both within and without the United States. But the preceding sentence shall not apply unless the gross income from sources within the United States, if it were the entire gross income of the corporation, would satisfy the gross income requirement provided in section 501 (a) (1)."

Respectfully submitted.

HENRY BRACH.

Senator WALSH. Mr. Johnson.

STATEMENT OF ARTHUR L. JOHNSON, NATIONAL EXECUTIVE AND LEGISLATIVE SECRETARY, GENERAL WELFARE FEDERATION OF AMERICA

Mr. JOHNSON. Mr. Chairman and members of the committee, on May 12, 1941, and again on April 17, 1942, before the House Ways and Means Committee, and on August 14, 1942, before your honorable committee, I advocated a 5-percent tax somewhat similar to the Victory tax later adopted, and suggested that 40 percent of it be refunded in post-war social-security annuities. The arrangement that was finally approved provided for a cash refund instead, and this is still the law. I understand that in the bill now before your honorable committee the Victory tax is being integrated into the income-tax structure, but this does not alter the principle involved, and I again respectfully urge that 40 percent, or two-fifths, of the present 5-percent Victory tax, when it is incorporated into the income-tax structure be set aside for a refund in post-war social-security annuities, the money to be placed in the social security reserve fund and borrowed by the Government to use in the war effort, just as is being done with the pay-roll-tax money today.

I desire to call the committee's attention to the fact that Secretary Morgenthau in his presentation of October 4 to the House Ways and Means Committee suggested a refund in life insurance and that when Economic Stabilization Director Fred Vinson was asked while before that committee a few days later as to the possibility of a refund in "annuities," he stated: "That would be all right."

We therefore have a trend in official thinking toward the proposition which the General Welfare Federation of America has been advancing for the last 3 ye[illegible] of a refund in social-security annuities.

For the secon[illegible] time we beg your committee to give some thought to this suggestion. It would solve many a problem in the tax field and it would be the first big step toward overhauling our Federal tax and social-security structures and dovetailing them into one solid mass that will sustain the weight that is to be placed upon them in the years that are to come.

It would, moreover, be a big step toward combating the menace of inflation, both now and after the war. Now is the time to siphon off excess purchasing power as the most effective way to prevent inflation, and after the war this stored-up purchasing power should be returned, not in one lump sum, as is possible in the case of War bonds, but in reasonable monthly installments when those paying are of the age of 65. Even life insurance companies discourage lump-sum payments as tending toward reckless spending, and the Government should do the same.

Such an arrangement would not be difficult to work out, as it would mean merely extending the present refund system over a longer period of time. The refunds could even be made through the Treasury Department, as at present, if there is any objection to placing the money in the social security reserve fund and borrowing it to use in the war effort. It would then merely become an obligation of the Government to refund when the taxpayer reached 65 and filed his claim for a refund in monthly annuities to protect him from privation and want in the sunset of life.

Our suggestion is not a complex one and is one which has already been approved by your committee in a more extreme form, as the committee, when it voted the Victory tax of 5 percent, ordered a refund in cash of 40 percent to married men and 25 percent to single men immediately upon the cessation of hostilities, which refund has now by act of Congress been ordered advanced to March 15 of next year. Our suggestion is, therefore, far more conservative than the system now in effect, as we have contended right along that the refund should be in post-war annuities, maturing at the age of 65 and not conditioned upon retirement, in amounts ranging from $30 per month to $120 per month, depending upon the amount contributed and the number of quarters the taxpayer was contributing.

This arrangement would tend to popularize the income-tax system as nothing else would do, as the clamor would be not to raise the amount of the exemptions but to lower it so that all adults would ultimately come under the protection of this annuity system that would combine a sugar-coated taxing system with an inflation-preventing social-security system that would guarantee protection in old age to all of America's citizens, not just half of them, as any system geared to pay rolls does.

Our idea is that, if this simple expedient of a post-war refund in annuities is adopted, the pay-roll tax system could easily, by a proper and fair readjustment of equities, be relegated to its proper sphere of protecting employees against the various hazards of life which face them while they are such employees and while their employers are still interested in them as such. This could include coverage for sickness, other disability, and hospitalization, as contemplated by the Wagner-Dingell bill, with the Government merely paying the bill at a private hospital if Congress wants to avoid the issue of socialized medicine, which is already stirring up considerable controversy.

In any event, the ultimate 3 percent pay-roll tax on employees and 3 percent pay-roll tax on employers, plus the 3 percent imposed upon employers in most States for unemployment compensation, if used to protect the employees against unemployment, sickness, and accidents and to protect their families in the event of their death, should be sufficient for these purposes.

This would result in the employer paying a 6 percent pay-roll tax and the employee paying a 3 percent pay-roll tax for protection against life's hazards while an employee, plus a 2 percent income tax on the employee for protection against privation and want in old age, which is common to all groups. The 2 percent income tax allotted for this purpose could be increased to 3 percent after the war when more revenue will be needed to sustain the system, or it could even be made 3 percent now by allotting three-fifths or 60 percent of the present Victory tax to this purpose when this tax is combined with the income tax, as it will be under the terms of the bill now under consideration.

This would mean that the employer and employee would each pay, in effect, a 6 percent pay-roll tax, which is the goal of the Wagner-Dingell bill. The only difference would be that no new taxes whatever would be necessary under this arrangement, as all of these taxes have already been imposed by Congress although some of them are not effective as yet, the pay-roll tax being scheduled to rise in 1949 to a

total of 9 percent, that is, 3 percent on the employee and 3 percent on the employer, plus an additional 3 percent on the employer for unemployment compensation. In fact, the whole thing could be accomplished without any increase whatever in taxes since under this arrangement we suggest the 40 percent, or two-fifths of the present Victory tax, would be utilized for the purpose we have set forth.

This should interest the proponents of the Wagner-Dingell bill as a means of accomplishing their objectives without a new tax during wartime or even after the war. Their task of trying to raise the pay-roll tax to 6 percent for the employer and 6 percent for the employee during wartime is indeed a stupendous one and the suggestion we are here making is at least worthy of their study, especially since it would result in real social security for most of the people of this Nation, while their proposal would leave out many large groups, such as the farmers, casual laborers, housewives, nurses, ministers, and the unemployed, and would bring in farm laborers and domestics only by taxing their employers without giving any protection whatever to these employers, who would be forced to pay directly a 6 percent pay-roll tax in addition to the indirect pay-roll taxes they now pay.

There is no reason why we in America cannot devise a system that will give social security to all, not just half of our people. The Constitution guarantees to all the "equal protection of the laws," and yet for 8 long years we have permitted a condition to exist in this Nation whereby one-half of our people are denied the right to the social security guaranteed to the other half. The Nation should not continue to remain "half slave and half free" and your committee today has an ideal opportunity to correct this great inequality while at the same time satisfying the American public with the tax program Congress is adopting through the bill now under discussion as nothing else would do.

We, as a nonprofit benevolent institution interested in the welfare of humanity and the well being of all citizens, make this suggestion on behalf of the 14 large groups of the public barred from the protection of the Social Security Act, which include the farmers, farm laborers, casual laborers, housewives, domestics, nurses, teachers, church employees, employees of nonprofit institutions, Government employees of cities, counties, and States, professional men, businessmen, the self-employed, and the unemployed. These groups now help to pay in passed-on taxes four-fifths of the present 5 percent pay-roll tax and get absolutely no benefits, while the two groups covered by the Social Security Act—the office workers and industrial workers—get four different kinds of protection under the law—a temporary pension, called unemployment compensation upon loss of position at any age, a permanent pension at 65, a pension for wives at 65, and survivorship benefits upon death at any age. This constitutes one of the most glaring inequities of all time, and we plead with your honorable committee to correct it by the simple expedient of voting a refund of two-fifths of the equivalent of the 5 percent Victory tax in post-war annuities in accordance with suggestions now emanating from Government sources, which suggestions bolster up the suggestions we made originally before this committee on August 14, 1942, a few weeks before the Victory tax was adopted with its lump-sum refund rather than reasonable monthly payment post-war refunds. We still feel that our original suggestion, which the committee adopted in part, is sound in its entirety and we plead again for its adoption at this time

as a means of popularizing the tax levy you are making on the people, as a means of combating inflation and as a means of guaranteeing, without cost to the Government, social security to all of America's citizens in the sunset of life.

I might add that if this suggestion of ours is given consideration, we would commend to you the schedule of annuities set forth in H. R. 836, known as the General Welfare Act, now supported in writing by over one-third of the Members of the House. This schedule calls for a minimum annuity of $30 per month plus $1 per month for every full $2 above $5 per calendar quarter that is paid as a tax by any individual for at least one-half of the quarters such individual is subject to the tax, with a maximum of $85 per month, which maximum we would be willing to see raised to $120 per month in conformity with the Wagner-Dingell bill.

STATEMENT OF JULIA ALGASE, VICE CHAIRMAN, NATIONAL BOARD OF DIRECTORS, THE LEAGUE OF WOMEN SHOPPERS, INC.

Mrs. ALGASE. Mr. Chairman and members of the Senate Finance Committee; I am here as a representative of the League of Women Shoppers, Inc., a national consumers' organization. The purposes and activities of our organization have always been directed toward the improvement and protection of the American standard of living. For the last 2 years we have increased our efforts to protect living standards from unwarranted hardships, knowing full well that great and necessary sacrifices have been demanded for the winning of the war. Our members have been interested in the establishment of and have participated in the staffing of ration boards, price panels, and consumer information centers, in war work of all kinds. We are well aware of the dangers of inflation and have helped to wage the battle against it.

We support all measures necessary to win the war. We believe military success depends upon the home front and that our best contribution to this success is to maintain the health and fighting spirit of the home front, particularly of those engaged in producing the matériel of war. We believe that no one should spare sacrifice to strengthen our armed forces, but we further believe in the equality of that sacrifice.

It is obvious that the kind and amount of the tax bill passed will have an enormous effect on America's total war effort in more ways than one.

In the first place, as to amount, the Government must raise 10.5 billion dollars from taxes in 1944. Secretary Morgenthau has pointed out the need for this amount to this committee in a most inspiring statement and we wish to echo his thoughts and sentiments with respect to the need. 10.5 billion dollars is a lot of money and the House bill, H. R. 3687, has cut this amount to $2,135,300,000 as though this war is something we can bargain about. The 10.5 billion dollars from taxes to help win the war must be raised. The position of the House Ways and Means Committee that Government economy which, as Mr. Morgenthau says is desirable at all times regardless of the nature of the revenue law in force, can be substituted for an adequate tax program is untenable. Equally untenable is the argument that our tax program has no bearing on the country's

inflationary problem. I quote from the report of the House Ways and Means Committee:

> The committee is firmly convinced that the proper psychology can be maintained only by strict economy in governmental expenditures through effective price control, rationing, and wage control.

We point out that without an adequate tax program similar to the one the Treasury has offered, or such as we have offered before the House Ways and Means Committee, neither price control, nor rationing, nor wage control, is possible. We cannot help but question very regretfully the attitude of the House Ways and Means Committee toward the inflation problem when it makes the following statement:

> Moreover, it was readily apparent that the current inflationary gap is small in magnitude compared with the grand total of more than $100,000,000,000 of accumulated savings in the hands of individuals in the form of War Savings bonds, cash surrender value of life insurance, savings deposits, and idle currency and demand deposits, of which 50 billion to 60 billion dollars represents the potential excess buying power because this amount is clearly an excess of normal savings.

We cannot understand what the committee means by "normal savings." These savings are part of our country's plan to combat inflation. How can the committee seriously say that those savings represent inflationary money and use these very savings as an excuse for an inadequate tax program? To use Secretary Morgenthau's words again:

> the campaigns for the voluntary purchase of War bonds with their emphasis in saving have been a strong influence in curbing spending.

We believe that our tax bill is being watched by our enemies with as much anxious interest as is the conference between several United Nations heads. What comes out of the conference may be rendered futile by the inadequacy of our tax program as far as the psychological effect is concerned, as well as in other important respects.

In the second place, the 10½ billion dollars needed must be raised according to ability to pay, for if an unequaled sacrifice is demanded and the burden of taxation falls on America's millions of low-income families, it will affect adversely the total war effort.

In the third place, higher but equitable taxation is necessary to prevent inflation, as stated in the President's seven-point policy, although the House Ways and Means Committee does not see this necessity.

Gentlemen, the League of Women Shopper's membership is made up in large part of professional, middle and upper class women. The arguments that we are about to present are not designed to protect us from increases in personal taxation. We thoroughly approve of removing inflationary purchasing power from all those citizens whose income are ample for their needs. Our concern is entirely with protecting the health and, therefore, the productive power of the underprivileged. With this in mind, our very first obligation is to reiterate our unqualified opposition to a sales tax which Secretary Morgenthau opposed before you. We do not see how his statement opposing the sales tax can be improved, but we offer the following additional points:

A sales tax hits low-income groups 20 or 30 times as hard as the top income brackets. Monograph No. 3 of the Temporary National Economic Committee shows that the people earning less than $500 a year in 1938 to 1939 paid 22 percent of their total income in taxes

of all kinds. According to the United States Treasury figures submitted March 1942 on the effect of a sales tax on different income groups, a 10-percent sales tax would make the above group pay an additional 10 percent of its total income in taxes, raising the total tax of this group to 32 percent of its substandard income. How can this possibly contribute to our successful prosecution of the war?

We cannot help but wonder whether the chairman of the taxation committee of the New York Board of Trade who recommended a 10-percent sales tax to the House Ways and Means Committee has to support a wife and children on $2,500 a year. This is very close to the minimum standard for health and decency. Yet, the 10-percent sales tax would cost this family around $250. We would like to see what items on this family's budget could be pared down.

We repeat that the sales tax is the exact opposite of the ability-to-pay income tax. A sales tax which starts at 10 percent for people making less than $500 a year, comes down to 2.7 percent for people making more than $10,000 a year. As we have stated in our introduction, we are firm believers in fighting inflation. We say that the argument that purchasing power must be drained from the lower income groups by a sales tax to prevent inflation is invalid. The figures of the National Resources Planning Board show that low-income families buy comparatively little of the consumer durable goods in which there are now shortages the purchase of which would contribute to inflation. In 1942, says the Office of Price Administration, families with incomes under $1,500 a year to $3,000 probably were not much above the level which adequately preserves the health, efficiency, and morale of civilian families.

Our membership can claim expertness in consumer questions, but for the purpose of this testimony we have made as extensive and careful a study of the problems involved in the new tax bill H. R. 3687, as the very short time has permitted, for ultimately every phase of it affects the consumer. These are our recommendations:

With respect to taxes on individual incomes:

First, omit the special 3-percent tax on low-income groups which is the House substitute for the Victory tax, the abolition of which the Treasury urged before the House Ways and Means Committee. We also took this position before the committee. We concur in Mr. Paul's statement opposing this special tax, which is even more confusing than the Victory tax. We wish to repeat that our income tax law should be based on ability to pay and the oppressive burden on low incomes, exemplified by the Victory tax, should not be replaced by other levies on such incomes.

We do not agree, however, with Mr. Morgenthau's proposal to the House Ways and Means Committee to combine the repeal of the Victory tax with the lowering of exemptions. Rather, we urge that individual tax exemptions be restored to $750 for single persons, $1,500 for married couples and $400 for each dependent. We also ask for the restoration of earned income credit as such credit does favor those whose income is earned rather than made through investment or speculation.

Second, increase individual income tax rates. In order to siphon off the excess purchasing power of the middle and higher income groups, we believe that on incomes above $3,000 tax rates should be

increased. The inflationary buying power is in the individual incomes above $3,000 a year and it is at this level that taxes should be increased, with a sharp increase starting at $5,000 per year and graduating more sharply upward to a ceiling of $25,000 net after taxes paid. The $154,800,000 which H. R. 3687 proposes to raise comes from 9,000,000 taxpayers near the bottom of the scale who are no threat to our economic stabilization program, but leaves untapped sources which would return from four to six and one-half billions in additional individual income taxes. The latter figure is that of Secretary Morgenthau before the House Ways and Means Committee and involved, among other things, the lowering of exemptions. Our position on exemptions is that not only should they not be lowered, but raised, as we have already stated.

Third, raise estate and gift taxes. Mr. Morgenthau, in testifying before the House Ways and Means Committee suggested that—

> the exemption for estate taxes be reduced from $60,000 to $40,000, that estate and gift rates be increased throughout the scale.

He said that in so doing an additional $400,000,000 could be raised. We believe this to be an excellent suggestion, but we say that at least a billion dollars could be raised if both estate and gift taxes were integrated and the exemption lowered to $20,000. The bill is deficient in not providing for additional income from this source.

Fourth, we wish to point out that the majority of the League of Women Shoppers members are married women, many of whom earn or receive independent incomes. They are willing to contribute to the war effort by figuring their income jointly with that of their husbands. It is recognized that separate returns are a perfect method of avoiding higher surtax rates and are usually filed by extremely wealthy persons after there have been transfers of securities and property from husband to wife and vice versa. H. R. 3687 does not remedy this situation, when it requires married persons filing separate returns each to take a single person's exemption. It is but a gesture of recognition of the present inequitable situation, without affording the remedy—which can be only by a mandatory joint return. It is not fair that because of the loophole of separate returns one man with a family to support should pay more taxes on an income of $5,000 than a husband and wife making $5,000 jointly. However, if separate returns are permitted, we strongly, most strongly advocate that the tax rate applied to the income of a married person filing such individual return should be higher than that levied on a single person of similar income, so that the same amount of revenue would go to the Government regardless of whether a single or joint return is made. We also urge that such joint incomes of $5,000 be entitled to an exemption for the added household expenses incurred by the wife in earning her share of the joint income. This is of especial importance now to the countless women who are taking on war jobs in response to the call of their country.

Last year we supported the Treasury's recommendation for the filing of joint returns by husbands and wives. We still consider this the best and simplest method of getting fair revenue from this source. In the community property States of which there are nine, a wife gets half of her husband's earnings by law of the State. As we have just outlined, a single return by each without provisions for a higher tax rate is unfair to the taxpayer in another State whose wife has

no income. He pays more than his neighbor in the community property State who has taken advantage of the individual returns for himself and his wife. Either higher individual rates for married persons or mandatory joint returns for married couples would bring more than $500,000,000 additional revenue.

Fifth, put a tax on present tax exempt securities. We say that all municipal, State and Government securities be subject to taxation. Interest on them constitutes the principal income of a large percentage of the higher income groups, which include individuals, banks, and corporations, all of which should be paying taxes on them. For example, as the United States Treasury has said, in one case such tax exempt individual income amounted to $1,083,700. That's a great deal of income to be tax exempt in times like these. $400,000,000 could be raised in this way and would add no burden to those groups unable to bear any further taxation.

Although it is true that some securities may bear tax-exemption clauses forming a contract which the holder claims may not be broken, these clauses should not be considered more sacred than the various contracts which have been broken by the exigencies of war. What can be more sacred than a husband's promise "to keep his wife in sickness or in health"? Yet war has called upon the soldier to break this promise and he and his wife have gallantly and willingly agreed to do so.

We believe that tax-exempt securities should go to war and contribute to the welfare of the Nation in the form of taxes levied on the income.

Sixth, now, with respect to taxes on corporations: The Treasury recommended to the House Ways and Means Committee a corporate tax rise from 40 to 50 percent. We endorse this general policy but we contend that 55 percent is needed to recapture excessive war profits. It has been estimated that in this way four billions can be raised with profits at a 1939 level, instead of $616,000,000 to be raised under H. R. 3687. The House Ways and Means Committee goes into an elaborate report attempting to show that high corporate taxes affect adversely the dividend income flowing to shareholders. But the Treasury figures offered by the committee show greater net dividends estimated for 1944 than for 1938 and 1939. Surely Congress does not want either man or corporation to profit by the war as that is antithetical to our country's philosophy. That there is this war profit is shown by amazing figures issued by the Department of Commerce with which the Congress is familiar. In 1943 during the war net corporate profits after taxes were paid were roughly 75 percent higher than in 1939 before the war. But more startling than this is the Department's figure of 8.4 billions of dollars net profit for 1943, an increase of 100 percent over 1939. Where is the equality between the firm stabilization of wages at practically a pre-war level, which has not equaled the actual rise in the cost of living and a doubling of corporate net profits? And this in a country dedicated to the concept that all men are created free and equal.

Seventh, include a real excess-profits tax. We recommend a normal gain on capital investment only. The option to compute excess profits on the average earnings method should be eliminated. Last year we recommended that every dollar of profit above 6 percent invested capital be considered excess profit and taxed accordingly for

the duration of the emergency. We state that regardless of the lowering of percentage for excess-profit credit provided for in H. R. 3687, the method of determination of credit against excess profit should be on invested capital only. We repeat, that no alternative method of computation should be permitted such as that of average profits over a period of pre-war years, as that gives rise to evasions which costs the Government many millions in revenue. We point out that this is a duration measure and insures that no real excess profit can be made by the war. We are not proposing a permanent limitation on excess profits of corporations. At present, we are concerned with the speedy and effective prosecution of the war as we believe the Congress is.

When Secretary Morgenthau said last year:

unreasonable profits are not necessary in order to obtain maximum production with economical business management—

he said that which has been proven by the enormous rise in the profits of corporations after taxes. When he said further:

the country will not tolerate the retention of undue profits at a time like this when millions are pledging their lives to save and perpetuate our freedom—

he voiced the dissatisfaction of those millions of low-income families whose living standards have been cut by war necessity and who see billions of corporate profits going to swell the tide of inflation which brings their standards even lower. Neither will the country tolerate a sales tax when such billions of dollars of corporate profit are being made as a result of the war.

Eighth. Abolish the loopholes now being used: We recommend the abolishment of provisions which now permit corporations to deduct as an expense the cost of insuring their executives. This has given rise to tremendous losses in revenue. We approve section 115 of H. R. 3687 headed "Acquisitions to avoid income or excess-profits tax."

The depletion tax dodge of oil and mining companies costs the Government $250,000,000 a year. To permit owners of oil wells and gas wells to deduct from their income 27½ percent of their gross receipts year after year after the entire cost of the property has been recovered is absolutely unwarranted during such crucial times.

Ninth. Tax-exempt corporations: We say that charitable or religious or educational corporations not subject to the income tax, who are engaged in a trade or business not incident to their charitable, religious, or educational activities, should be taxed for those activities. For instance, colleges operating hotels, charitable and religious organizations operating buildings as landlords should be taxed on the profits from these ventures. H. R. 3687—exempting these organizations from the requirement to file returns under section 112 shows a discrimination against certain types of organizations which may be so engaged in favor of other organizations similarly engaged in extra-curricular activity. How many labor unions, for instance, are engaged in such extra curricular activity as against the educational, religious, and charitable organizations? Yet the latter need file no report under the bill—but labor unions and such organizations as cooperatives would have to.

Tenth. With respect to the excise taxes: We approve of the bill's provision for increase in excise-tax rates along with certain new excise taxes.

The tax revisions we propose, and our opposition to a sales tax are based on the theory of raising revenue from sources able to stand it best and should bring in close to the 10.5 billions asked for by the Treasury. If it is demonstrably possible to raise the necessary 10.5 billions of dollars by these methods, is it not inconceivable to contemplate a sales tax which imposes along with other existing taxes a total of 32 percent of the income of our lowest income groups who still represent almost a third of our American people?

Finally, in agreement with the Treasury program's attempt at simplification we have suggested additional methods for simplifying and tightening up the tax program. If provisions are intricate, those who are versed in dodges and evasions can do a fine job of keeping within the law and still deprive the country of much needed millions of revenue. Make it simple and make it stick. We back the attack not only with War bonds but with taxes. Let us pay those taxes according to our ability to pay. We are in the throes of a war the dimension of which is the world. Our part in it is a fight for the equality of man and the continuation of a hard won freedom. Let us prove it by sharing the burden of paying for our fight in the fairest way. The poor never mind hardship if they are not the only ones to bear it. The people will accept a higher income tax gracefully but never a sales tax when they know that every other fair method of getting revenue into the Treasury has been exhausted and that no one is getting swollen profits out of the war. It is then that those falling on bloody battlefields will die in hope and not in vain.

Senator WALSH. Mr. Burns.

STATEMENT OF CLARENCE V. BURNS, ASSISTANT TREASURER, AMERICAN ZINC, LEAD & SMELTING CO.

Mr. BURNS. There is no need for an amendment to make effective the intent of the exemption from excess-profits tax provided by present law and to avoid administrative difficulties which arise from the present wording of section 735 (c).

To stimulate the production of zinc, lead, and copper, the War Production Board and the Office of Price Administration have arranged since February 1942 for the payment by Metals Reserve Co. of certain premium prices in excess of the ceiling price for production in excess of specified established quotas.

Since any stimulating effect thereof would be virtually lost if the premium or so-called bonus was subjected to the excess-profits tax, the Revenue Act of 1942 included in section 735—with appropriate wording in section 711 to make it effective—provisions to exempt "nontaxable bonus income" from excess-profits tax, but leaving it subject to normal and surtax. The present provision, as amended by the Disney Act to extend such exemption to mine tailings as well as to direct mine production is as follows:

The term "nontaxable bonus income" means the amount of the income derived from bonus payments made by any agency of the United States Government on account of the production in excess of a specified quota of: (1) A mineral product or timber, the exhaustion of which gives rise to an allowance for depletion under section 23 (m), *but such amount shall not exceed the net income (computed with the allowance for depletion) attributable to the output in excess of such quota;* or (2) a mineral product extracted or recovered from mine tailings by a corporation which owns no economic interest in the mineral property from which the ore

containing such tailings was mined, *but such amount shall not exceed the net income attributable to the output in excess of such quota.*

The revenue bill of 1942 as passed by the House provided for the exemption from excess-profits tax of the full amount of the premiums received. The Treasury approved the exemption but urged that there should be a limitation so that mining corporations receiving bonus income in excess of the net income from a given property could not, in effect, reduce excess profits net income from other mining properties or other operations not related to mining. To accomplish this purpose the wording in italics in (1) above was written into the bill, and similar wording was used in (2) when that provision was added by the Disney Act.

In attempting to formulate the appropriate regulations (sec. 30.735-4; Regulations 109) this limiting provision was found difficult to interpret as written (excepting only where a zero quota is allowed and only a single metal is produced so all production is above-quota of that metal). The wording used would in most cases require the determination of the net income attributable to the production of that metal which was not above the quota and also income attributable to any other metals produced from that property. This would require cost allocations, often impossible or impracticable to make with any certainty, or would require the adoption of some arbitrary rules. The regulations prescribe a procedure under which the bonus received is, in effect, attributed to the total metal production, although it is received only on the above-quota production. This is not in accord with the intent of the act, and in many cases materially reduces the bonus exemption, thereby tending to nullify its value in stimulating output of these war metals. The appropriate remedy is to have the law express clearly its original intent, and amendment is proposed accordingly to make the simple limitation that the bonus exemption shall not exceed the amount of the net income from the property, or the amount of the bonus, whichever is lower (in each case the amount would be after depletion deduction.)

In making such amendment to section 735 (c) it is necessary to also amend section 735 (d) which latter is the provision to deal with situations where either the exemption of excess output or the exemption of bonus income might be applicable. Unquestionably, there should be no duplication of exemptions. The essence of the present provision in subsection (d) is that if the taxpayer elects the bonus exemption as to above-quota production, such production is to be excluded from the production on which excess output exemption is computed. The amendment would make the appropriate change in subsection (c) and would also add a subsection (e) to place an over-all limitation on the entire amount of exemptions under section 735 so that in the aggregate they could in no case exceed the total net income from that property. The subsections as they are proposed to be amended are set forth on the sheet attached.

The amendments should be made retroactive as expressing the original intent of these provisions of the 1942 act.

(The matter referred to is as follows:)

SECTION —. NONTAXABLE BONUS INCOME

(a) Sections 735 (c) and (d) are amended and a new subsection (e) is added, all to read as follows (present wording to be omitted is included in black brackets, new wording to be inserted is italicized):

"(c) NONTAXABLE BONUS INCOME.—The term 'nontaxable bonus income' means the amount of the income derived from bonus payments made by any agency of the United States Government on account of the production in excess of a specified quota of:

"(1) A mineral product or timber, the exhaustion of which gives rise to an allowance for depletion under section 23 (m), but such amount shall not exceed [the net income (computed with the allowance for depletion) attributable to the output in excess of such quota; or] *the net income from the property (computed with the allowance for depletion) or the amount of the bonus paid after deduction of the additional depletion allowable by reason of the bonus payment, whichever is lower; or*

"(2) A mineral product extracted or recovered from mine tailings by a corporation which owns no economic interest in the mineral property from which the ore containing such tailings was mined, but such amount shall not exceed [the net income attributable to the output in excess of such quota] *the net income from the property or the amount of the bonus paid, whichever is lower.*

"(d) RULE IN CASE INCOME FROM EXCESS OUTPUT INCLUDES BONUS PAYMENT.—In any case in which the income attributable to the excess output includes bonus payments (as provided in subsection (c)), the taxpayer may elect, under regulations prescribed by the Commissioner with the approval of the Secretary, to receive either the benefits of subsection (b) or subsection (c) with respect to [such income as is attributable to excess output above the specified quota] *the mineral units on which the bonus payments were made.*

"(e) *The aggregate of the nontaxable income from exempt excess output and nontaxable bonus income under subsections (b) and (c) of this section, with respect to a property, shall not exceed the net income from such property computed with the allowance for depletion.*"

(b) The amendment made by subsection (a) hereof shall be applicable to taxable years ending after February 1, 1942.

Senator WALSH. We thank you, sir.

I have several memorandums and proposed amendments which I will submit for the record at this point.

(Memorandum from John S. Begley, attorney, representing the Mississiquoi Paper Co. of Sheldon Springs, Vt., requesting certain changes in sections 114-A and 114-B of the Internal Revenue Code. This memorandum urges the adoption of the resolution of the American Bar Association with respect to the changes to correct the interpretation of the internal revenue law contained in the 5-to-4 decision of the Supreme Court in the case of the Virginian Hotel Corporation against Helvering. A copy of the decision is attached.)

Virginian Hotel Corporation of Lynchburg, Petitioner, v. Guy T. Helvering, Commissioner of Internal Revenue

Income Taxes, § 39—deduction for depreciation—reduction of basis by unclaimed depreciation.

1. Under the provisions of § 113 (b) (1) (B) of the Internal Revenue Code, that the basis upon which depreciation is to be allowed in determining taxable income is the cost of the property with proper adjustments for depreciation "to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws," the depreciation basis is reduced by the amount "allowable" each year, whether or not it is claimed.

Income Taxes, § 39—deductions for depreciation may not be accumulated.

2. In making a deduction for depreciation in ascertaining taxable income, depreciation may not be accumulated and held for use in that year in which it will bring the taxpayer the most tax benefit.

Income Taxes, § 39—deduction for depreciation—reduction of basis as conditioned on tax benefit.

3. The word "allowed" in the provision of Internal Revenue Code, § 113 (b) (1) (B), that the basis upon which depreciation is to be allowed is the cost of the property with proper adjustments for depreciation "to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws," does not contemplate that the depreciation basis shall be reduced only to the extent that deduction for depreciation has resulted in a tax benefit.

[No. 766]

Argued May 12 and 13, 1943. Decided June 7, 1943

On writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit to review a judgment reversing a decision of the United States Tax Court on redetermination of a deficiency in income tax. Affirmed.

See same case below, 132 F. (2d) 909.

William A. Sutherland, of Atlanta, Georgia, argued the cause for petitioner.

Samuel H. Levy, of Washington, D. C., argued the cause for respondent.

Mr. Justice Douglas delivered the opinion of the Court:

The facts of this case are stipulated. Petitioner operates an hotel. From 1927 through 1937 petitioner (or its predecessor) reported in its income-tax returns depreciation on certain of its assets on a straight-line basis.[1] No objection was taken by the Commissioner or his agents to the amounts claimed and deducted. In 1938 petitioner claimed a deduction for depreciation at the same rates. The Commissioner determined that the useful life of the equipment was longer than petitioner claimed and that therefore lower depreciation rates should be used.[2] Accordingly a deficiency was computed. The depreciation theretofore claimed as deductions was subtracted from the cost of the property. The remainder was taken as the new basis for computing depreciation. A lesser deduction for depreciation accordingly was allowed.[3] There had been a net gain for some of the years in question. For the years 1931 to 1936, inclusive, there was a net loss and, says the stipulation, "the entire amount of depreciation deducted on the income-tax returns for those years did not serve to reduce the taxable income." Petitioner does not challenge the new rates. It contends that the amount of depreciation claimed for the years 1931 to 1936, inclusive, in excess of the amount properly allowable should not be subtracted from the depreciation basis, since it did not serve to reduce taxable income in those years. The Tax Court in reliance on an earlier ruling[4] held for the petitioner. The Circuit Court of Appeals reversed. 132 F. (2d) 909. The case is here on a petition for a writ of certiorari which we granted [——— U. S. ———, ante, 778, 63 S. Ct. 856] because of a conflict between the decision below and *Pittsburgh Brewing Co.* v. *Commissioner of Internal Revenue*, 107 F. (2d) 155, decided by the Circuit Court of Appeals for the Third Circuit.

A reasonable allowance for depreciation is one of several items which Congress has declared shall be "allowed" as a deduction in computing net income. Internal Revenue Code, § 23 (1), 26 U. S. C. A. § 23 (1), 6 F. C. A. title 26, § 23 (1). The basis upon which depreciation is to be "allowed" is the cost of the property with proper adjustments for depreciation "to the extent allowed (but not less than the amount allowable) under this Act or prior income-tax laws."[5] That provision makes plain that the depreciation basis is reduced by the amount "allowable" each year whether or not it is claimed. *Fidelity-Philadelphia Trust Co.* v. *Commissioner of Internal Revenue* (C. C. A. 3d) 47 F. (2d) 36. Moreover the basis must be reduced by that amount even though no tax benefit results from the use of depreciation as a deduction. Wear and tear do not wait on net income. Nor can depreciation be accumulated and held for use in that year in which it will bring the taxpayer the most tax benefit. Congress has elected to make the year the unit of taxation. *Burnet* v. *Sanford & B. Co.* 282 U. S. 359, 75 L. ed. 383, 51 S. Ct. 150. Thus the amount "allowable" must be taken each year. *United States* v. *Ludley*, 274 U. S. 295, 304, 71 L. ed. 1054, 1059, 47 S. Ct. 608.

But it is said that "allowed" unlike "allowable" connotes the receipt of a tax benefit. The argument is that though depreciation in excess of an "allowable" amount is claimed by the taxpayer and not disallowed by the Commissioner, it is nevertheless not "allowed" if the deductions other than depreciation are sufficient

[1] 15% on carpets and 10% on all other equipment. At those rates the properties would have been fully depreciated in 6⅔ and 10 years, respectively.

[2] 8% on carpets and 5% on the other equipment, the estimated life being 12½ years and 20 years, respectively.

[3] $1,295.47 for 1938 as compared with $4,341.97 which was claimed. The difference between the depreciation claimed in the loss years and the depreciation properly allowable in such years is $31,400.25.

[4] *Kennedy Laundry Co.* v. *Commissioner of Internal Revenue*, 46 B. T. A. (F) 70, which followed *Pittsburgh Brewing Co.* v. *Commissioner of Internal Revenue* (C. C. A. 3d) 107 F. (2d) 155. Prior to the *Kennedy Laundry Co. case* and prior to the time when *Pittsburgh Brewing Co.* v. *Commissioner of Internal Revenue* 37 B. T. A. (F.) 439, was overruled, the Tax Court took a contrary view. Its decision in the *Kennedy Laundry Co. case* was reversed by the Circuit Court of Appeals (C. C. A. 7th), 133 F. (2d) 650.

[5] Sec. 113 (b) (1) (B), 26 U. S. C. A. § 113 (b) (1) (B), 6 F. C. A. title 26, § 113 (b) (1) (B) which is made applicable by reason of § 23 (n), § 114, and § 113 (a), 26 U. S. C. A. §§ 23 (n), 114, and 113 (a), 6 U. S. C. A. title 26, §§ 23 (n), 114, and 113 (a).

to produce a loss for the year in question. "Allowed" in this setting plainly has the effect of requiring a reduction of the depredation basis by an amount which is in excess of depreciation properly deductible. We do not agree, however, with the contention that such a reduction must be made only to the extent that the deduction for depreciation has resulted in a tax benefit. The requirement that the basis should be adjusted for depreciation "to the extent allowed (but not less than the amount allowable)" first appeared in the Revenue Act of [June 6] 1932. 47 Stat 169, 201, c. 209, 26 U. S. C. A. § 113 (b) (1) (B), 6 F. C. A. title 26, § 113 (b) (1) (B). Prior to that time the adjustment required was for the amount of depreciation "allowable." [6] The purpose of the amendment in 1932 was to make sure that taxpayers who had made excessive deductions in one year could not reduce the depreciation basis by the lesser amount of depreciation which was "allowable." If they could, then the government might be barred from collecting additional taxes which would have been payable had the lower rate been used originally.[7] But we find no suggestion that "allowed," as distinguished from "allowable," depreciation is confined to those deductions which result in tax benefits. "Allowed" connotes a grant. Under our federal tax system there is no machinery for formal allowances of deductions from gross income. Deductions stand if the Commissioner takes no steps to challenge them. Income-tax returns entail numerous deductions. If the deductions are not challenged, they certainly are "allowed" since tax liability is then determined on the basis of the returns. Apart from contested cases, that is indeed the only way in which deductions are "allowed." And when all deductions are treated alike by the taxpayer and by the Commissioner, it is difficult to see why some items may be said to be "allowed" and others not "allowed." [8] It would take clear and compelling indications for us to conclude that "allowed" as used in § 113 (b) (1) (B) means something different than it does in the general setting of the revenue acts. See *Helvering* v. *State-Planters Bank & T. Co.* (C. C. A. 4th) 130 F (2d) 44, 143 A. L. R. 333.

Congress has provided for deductions of annual amounts of depreciation which along with salvage value, will replace the original investment of the property at the time of its retirement. *United States* v. *Ludey*, 274 U. S. 295, 71 L. ed. 1054, 47 S. Ct. 608, supra; *Detroit Edison Co.* v. *Commissioner of Internal Revenue*, 318 U. S. —, ante, 917, 63 S. Ct. 902. The rule which has been fashioned by the court below deprives the taxpayer of no portion of that deduction. Under that rule taxpayers often will not recover their investment tax-free. But Congress has made no such guaranty. Nor has Congress indicated that a taxpayer who has obtained no tax advantage from a depreciation deduction should be allowed to take it a second time. The policy which does not permit the second deduction in case of "allowable" depreciation (*Beckridge Corp.* v. *Commissioner of Internal Revenue* (C. C. A. 2d) 129 F. (2d) 318) is equally cogent as respects depreciation which is "allowed."

Affirmed.

Mr. Chief Justice Stone, dissenting:

It is true that the [May 28] 1938 Revenue Act does not speak of a "tax benefit" to the taxpayer. Section 23 speaks only of deductions from gross income which "shall be allowed" in computing net income, among which it includes, § 23 (l), 26 U. S. C. A. § 23 (l), 6 F. C. A. title 26, § 23 (l), "a reasonable allowance for the exhaustion, wear and tear of property used in trade or business." And by § 113

[6] For a summary of the legislative history, see 40 Columbia L. Rev. 840.

[7] S. Rep. No. 665, 72d Cong., 1st Sess., p. 29: "The Treasury has frequently encountered cases where a taxpayer, who has taken and been allowed depreciation deductions at a certain rate consistently over a period of years, later finds it to his advantage to claim that the allowances so made to him were excessive and that the amounts which were in fact 'allowable' were much less. By this time the Government may be barred from collecting the additional taxes which would be due for the prior years upon the strength of the taxpayer's present contentions. The Treasury is obliged to rely very largely upon the good faith and judgment of the taxpayer in the determination of the allowances for depreciation, since these are primarily matters of judgment and are governed by facts particularly within the knowledge of the taxpayer, and the Treasury should not be penalized for having approved the taxpayer's deductions. While the committee does not regard the existing law as countenancing any such inequitable results, it believes the new bill should specifically preclude any such possibility."

[8] As we have noted, the stipulation of facts states that "the entire amount of depreciation deducted on the income-tax returns" for the years in question "did not serve to reduce the taxable income." That has been taken to mean that no part of the depreciation deduction resulted in tax benefits. We do not stop to inquire how that could be true when the depreciation deducted on each return from 1931 through 1938 was larger than the net loss for each of those years. If the stipulation were not accepted, one other problem would be presented. That is the theory that when there is a loss, depreciation may be singled out as not offsetting gross income, even though it is only one of several deductions which is claimed. See *Kennedy Laundry Co.* v. *Commissioner of Internal Revenue*, 44 B. T. A. (F) 70, 75, Judge Disney dissenting. In view of the stipulation we do not reach that question. Cf. *Butler Bros.* v. *McColgan*, 315 U. S. 501, 508, 509, 86 L. ed., 991, 997, 62 S. Ct. 701.

(b) (1) (B) the basis for depreciation of property is its cost adjusted by depreciation "to the extent allowed (but not less than the amount allowable)." It is equally true and obvious, and of some importance to the correct interpretation of the statute, that any depreciation in excess of the reasonable allowance authorized can, under the statute, result in no tax advantage to the taxpayer and in no tax prejudice to the Government, unless the excess has in fact been deducted from the taxpayer's gross income.

I can find no warrant in the purpose or the words of the statute, or in the principles of accounting, for our saying that the taxpayer is required to reduce his depreciation base by any amount in excess of the depreciation "allowable," which excess he never has in fact deducted from gross income. Whatever else the statutory reference to depreciation "allowed" may mean, it obviously cannot and ought not to be construed to mean that a deduction for depreciation which has never in fact been subtracted from gross income is a deduction "allowed."

And there is no reason why such should be deemed to be its meaning. The only function of depreciation in the income tax laws is the establishment of an amount, which may be deducted annually from gross income, sufficient in the aggregate to restore a wasting capital asset at the end of its estimated life. The scheme of the 1938 Revenue Act is to prescribe the permissible deductions for depreciation, and to preclude the taxpayer from gaining any unwarranted advantage by the amount and distribution of those deductions. The Act accomplishes the latter by compelling the taxpayer to reduce his depreciation base by the amount of the allowable annual depreciation, whether deducted from gross income or not, and by such further amount as he has in fact deducted from gross income. No reason is suggested why the taxpayer's tax for future years should be increased by reducing his depreciation base by any amount in excess of the depreciation "allowable," unless the excess has at some time and in some manner been deducted from gross income. So inequitable a result cannot rightly be achieved by saying that a "deduction" for depreciation which never has been deducted from gross income has nevertheless been "allowed."

What I have said does not imply that a taxpayer, who has deducted excessive depreciation from his gross income in any year, is not subject to a deficiency assessment as the statutes and regulations prescribe; or that excessive deductions for depreciation taken from gross income—or allowable depreciation, whether so deducted or not—may not properly be used to reduce the taxpayer's depreciation base. The statute so provides. But I do assert that, under the system of taxation which we have established, the overstatement of the taxpayer's depreciation base on which the Government insists is not to be justified because the taxpayer may in some other year have deducted from gross income excessive depreciation which has already been subtracted from his depreciaion base. See *Burnet* v. *Sanford & B. Co.* 282 U. S. 359, 365, 75 L. ed. 383, 387, 51 S. Ct. 150. The statute neither compels nor permits so incongruous a result. The judgment should be reversed.

Mr. Justice Roberts, Mr. Justice Murphy and Mr. Justice Jackson join in this dissent.

Mr. Justice Jackson, dissenting:

The first and fundamental step in determining accrued depreciation is to estimate the probable useful life of the property to be depreciated. This depends upon judgment and is not capable of exact determination. When it is found, and after making allowance for probable salvage value at the time of retirement, it is a mere matter of mathematics to compute under the straight-line method the rate of annual accrual.

This rate when applied to the cost of the depreciable property fixes two things: (1) The amount of the depreciation accrual to deduct from gross, before determining net, income. For this purpose a high rate works in favor of the taxpayer for any given year. (2) It also determines the amount by which the cost base must be reduced for application of depreciation rates the following year. In this aspect a high depreciation rate works in favor of the Government.

The Virginian Hotel Corporation misconceived, as the Commissioner thinks the probable life of its depreciable property. Attributing to it a longer life span he corrected that judgment. To apply that correction consistently would lower the rate and consequent deduction on account of depreciation and cause a smaller subtraction from the valuation base, leaving a larger base to which the smaller rate would be applied.

The Commissioner proposed to correct taxpayer's returns by considering only the year in question. He eliminated the error as far as it affected the rate and thus reduced the depreciation accrual and increased the tax. But he retained the

base as reduced by the taxpayer's accumulated errors, refusing to readjust the base consistently with the corrected depreciation rates.

To the extent that the taxpayer had obtained advantage from the use of the higher depreciation rate, I would think it quite justifiable to refuse to make a correction. The Government, however, stipulates as to the years in question that "the entire amount of the depreciation deducted on the income tax returns for those years did not serve to reduce the taxable income." We should not disregard a deliberately made stipulation, even if, on our limited knowledge of its background, we are in doubt as to why it was made. The question comes simply to this: Whether the Commissioner, upon determining whether taxpayer has in good faith erred, may use a correction insofar as it helps the Government and adhere to the mistake insofar as it injures the taxpayer. I think that no straining should be done to find a construction of the statutes that will support the result.

I am the less inclined to lay down a rule that will permit the Government to make inconsistent corrections in the matter of depreciation because consistency in the matter of depreciation is one of the few important principles of its application. There has been no more futile tax litigation than that over depreciation rates. In an era of rising taxes the faster a taxpayer depleted his base for depreciation the more the Government realized in revenue from him. If this present taxpayer had been permitted to continue its high depreciation rates, it would have come into the present era of exceedingly high taxes with its depreciation base correspondingly exhausted. What is important for the protection of the revenues is that accrual for depreciation be applied only to property that is properly depreciable, that it be stopped when the property is fully depreciated, and that the rate be consistently applied so that the taxpayer cannot choose to take only a little depreciation when he has a little income and a lot of depreciation when he has a large income. If these conditions are observed, litigation about the rate serves chiefly to vindicate theories rather than to protect the revenues.

If the Government desires to make revisions of theoretical rates, there is no reason why it should not observe the rule of consistency that is one of the cardinal rules to impose on the taxpayer. Hence, I join in the dissenting opinion of the Chief Justice.

The Internal Revenue Code, section 114 (a), provides as follows:

"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) provides as follows:

"The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a) adjusted as hereinafter provided.

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

(B) In respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, *to the extent allowed* (*but not less than the amount allowable*) under this chapter of prior income tax laws * * *." [Italics supplied.]

In other words, the law as now in force requires that depreciation be computed upon the cost or other basis and that adjustment must be made with reference to depreciation previously taken. Previous depreciation is considered to include not only all depreciation for previous years at rates which are now considered proper (called the amount allowable), but also all depreciation at excessive rates if taken in previous years (called the amount allowed). The point of the *Virginian Hotel Corporation case* was that depreciation shown in a return for a previous year is treated as allowed, even though the return showed a net loss which was greater than the excess depreciation and therefore the corporation gained no tax benefit from the excess depreciation claimed.

In the copy of the recommendation of the American Bar Association (see below), I have put brackets around the parts of section 113 (b) (1) (B) which are in that section of the Internal Revenue Code as it now stands, and I have italicized the part of that section which is new.

The revenue bill of 1943 as passed by the House does not contain the amendment on depreciation as recommended by the American Bar Association, but it does include another recommendation limiting the liability of a parent who has put property in trust, the income of which may be used for the support of the grantor's children. A third recommendation, relative to extending the time for claiming

special excess profits tax relief, is contained in a special bill (H. R. 3363) which has now passed both Houses of Congress.

The American Bar Association, at its annual session held last August, recommended a number of amendments of the Internal Revenue Code. These resolutions were adopted by the section on taxation and also by the house of delegates, that is, the main body of representatives of the association.

Among the resolutions adopted was the following:

"*Resolved*, That the American Bar Association recommend to Congress the amendment of section 113 (b) (1) of the Internal Revenue Code to permit correction of erroneous deductions of excessive depreciation where the Treasury has not been penalized by such erroneous deductions.

Be it further resolved, That the section of taxation be directed to urge the following proposed amendment or its equivalent amendment in purpose and effect upon the proper committee of Congress:

(a) The portion of subparagraph (B) of section 113 (b) (1) preceding the first period shall be amended to read as follows:

"(B) [in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depreciation to the extent] *of so much of the deduction as has served to reduce the taxes which in the absence of such deduction would have been payable*, [but not less than the amount allowable under this chapter or under prior income tax laws.]

(b) The amendments made by this act shall be applicable with respect to taxable years beginning after December 31, 1938.

(c) For the purposes of the Revenue Act of 1932 and all subsequent revenue acts, the amendments made to the Internal Revenue Code by section (a) of this act shall be effective as if they were a part of each such revenue act on the date of its enactment.

P. S.—To correct 5 to 4 decision of United States Supreme Court in *Virginia Hotel Corp.* v. *Helvering*.

(Brief, urging changes in sec. C–115 of the proposed House bill, relating to the inequities applied to corporations which completely liquidated and dissolved prior to January 1, 1943.)

RE SECTION 115 OF PROPOSED REVENUE BILL OF 1943

1. Section (c) 115 makes changes retroactive to taxable years beginning after December 31, 1939.

(a) There was a general agreement that the provisions of the bill would not be made retroactive but only have prospective operation. Section 101, the first section of the bill, lays down the general rule that all of the provisions (unless otherwise provided) are to be effective only as to taxable years beginning after December 31, 1943. See Ways and Means Committee Report 871, p. 39.

(b) To correct special retroactive application of section, strike out subsection (c) of 115. The result of such amendment would be to make section 115 have a prospective operation beginning like other sections of the bill with taxable years beginning after December 31, 1943.

2. As written, section 115 would apply retroactively to corporations which have previously been completely liquidated and dissolved.

In order to remove the inequities of section 115 as applied to corporations which completely liquidated and dissolved prior to anyone ever hearing of this provision, amendment should be made to subsection (c) of 115, even if it is to be made retroactive by adding at the end thereof "except as to corporations which have been dissolved or liquidated prior to January 1, 1943."

3. Section 115 as drafted now turns upon what "the Commissioner finds" and is, in effect, a delegation to him of authority to arbitrarily increase the tax rate.

(a) The Commissioner is the official charged with assessing all taxes (for example, all suits in the Tax Court are now brought by the taxpayer against the Commissioner of Internal Revenue). Consequently, the Commissioner will be acting in this case as judge and jury. Moreover, the taxpayer must always enter a transaction and determine its effects prospectively, whereas, under this provision, the Commissioner has advantage of hindsight. The Commissioner by stating that he "finds" tax avoidance, can multiply the tax burden (or rate) many times over that otherwise fixed by express provisions in the same law. To illustrate: The tax law imposes its rates upon net income. Net income is gross income, less deductions. As everyone knows, the margin of profit (net income) is usually but a small percentage of gross. By applying hindsight and

disallowing all deductions, the Commissioner's "finding" is a device to increase the rate.

For example:

	Now	Bill		Now	Bill
Gross income	$100,000	$100,000	Rate 40 percent normal tax	$4,000	$40,000
Deductions	90,000	0	Rate 95 percent excess-profits tax	9,000	90,000
Net income	10,000	100,000			

As shown above, by disallowing $90,000 deductions, the rate has been increased 10 times. Certainly the section should require the Commissioner to advance to the Tax Court, the facts necessary to such a drastic increase in tax burden. To accomplish this, the section 115 (a) should be amended by striking out the word "Commissioner" in the sentence "The Commissioner finds" and inserting "Tax Court or Court" so that the finding would have to be as the result of a judicial rather than an administrative determination.

(b) The Supreme Court has held that if there are one, two, or three ways of doing a proposed transaction, it is entirely proper for a taxpayer to select the one way under which he would pay the least tax. The bill as drawn puts in the hands of the Commissioner, the power to use hindsight and to say that by using a course which results in the least tax, the taxpayer has avoided the payment of a larger tax, which would have been payable if he had done the transaction some other way and to then penalize what has heretofore been permitted, by disallowing the deductions which have the effect of increasing the tax rate. A provision should be added to the bill stating that it is not intended by this provision to prevent a taxpayer selecting one of several methods, which will result in the payment of the least tax.

(c) In addition to turning over the power to tax, to the Commissioner, based on his "findings" the section provides a broad and improper standard.

(1) The section would operate if "one of the principal purposes" was the avoidance of Federal tax.

(2) "Avoidance" of tax has always been regarded as legal and is used to describe a resort to the text of other sections in the Revenue Act. "Evasion" has been the term used to designate improper action.

(3) The section should be amended by striking out the word "avoidance" and inserting the word "evasion."

(4) Also, the section should be amended by striking out "one of" the principal purposes so as to read "the principal purpose for which such acquisition was made or availed of is the evasion of Federal income or excess-profits taxes."

(5) It should be noted that the references in the committee's report (Ways and Means report, p. 50) to section 45 of the Internal Revenue Code which already gives the Commissioner wide authority to allocate income, turns upon "evasion" of taxes, but does not use the term "avoidance" of taxes.

CONCLUSION

There is no wisdom or fairness in enacting in a hurry a provision such as 115, especially where the section is made retroactive. Section 115 has, due to the fact that it was put in the House bill at the last minute, received little consideration. It has been "sold" on the theory that it closes up a tax loophole. Yet in the same breath, the House committee report states that the courts can interpret the present law so as to invalidate the practices which are desired to be prevented. If this is so, there is no need to incorporate this provision in the present act. As long as the provision is to be made retroactive it can be inserted in the next revenue bill, which will give some time to consider the scope of a provision necessary to remedy the cases complained of.

The broad method in which this provision has been drawn indicates that it is merely another New Deal attempt to secure broad undefined administrative power for the Commissioner to increase corporate taxes by "finding" some alleged tax avoidance and then doubling, tripling, or multiplying the corporation's tax rate by disallowing deductions, deductions which Congress has given to taxpayers under other sections of the law. The section as drafted might be said to remove the fly on the wall (the loophole) by removing the whole wall (the deductions granted by Congress in other sections of the law). The Commissioner will have the right to set aside deductions granted by Congress in other sections of the law.

SUGGESTED AMENDMENT OF SECTION 502 OF HOUSE BILL

Amend section 502 of the House Bill to read as follows:

"SEC. 502. CHANGE OF TRUSTEES, ETC., UNDER CERTAIN DISCRETIONARY TRUSTS NOT A TRANSFER SUBJECT TO GIFT TAX.—

"(a) Section 1000 of the Internal Revenue Code (imposing the gift tax) is amended by inserting at the end thereof the following:

"'(e) DISCRETIONARY TRUSTS.—In the case of a trust created prior to September 1, 1943, no part of the net income of which is, under section 166, includible in computing the net income of the grantor, (1) no appointment, prior to January 1, 1945, of a new, successor, or additional trustee or trustees, and (2) no vesting, prior to January 1, 1945, in any trustee or trustees, of power with respect to the selection of beneficiaries or the distribution of corpus or income, or power or control with respect to the trust property, and (3) no exercise, termination, or relinquishment by the grantor or any trustee, prior to January 1, 1945, of any such power or control, shall be deemed to constitute a transfer of property for the purposes of this chapter. If the trust was created after December 31, 1938, this subsection shall not apply unless a gift tax was paid on account of such trust.'

"(b) Subsection (a) shall apply to the calendar year 1939 and succeeding calendar years."

(The following letters and memorandum were submitted for inclusion in the record:)

CONFERENCE OF ALCOHOLIC BEVERAGE INDUSTRIES,
December 2, 1943.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance, United States Senate,
Washington, D. C.

DEAR SENATOR GEORGE: I have not had the privilege of meeting you but friends have told me you are extremely fair-minded. I feel, therefore, you will accept this letter simply as a sincere viewpoint on the proposal you have recently made to reduce from 8 to 4 years the period during which whisky may remain in bond, tax-free.

It is asserted such a change will produce $1,200,000,000 additional revenue in the next 2 years. This obviously gives no consideration to the whisky over 4 years old which will be withdrawn anyway—even under the present regulation.

In a larger sense, isn't the word "additional" a misnomer? Under the present 8-year rule, the Government will get its tax on every gallon withdrawn from bond. At best then, it is simply a matter of timing.

A lowering of the period during which whisky may remain tax-free in bond will definitely affect the quality of American whisky, for at the present—not to speak of the proposed terrifically high rates—it would probably be impossible for a distiller to pay these taxes far in advance of sale of the merchandise.

I am sure it would be agreed by all experts that 4 years is much too short a period of aging to provide complete maturity for all whiskies. A great many of the brands in this country either consist of whisky older than 4 years or at least contain base whiskies which are more than this age. Moreover, this viewpoint on quality is not limited to the United States, for it is well known that most Scotch whiskies are from 8 to 12 years old and Canadian whiskies from 6 to 8.

In order to temporarily increase the rate of the Government's collection of taxes on whisky, let's not do something which will permanently lower the quality standards of whisky in the United States.

There has been some discussion in newspapers recently indicating that one of the purposes of a change in the 8-year regulation is to force more whisky on the market. This would only be justified if it were true that there is actually plenty of whisky and that distillers are holding it back for some selfish reason. I feel sure you do not believe these stories and that instead you do understand that there is a definite shortage due to abnormally high demand and lack of production for 14 months.

Therefore, far from needing some change in the law to force whisky on the market, such a plan would cause positive harm. For over a year, the responsible people in this industry have spent much of their time on problems in the interests of the public. Their approach to the difficult question of whisky supply, believe me, Senator, has been sincere and thoughtful. They have been willing

to risk misunderstanding and face criticism to do what they believed would prove sound in the long run—for the public itself.

And finally, let's not forget that when all the facts are understood by the public, it will be critical indeed if its Government and the industry have allowed themselves to be stampeded into some course of action which, though temporarily popular, causes far greater trouble later on.

I have the deepest respect for the tremendous responsibilities you face as chairman of the Senate Finance Committee in these difficult times. This letter is respectfully submitted in the belief that you want every viewpoint on the question at issue, and I shall appreciate it if this is made a part of the record.

Very sincerely yours,

KENNETH S. BAXTER, *Executive Director.*

NATIONAL LAWYERS GUILD,
New York, N. Y., November 26, 1943.

To the Members of the Senate Finance Committee:

As set forth in the joint statement enclosed, the coalition of eight national organizations which have united on a common Federal tax program, embracing the Congress of Industrial Organizations, National Farmers Union, Brotherhood of Railroad Trainmen, National Association for the Advancement of Colored People, National Women's Trade Union League of America, League of Women Shoppers, Consumers Union, and National Lawyers Guild, favor important amendments to the tax bill, H. R. 3687, now being considered by your committee.

The tax bill reported by the Ways and Means Committee and adopted by the House of Representatives under a gag rule which prevented amendments of a consequence, and without any real debate, is wholly inadequate and fails to meet the basic requirements of a wartime revenue measure.

The joint statement of the coalition makes clear its complete disagreement with those who assert that we must turn to a sales tax as the only source from which additional revenues can be secured. Additional billions in new revenue can be raised without undue sacrifice by adopting the concrete proposals advocated by the coalition, which call for:

1. An increase in the corporate tax rate from 40 percent to at least 50 percent.
2. The elimination of the option to compute excess profits on the average-earnings method.
3. Increased tax rates and lowered exemptions for estates and gifts.
4. Elimination of special privileges so as to provide for mandatory joint returns, taxation of governmental securities, and elimination of percentage-depletion allowances for oil and mining properties.
5. Increased personal taxes on incomes above $3,000 a year, along with a $25,000 ceiling on net incomes, after taxes.

H. R. 3687 would perpetuate the oppressive burden of the Victory tax on 9,000,000 hard-pressed families, substituting for the temporary Victory tax a permanent tax on the poor, calling for a minimum tax of 3 percent on incomes of married persons above $700 plus $100 for each dependent. This minimum tax imposes a levy on the poor man's bread and is positively cruel from an equitable social viewpoint. The coalition's joint statement urges the elimination of this 3-percent minimum tax.

In the face of the steep rise in living costs, it is imperative to adjust income-tax exemptions to that taxes shall not cut into the necessary subsistence of the citizen or his family. The coalition, in its joint statement, urges that personal exemptions be restored to $750 for single persons, $1,500 for married persons, and $400 for each dependent. The paramount importance of health and morale must be recognized in protecting the men and women who toil on the farm and in the factory and on the railroad so that our fighting fronts are fully supplied.

We urge you to support actively the amendments proposed, and shall appreciate an expression of your views.

Respectfully yours,

ROBERT W. KENNY, *President.*

RADCLIFFE MORRIS URQUHART,
Lansdale, Pa., December 3, 1943.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: My brother and I are inventors of foam fire fighting methods and apparatus employed extensively throughout the world. Our inventions have received high official commendation from the Government and have in this war saved the Government many ships in battle, large sums of money, and, most important, the lives of many fighting men.

We offered the War and Navy Departments the direct licenses under our patents which were rejected because the equipment and supplies used were purchased from authorized agents.

Later, because of the importance of the inventions, the Navy Department asked us to reduce our royalties to the Government and made several oral propositions that would have reduced my income considerably below my actual expenses before taxes. These I refused in writing, stating my reasons and making several reasonable counteroffers. We have never had any written reply to any of our letters. During these negotiations, the Navy Department representative said: "If you don't accept, we will give you nothing, and you can go to the Court of Claims and perhaps your grandchildren might collect."

He issued notices under Public Law 768 cutting off all license fees on Mechanical Foam and also threatened to issue orders under Public Law 768 cutting off all my income from license fees under Chemical Foam, if we did not accept his unfair and unreasonable propositions on Mechanical Foam. He then actually issued notices under Public Law 768 carrying out this threat and stopping all payments on Chemical Foam contrary to the spirit of this law.

The full history of our case has been given in detail in letters and statements accompanied by affidavits showing what happened at the Navy Department conferences, which were forwarded by our attorneys, Strauch & Hoffman, to Mr. Kenneth H. Rockey, Navy Price Adjustment Board, under dates of November 8, 23, and 30, 1943, on my behalf, and on behalf of the American Fomon Company.

I realize your committee is very busy and therefore, in lieu of testimony before the committee by me, I would appreciate it if you will place this letter in the record of your hearings, with copies of the above-identified letters and attached affidavits and statements to the Navy Price Adjustment Board if you feel further detail is desirable.

You will find in the files of the Navy Department what I feel is an outrageous bureaucratic disregard of the plain wording and intent of Congress as expressed in the renegotiation law and in Public Law 768, flagrant disregard of constitutional rights and processes, and unfair and illegal use and abuse of the power of Federal office to cut off our income in an effort to starve us into submission.

Respectfully,

R. M. URQUHART.

DISTILLED SPIRITS INSTITUTE, INC.,
Washington, D. C., November 30, 1943.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance, United States Senate,
Washington, D. C.

DEAR MR. GEORGE: On behalf of members of the distilled-spirits industry we respectfully submit the following statement for incorporation in the record of the hearings on H. R. 3687, the revenue bill of 1943.

We express no judgment on what the rate of tax on distilled spirits should be in the present bill. The House fixed the rate at $9 per proof gallon after having considered both $8 and $10 rates. The distilled-spirits industry's position should and must be and is one of acquiescence in whatever excise-tax rate on distilled spirits is deemed by the Congress to be necessary during the war period. While the United States is at war, the Federal Government's revenue needs are the paramount consideration. In times like these, whatever excise tax appears likely to produce the maximum revenue for the Federal Government will best serve the national interest. The revenue which must be raised, the form which the various taxes may take, the prospective national income, and the impact of the different taxes on the industrial economy of the country, all are factors with which the committee is much more familiar than are we and, further, Congress is much

better able than others can be to appraise the effect of the imposition of additional taxes on the people of this country. The tax on distilled spirits is a manufacturer's excise tax which is collected at the point of production and thereafter is passed on through the channels of trade to the ultimate consumer. Distilled spirits are already heavily taxed and we are confident your committee will give that fact full weight in arriving at a determination of the rates in the pending bill.

The House, in fixing the $9 rate, also provided for a post-war rate of $6 per proof gallon. With the policy of providing for a reduced post-war rate we fully agree. We desire, however, to renew the suggestions we made to the Committee on Ways and Means as follows:

1. That upon the termination of the wartime rate the excise tax on distilled spirits then in bond or thereafter produced or imported be a tax of $4 per proof gallon when withdrawn, to be collected under the provisions of existing law.

2. That there be refunded under regulations promulgated by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury the difference between the tax imposed by this law and $4 per proof gallon as to all distilled spirits held for sale on the day the $4 rate becomes effective.

3. If a retail or wholesale sales tax is imposed, consideration should be given to the excise burden already imposed upon distilled spirits or any other product now subject to excise taxes.

POST-WAR RATE

We suggest a $4 per proof gallon post-war rate for the following reasons:

1. National income, post-war is sure to drop below the gigantic war income. Lay-off of thousands of employees in war plants during the period of plant conversion to peacetime operations and the demobilization of the armed forces, no matter how scientifically that is accomplished, is bound to result in large unemployment and consequent depression of national income.

2. Excise rates so high compared with purchasing power as to make it impossible for the average person to purchase a normal supply of distilled spirits are injurious to the industry and to public morale. A tax rate making it impossible for the average citizen to meet his normal requirements with a tax-paid product is as to him identical with prohibition on sales. The effect of prohibition on sale on the public morale is a matter of record. Certainly there should be no tax rate which would, post-war, make it impossible for the average citizen to purchase tax-paid distilled spirits.

3. We suggest a $4 per proof gallon tax, post-war, not because we are sure the purchasing power will justify such a high rate but because taking into consideration the past peacetime rates we feel that post-war possibilities do not justify a rate above that figure. Aside from extraordinary conditions, such as war or prohibition, the high rate for peacetimes has been $2.25 per proof gallon.

Historically, the excise tax on distilled spirits has been at the following rates during the periods stated:

Federal excise tax rates

Aug. 1, 1862–Mar. 7, 1864	$0.20
Mar. 7–July 1, 1864	.60
July 1, 1864–Jan. 1, 1865	1.50
Jan. 1, 1865–July 20, 1868	2.00
July 20, 1868–June 6, 1872	.50
June 6, 1872–Mar. 3, 1875	.70
Mar. 3, 1875–Aug. 27, 1894	.90
Aug. 27, 1894–Oct. 3, 1917	1.10
Oct. 3, 1917–Feb. 24, 1919:	
Basic rate	2.20
Withdrawn for beverage use	3.20
Feb. 25, 1919–Jan. 1, 1927:	
Basic rate	2.20
Withdrawn for (from Nov. 23, 1921, if "diverted to") beverage use	6.40
Jan. 1, 1927–Jan. 1, 1928.	
Basic rate	1.65
Diverted to beverage use	6.40
Jan. 1, 1928–Jan. 11, 1934:	
Basic rate	1.10
Diverted to beverage use (prior to repeal of prohibition, Dec. 6, 1933)	6.40

Federal excise tax rates—Continued

Jan. 12, 1934–June 30, 1938	$2.00
July 1, 1938, and thereafter	2.25
July 1, 1940, and thereafter	3.00
Oct. 1, 1941	4.00
Nov. 1, 1942	6.00

As appears from the above table, the rate suggested would exceed any normal peacetime rate. The $6 rate came on the verge of our participation in the present world conflict. The $6.40 rate as shown in the above table was imposed during the last world war. It became effective in February 1919 and was left in effect during the period of wartime and national prohibition as a punitive tax on prohibition law violators. It was in fact a punitive tax when imposed and it was repealed with the repeal of prohibition. Prohibition on beverage sale became effective July 1, 1919, so that under the $6.40 rate, which was applicable only to beverage spirits, the tax was collected on beverage sales only between February 25 and June 30, 1919. At that time no State imposed a gallonage tax on distilled spirits. Today every State has such tax superimposed on the same spirits as to which is paid the Federal tax. The State tax runs from 40 cents to $1.92 per gallon. The average is $1.08 per gallon. A $4 Federal tax is therefore equivalent to more than $5.08 preprohibition tax.

FLOOR STOCK REFUND

The pending revenue bill increases the tax on distilled spirits from $6 per proof gallon to $9 per proof gallon and provides that 6 months after the termination of hostilities the tax shall revert to $6 per proof gallon, that being the rate in effect on January 1, 1943. Obviously, in a normal peace economy the $9 rate would be dangerous to the country, the revenue, and the trade. This having been decided we will not further discuss it in this letter.

The tax on distilled spirits is applicable to both domestic and imported distilled spirits. On domestic spirits it is paid by the distiller when the spirits are withdrawn from the internal revenue bonded warehouses. On imported spirits it is paid by the importer when the spirits are withdrawn from the customs bonded warehouses. In both instances it is then passed on as the spirits are sold to the wholesaler, the retailer, and the consumer.

Normally the tax-paid spirits held for sale by the trade in equivalent to about a 90-day supply.

Immediately the tax is reduced all spirits coming out of bonded warehouses will reach the trade carrying the lower tax and those spirits will be sold in competition with spirits still in hands of the trade which were tax-paid at the higher rate.

The law should provide for a refund on tax-paid floor stocks held for sale by the trade on the day the tax is reduced. Such refund should be equal to the tax reduction. This is consistent with established congressional policy.

Congress has consistently recognized the necessity for keeping the tax rate the same on all spirits offered for sale. When the tax rate has been increased, the new rate has been made applicable to distilled spirits in bond and the increase has been made applicable to tax-paid stocks held for sale. Conversely, when the tax is reduced a refund should be made to those holding for sale the product on which the higher tax has been paid. Those products on which the higher tax has been paid must compete when sold with the lower-taxed item, and unless the tax is adjusted the vendors would have to absorb the differential. That would mean bankruptcy for many industry members.

PRECEDENTS

There is ample precedent for the proposal herein suggested.

The Agriculture Adjustment Act imposed a processing tax on the processing of certain commodities. It also imposed by section 16 (a) a floor-stock tax on articles held for sale into which the taxed commodities had been previously processed. The processing tax, like the war tax, was a temporary tax. Therefore the act (48 Stat. 40) enacted May 12, 1933, provided for a refund of the tax paid on the processing of commodities into articles which were still held for sale when the tax terminated. By an amendment of August 24, 1935, the refund provision was made to read as follows:

"(2) Whenever the processing tax is wholly terminated, (A) there shall be refunded or credited in the case of a person holding such stocks with respect to which a tax under this chapter has been paid, or (B) shall be credited or abated

in the case of a person holding such stocks with respect to which a tax under this chapter is payable, where such person is the processor liable for the payment of such tax, or (C) there shall be refunded or credited (but not before the tax has been paid) in the case of a person holding such stocks with respect to which a tax under this chapter is payable, where such person is not the processor liable for the payment of such tax, a sum in an amount equivalent to the processing tax which would have been payable with respect to the commodity from which processed if the processing had occurred on such date: *Provided*, That in the case of any commodity with respect to which there was any increase, effective prior to June 1, 1934, in the rate of the processing tax, no such refund, credit, or abatement shall be in an amount which exceeds the equivalent of the initial rate of the processing tax in effect with respect to such commodity."

There is also a specific precedent for imposing a temporary tax on distilled spirits. By the act of June 25, 1940, a defense tax was imposed on distilled spirits. The act specifically provided that the tax would be effective for only 5 years. That act amended section 2800 (g) of the Internal Revenue Code to read as follows:

"(g) DEFENSE TAX FOR FIVE YEARS.—In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'DEFENSE TAX RATE':

Section	Description of tax	Old rate	Defense tax rate
2800 (a) (1).....	Distilled spirits generally.....	$2.25	$3.00
2800 (a) (1).....	Brandy.....	2.00	2.75
2800 (a) (3).....	Imported perfumes.....	2.25	3.00

While no provision for floor-stock refunds was provided for in that act, no harm came from the oversight and the industry had no opportunity to present the problem to Congress because war developments made it necessary that the tax be converted from a temporary to a permanent tax very shortly after it was imposed.

There is also a specific precedent for floor-stock refunds. In fact there was a condition immediately following prohibition practically identical with that herein discussed, i. e., distilled spirits on the market tax-paid at two rates. Congress recognizing the problem specifically provided for refund of the differential paid on the spirits at the higher rate.

As hereinabove pointed out the Revenue Act of 1918, passed February 24, 1919, imposed a tax of $6.40 per gallon on beverage spirits and a tax of $2.20 per gallon on nonbeverage spirits. On July 1, 1919, beverage sale was temporarily prohibited by the Wartime Prohibition Act. Before that expired and on January 16, 1920, such prohibition was made permanent by the National Prohibition Act. Due to the rush of preprohibition buying the distributing trade had practically no tax-paid beverage spirits on hand when the prohibition on beverage sale became effective. However, in 1925 Congress found that some of the distillers did have such tax-paid stocks on hand and had held them for some 5 years, being unable to dispose of them except at a terrific financial loss.

On February 11, 1925 (43 Stat. 860) Congress corrected the oversight and passed an act reading as follows:

"That the Commissioner of Internal Revenue may, pursuant to the provisions of section 3220, Revised Statutes, as amended, allow the claim of any distiller for the refund of taxes paid in excess of $2.20 per proof gallon on any distilled spirits produced and now owned by him and stored on the premises of the distillery where produced, but no refund shall be allowed unless such spirits are contained in the distiller's original packages in which they were tax-paid, or in regularly stamped bottles and cases in which they were placed when bottled in bond, or in stamped or unstamped bottles into which they have been placed while on and without removal from the distillery premises: *Provided*, That the Commissioner of Internal Revenue may direct that any spirits on which refund of tax is claimed under this section shall be removed to and stored in a warehouse designated by him."

In the instant case relief on floor stocks simultaneous with the reduction in tax is necessary if bankruptcy of many concerns is to be avoided.

The 6 months' lag between termination of hostilities and reduction in tax is no answer to the problem. To say that floor stocks could be reduced during that period is merely to say that all shipments should stop and that distillers should close up shop until the distributing trade has sold out. Not only is that unsound, but as a market was cleaned out of one brand the producer of that brand would start shipping at the new tax rate and the holders of spirits of all remaining brands on the market would then have to absorb the tax differential on those other brands.

There have been two suggestions as to the form of the refund: (1) A cash refund, and (2) a refund by certificate usable in paying taxes in the future. Either method is satisfactory provided the certificates are negotiable within the trade. Inasmuch as the tax is paid to the Government only by the distiller and importer the certificates must get back to the distiller and importer if they are to be used in payment of distilled spirits taxes.

No administrative problem exists as to the proposed refund except clerical work. The floor-stock refunds are made in the same manner that floor-stock taxes are collected, under regulations promulgated by the Treasury. The Treasury has complete control and in any suspicious case can require the claimant to establish his right to refund in the courts. This gives the Treasury a better grip on claims for refund of floor-stock taxes than it has when it collects floor-stock taxes at the time of increased rates.

While this letter deals with distilled spirits, the philosophy is equally applicable to wine and all excise taxes which when imposed are made applicable to floor stocks. We, therefore, suggest the following provision:

"FLOOR STOCK TAX REFUND.—The Commissioner of Internal Revenue, under regulations prescribed by him with the approval of the Secretary of the Treasury, shall refund the difference between the tax imposed by this act and the internal revenue tax paid (including floor-stock taxes paid) on all commodities as to which a floor tax is imposed by this act and which, on the day the tax imposed by this act terminates, are held and intended for sale or for use in the manufacture or production of any article intended for sale."

Respectfully submitted.

DISTILLED SPIRITS INSTITUTE, INC.,
HOWARD T. JONES, *General Counsel.*

MEMORANDUM REGARDING LIQUOR TAX

(By Joseph L. Regan, acting president, National Retail Liquor Package Stores Association)

This year I again have opportunity to appear for the purpose of presenting the facts and conditions to your attention. Part of my problems require my seeking governmental understanding and aid. Now gentlemen, on behalf of the thousands of the retail package store owners throughout the country, I come to you asking your assistance, for it is a matter that only you can help us with.

Our position for the last few years has not been very favorable from either a financial or regulatory viewpoint. More and more rules and regulations force restrictions both unreasonable and unfair upon our business. In many States, bills to liquor stores have to be paid in cash on delivery or within 30 days, although some of our merchandise may not be sold for many months after we receive it. Dimouts today as a result of civilian defense and Army order, cause a loss of business. Many of the prospective customers for our alcoholic or malt beverages are now in the armed forces, while we in our own way are attempting whenever and wherever possible to assist in the efforts of our great country through the sale of stamps and bonds, through working for the United Service Organization movement and in cooperating with law enforcement authorities.

A number of our stores were forced out of business at the time of the last tax increase due to the lack of ready cash. They were also unable to furnish bonds to insure payment of the tax when due, so they had no other alternative but surrender their licenses and close their doors, a bad situation for a small retailer who has a family to support.

We plead this time for your aid through the granting of a floor tax exemption, not of 1,000 gallons, but for 250 gallons. In asking for your help, we feel we should bend backwards to avoid seeking anything unreasonable. A 250-gallon exemption is not unreasonable.

Deliveries to us being rationed today and not being able to make deliveries often, our losses of business have placed us under great handicaps. Some stores just managed to get over paying the last tax, and now this new tax may mean another heavy burden which many Licensee's will not be able to stand. Bond costs have become so excessive that only those with A-1 credit ratings have the opportunity of procuring them. In almost all States cash is required for the purchase by retailers of alcoholic beverages, which cash we cannot often get. In these States the retailers will find it impossible to continue and bankruptcies will result unless an exemption is granted.

This new tax is undoubtedly an emergency tax, and taxation itself to be fair should be equal, to some extent with the ability to pay. The small package store man or tavern owner who is just about making ends meet, should, in fair play, receive the opportunity to continue his business without being crippled, of exempting the 250 gallons of the merchandise on his floor from the tax it will help in these trying days and not leave the retailer carrying the burden which he can ill afford. When liquor carries too great a tax, as all the recent publicity disclosed, it means that the Federal Government gets less revenue and the States likewise are deprived of income. Bootlegging results, with racketeering and illegal activity in its wake.

Many of us feel that liquor is being taxed too high, but for patriotic reasons we do not make this claim; but we urge you to see our position and to give us the helping hand which will permit us to continue in business. The average store carries about 400 gallons. When we ask for a 250-gallon exemption, we have gone to rock bottom hoping that you will understand that we are trying to be fair in every way.

Some of the merchandise which we have on hand does not sell very often and with the increase of tax on that merchandise, the retailer will have to have real money to meet his obligations unless he gets the exemption. His outlook is indeed dark. We know that you do not want the retailers to go out of business with the loss to landlords, to municipalities, to the State and Federal Governments, the loss of employment and the loss of investments of the people whose few hundred or couple of thousand of dollars that they have worked their entire life for are at stake here.

The tax having been trebled and then some, has placed us in a position where we must have some help. You are the gentlemen who can assist us, and we know that the American way of giving the little fellow a break will be considered by you to avoid our being pushed against the wall and being forced out of business.

A 250-gallon exemption was granted before on floor stock tax, and the history and experience of it we believe, was favorable.

General liquor business throughout the country being as bad as it is, with merchandise being more than difficult to procure and cost prices to the retailer being high, without the opportunity of having the hours, the advertising advantages and delivery advantages, we feel the pressure on all sides and we think that the Government should help us rather than injure us.

The shortage today of merchandise has brought new situations and problems to us. Our rentals have not been diminished. Our license fees are the same and labor wages are still increasing.

When will the liquor taxation end? That is not only a question but a plea for fair treatment by an industry seeking a solution to its painful dilemma.

Our request respectfully made is that the bill as drawn should provide that the tax now being placed upon our goods and the one prior thereto should be eliminated at the cessation of hostilities.

Think, gentlemen, as to what could occur if sugar becomes plentiful in a free labor market and legitimate liquor is taxed as high as the proposed amount per gallon. The old-time bootlegger will be a small businessman in comparison to the crime-festering magnate who will then prosper. Yours is the problem, we are those who may be able to continue in business or may have to join the ranks of the future unemployed. It's in all fairness just a war tax. Let's keep it that way by limiting the effect and time of this tax to the period of the war only. There'll be little goods available then as it appears and why put a premium on illegal manufacturing, distribution, and sale.

Help us to keep our industry clean and to remain in the legalized small business we have for the last 10 years been conducting.

May we have your help?

STATEMENT OF GRUEN WATCH CO., CINCINNATI, OHIO

To the Members of the Committee on Finance, United States Senate.

Recognizing the necessity for increased revenues for the Federal Government, nevertheless we believe the Committee should consider the undesirability of an increase in the present tax on watches, clocks, cases, and watch movements.

Under the present tax bill, it is proposed to increase the excise tax on watches from 10 to 20 percent of the retail price. We believe that increased rate should not be applied to timepieces, that timepieces are necessary equipment to all workers.

We agree, watches which are ornamented with stones are purchased not only for the timepiece, but as decorative accessories, and as to such ornamented watches possibly the increased tax should be applied and we would not object to an increase in the rate of tax upon such watches. Less than 5 percent of purchases of watches are in this group, however, and a greater return of Federal tax will result to the Treasury by retaining the present rate of tax upon all watches than by an increase, which would discourage the purchase of watches at reasonable cost. Of the 95 percent of watches, other than watches ornamented with stones, practically all of them are sold to persons with limited amounts to spend and for whom watches are a necessary part of their working equipment. They are purchased by war workers, defense workers, service men and women, doctors, nurses, transportation workers, students, civilian relief workers and others. To such people the mere addition of tax may force the purchase of a cheap and undependable "copied" instrument instead of one of high quality and precise workmanship.

Much of the difficulty in servicing watches at this time is the result of the purchase of instruments which are cheaply made and therefore unreliable, and for which repair parts are unobtainable. Moreover, even if repair parts could be obtained for such inferior timepieces, there is not sufficient manpower to provide the skilled workers required to keep them running.

Dependable timepieces are so necessary to military and naval personnel and so limited in number that, on agreement between the War and Navy Departments and the War Production Board, a "freeze order" has been placed on all importations of watches and movements to assure adequate deliveries to Army exchanges and Navy ships' stores.

We suggest as an amendment to the present tax bill, therefore, a new paragraph to retain the present tax on watches, clocks, cases and movements.

THE GRUEN WATCH CO.

SUBPART D—TAX ON JEWELRY, ETC.

"(32) SEC. 2400. TAX ON JEWELRY, ETC.—There is hereby imposed upon the following articles sold at retail a tax equivalent to 10 per centum of the price for which so sold: All articles commonly or commercially known as jewelry, whether real or imitation; pearls, precious and semiprecious stones, and imitations thereof; articles made of, or ornamented, mounted or fitted with, precious metals or imitations thereof; watches and clocks and cases and movements therefor; gold, gold-plated, silver, silver-plated or sterling flatware or hollow ware; opera glasses; lorgnettes; marine glasses; field glasses; and binoculars. The tax imposed by this section shall not apply to any article used for religious purposes, to surgical instruments, or to frames or mountings for spectacles or eyeglasses, or to a fountain pen if the only parts of the pen which consist of precious metals are essential parts not used for ornamental purposes."

Suggested amendment: Line 7, after the semicolon, strike out the following: "watches and clocks and cases and movements therefor;".

Suggested amendment: As a new paragraph, insert the following:

"There is hereby imposed upon watches and clocks and cases and movements therefor sold at retail a tax equivalent to 10 per centum of the price for which so sold."

Senator WALSH. Mr. Haynes Mackenzie.

STATEMENT OF ALBERT HAYNES MACKENZIE, SILVER SPRING, MD.

Mr. MACKENZIE. Mr. Chairman, if it should require reemphasis, the cornerstone of the lottery project here submitted is its prerequisite of a bond purchase to the right to buy five lottery tickets at $2 each. The reasons for the exception to service men and women regarding the first bond purchase need not be further labored here as they have been treated in the body of this proposal.

The most articulate objections to lotteries are as follows: First, that if widely participated in, they would amount to a direct tax whose incidence would vary in accordance with gambling inclinations and not with the taxpaying capacities of the participants; and second, that gambling among the lower-income groups produces disturbing social results.

Assuming for the moment that the foregoing objections are true, still, they are not applicable to the instant project wherein participation is conditioned upon the possession of a definite margin of surplus, to wit, the $18.75 bond price, before the vice of gambling may be indulged. This fundamental factor of the scheme meets, and at the same time obviates, both of the above objections and prevents this type of lottery from becoming either a direct tax or a play upon the frailties of the impecunious.

While on the subject of direct taxes, it should be pointed out, parenthetically, that although a general sales tax is offered and labeled as an excise, or indirect tax, it most clearly becomes a direct tax by reason of the fact that none can escape its incidence.

Passing from the above matters, consideration should next be directed to two very important consequences of the war bond-lottery project:

First: That it will, as elsewhere indicated, release much of the excess purchasing pressure now exerting dangerous upward forces on vital price levels.

Second: That it will by its very functioning produce an accumulation of reserve buying power against the days of relative depression which are bound to attend the "transition" or "readjustment" period after the war.

In this regard it could and should be made a mandatory condition in such bonds that their redemption shall not commence until 2 years after the signing of the ultimate peace and that then such bonds shall successively mature every 3 months pursuant to the order in which they issued. In this manner an orderly, timely, and sustained restoration of public purchasing power will be effected.

1. It is proposed that a national war lottery be conducted in which the requirement for participation would be the purchase of an $18.75—$25 face value—War bond. Each War bond would then entitle its purchaser to buy five lottery tickets at $2 each.

A new lottery should be conducted each quarter and a corresponding new series of bonds issued therewith.

2. Members of the armed forces should be permitted to purchase their first five lottery tickets in each lottery without the necessity of buying a corresponding bond, but the purchase of a bond or bonds shall be required in order to buy additional lottery tickets.

3. The Treasury Department, cooperating with the Post Office Department, should conduct the lottery and sales of bonds. Lottery ticket sales could be made through all local post offices, including armed forces post offices or their equivalent. The sale of lottery tickets should be endorsed in ink on the bonds tendered for that purpose.

4. Lottery prizes should be exempt under all Federal income-tax laws.

5. No bonds except such as are purchased by and in the name of an individual should be eligible for lottery ticket purchases.

6. The drawing of numbers should be conducted in one place by a committee of widely mixed representation. It should be executed after the pattern of the selective service numbers drawing.

For simplicity, the ticket numbers should run only to 100,000 and be prefixed by a letter or number combination for every such 100,000. For example, the first 100,000 would be A–100,000 or 1–100,000. Thus the seventy-seventh 100,000 would be ZZY–100,000 or 77–100,000.

Taking the assumptions and suggestions hereafter set up, there would be 6,800 prizes. There should be 3 drawing bowls or squirrel cages. One from which a number between 1 and 100,000 would be drawn; a second from which a prefix number or letter would have to be drawn—after each prefix was drawn it would obviously have to be restored to its particular bowl or cage and might conceivably be drawn several times; a third from which a specific amount in prize money would be drawn. This amount would then attach to the combination of the first 2 drawings. In short, 3 drawings would be made to dispose of each prize.

7. The tickets would be distributed on the basis of estimated population including Army and Navy camps. Additional needs could be supplemented from the central source.

8. Based upon an assumption that 25,000,000 lottery eligible bonds would be sold in each quarterly issue, and that the right to purchase five $2 lottery tickets with each of such bonds was fully exercised, the following would be the gross quarterly and yearly income from bonds and tickets, respectively:

	25,000,000	
	×$18.75	
	$465,750,000	from bonds
plus	250,000,000	from tickets
	$718,750,000	total quarterly
	×4	
	$2,875,000,000	total annually

On the assumption that 50,000,000 lottery eligible bonds were sold in each quarter and the corresponding lottery rights exercised, the total gross annual income would be $5,750,000,000.

To this sum, of course, would be added that derived from the normal purchase of bonds by insurance companies, investment houses, and so forth.

9. Upon the further assumption that one-tenth of the gross income from the sale of lottery tickets along—and not bonds—should be expended in prizes, then upon the first premise set out in the preceding

paragraph, namely, the sale of $250,000,000 worth of lottery tickets per quarter, the sum of $25,000,000 would be paid out in prizes.

Thus $100,000,000 per annum would be the total prize money.

Upon the foregoing assumptions the following brackets and amounts of prizes are suggested:

100 prizes of $50,000 each	$5, 000, 000
200 prizes of $25,000	5, 000, 000
500 prizes of $10,000 each	5, 000, 000
1,000 prices of $5,000 each	5, 000, 000
5,000 prizes of $1,000 each	5, 000, 000
6,800 prizes, total	25, 000, 000

10. Although it would no doubt cause an increase over the above 10-percent of income disbursal, it is nonetheless suggested that any prize won by a man or woman member of the Armed Forces should be doubled.

In this connection it is urged that a definition by express listing of the various branches of the armed services be made so that none not in such list of branches could claim double prize money.

11. Whereas, although a quarterly disbursal of $25,000,000 in prize money has been here suggested as a figure with which to initiate the program—which figure, of course, will be subject to the modifications effected by double payment to members of the armed forces—and represents 10 percent of the conjectured first lottery—but not bond—income, nevertheless, the disbursals for each succeeding drawing might well be based upon the income actually received from the immediately preceding lottery.

By the adoption of this device, the people themselves would determine in advance the amount of prize money set up in successive lotteries.

12. Based upon the foregoing set-up, a ratio of 10 to 18.75, or better than one-half the equivalent of a tax-dollar income to a borrowed-dollar income, would be obtained, which is certainly a mark of conservatism and prudence in a government whose national debt is running away with it.

13. Beside the income from the twofold source of bonds and lottery tickets, a great benefit to the national economy to be derived from the lottery program is that it would painlessly drain off much of the surplus purchasing power which exerts such troublesome upward pressure on the fabric of prices.

14. This program would be of special appeal to men in the armed forces.

15. The punishment for counterfeiting should be made comparable to that fixed for other Federal counterfeiting violations.

16. The American people want to gamble. A war lottery would provide a beneficial outlet for that urge. Let the psuedo-moralists reflect that we, as a nation, are already gambling our lives and our fortunes in this war, beside which the gambling of a few dollars would be a small thing.

Let them further reflect that every cent of the money so gambled—less the prizes—augmented as it would be by bond sales, pours into the coffers of their Government to purchase the implements of victory.

Senator WALSH. Mr. Hale.

STATEMENT OF JOHN S. HALE, JAMESTOWN, TENN.

Mr. HALE. Mr. Chairman, and members of the committee; I represent two small mining companies in Tennessee, Jamestown, Tenn., and we mine barites, and we have found this year a very large increased demand for our product. It goes particularly into the glass industry and is used as a conditioner of what they call the batch, which greatly toughens the resultant container glass. There is a tremendous increase in demand for containers due to the shortage of tin. We have demands for barites far in excess of what we can supply and we have tried to buy it from other producers and we find they are in the same condition as we are.

Senator WALSH. Is there a ceiling on the price?

Mr. HALE. Yes; there is a ceiling price.

Senator DAVIS. When was it discovered that it was useful in glass? Is it an old use?

Mr. HALE. I would say in the last 5 or 6 years they have been using it.

Senator DAVIS. It toughens the glass?

Mr. HALE. It toughens the glass. There is a great deal less breakage, Senator, as they mold the glass containers. As I understand it, it doesn't do so much to it afterward, but at the time they are molding them it greatly reduces the percentage of breakage.

We can see no reason why, if the minerals that are included in the act, such as flake graphite, fluorspar, and those minerals get this benefit, that barites should not be likewise included.

So far as depletion is concerned, we deplete our deposits probably quicker than any other material. We find it in residual clay formation, and it is in there in the form of sand and boulders and gravel, and we have to take it from those clay forms and wash it. Barites has a high specific gravity, and we separate it by a gravitation process, but we find our ore deposits are depleted in a very short time. Three to five years is considered a long time for a barites deposit to last.

Senator DAVIS. Is it found in the mountains or in the clay in the valleys?

Mr. HALE. It is generally found in the clay in the valleys. Geologically, I understand it is deposited from the decomposition of limestone.

All that I am asking this committee to do is to treat us identically alike with all the other mining industries. Treat us like they are being treated, and include barites with 15-percent depletion just the same as those other minerals.

We have had the question up with the War Production Board and they are very much concerned over the very large probable shortage of barites in the United States in the next year, and so far as my contact with the producers, I am led to believe that we will have a tremendous shortage unless we get two things—an increase in price, and some tax concession.

Senator DAVIS. Is it used in any glass except containers?

Mr. HALE. I don't think they use it much in plate glass.

Senator DAVIS. Or window glass?

Mr. HALE. I don't think they do.

Senator DAVIS. Does it make the glass clearer?

Mr. HALE. That is one reason why they use it. You can use some other minerals which toughen the batch the same as barites, but they cloud it. Barites does not cloud it. It is perfectly transparent.

Senator DAVIS. Thank you very much.

Mr. HALE. And it is used in large chemical industries. We ship an enormous amount to du Pont and the large chemical companies. They use it in making paints. It is also used in the oil business.

I thank the gentlemen and ask permission to file a brief at a later date.

Senator WALSH. Are your industries in distress?

Mr. HALE. So far as we are concerned, we are in deep distress.

Senator WALSH. With the ceiling price you are not able to make money?

Mr. HALE. We are not able to make money with the ceiling price, and we are exhausting all our ore, and the demand is just so great that we are going to wind up without any ore and without any money.

Senator WALSH. Thank you.

(The following brief was submitted by the witness for the record:)

SUPPLEMENTAL STATEMENT OF JOHN S. HALE, JAMESTOWN, TENN.

Mr. Chairman, and gentlemen of the Finance Committee of the Senate, through the courtesy of Senator Stewart of Tennessee I have had the honor to appear before your committee on behalf of barite miners and producers of Tennessee.

As a witness before your committee and in this brief I represent the Wolf River Corporation and the Magnet Cove Barium Corporation, both of Jamestown, Tenn. These companies mine, process, and prepare for market the mineral barite.

The barite mining industry, insofar as I know it in the United States, is done by small mining concerns such as ours. Our product is sold to large users such as du Pont, New Jersey Zinc Co., Barium Reduction Corporation, who turn the mineral into barium chemicals, and particularly lithopone for paints.

We have tried to specialize in high quality barite which goes into the glass trade. Our customers for glass ore are Hazel-Atlas Glass Co., Bradford, Pa.; Ball Brothers, Indianapolis, Ind.; and Owens-Illinois Glass Co., Pittsburgh, Pa.

As your committee knows, the basis of glass is silicon, which is one of the most prevalent of elements in nature. The glass chemists have found that the addition of a certain percent of barite to the silicon produces a much tougher batch which saves breakage in molding glass containers. Due to the shortage of tin, the glass container business is booming. We have requests and demands from our customers for at least four times as much ore as we can produce.

Heretofore we have always kept on hand from year to year a stock pile or inventory in ore of about 20,000 tons, which was in normal times about the quantity of ore we would sell in a year. Today we have no stock pile, and a survey among the other producers of this ore shows that none of them have on hand any ore to take care of their customers. In other words, we are all on a day-to-day production basis, with orders booked ahead for more than we can produce.

We have always been what I would call a poor mining industry. That is, by careful management from year to year we have made a little money. Now our demands for ore have greatly increased and we find ourselves mining out and completely depleting our ore bodies. Due to high taxes we will, after the demand is over, be without ore and without money.

I suggest that the tax bill be amended in section 114, subsection (4), to include barite on a 15 percent depletion basis along with metals, fluorspar, feldspar, ball and sagger, clay, etc.

Such a suggestion is only fair to barite miners and producers. Every single hazard that applies to the minerals included in the bill for percentage depletion applies to barite.

Barite where we mine it is found in residual clay beds. We find that from 3 to 5 years mining in a particular locality or ore bed exhausts that bed and that we have to move on to another deposit with a more hopeful outlook. In other words, a workable deposit of barite is depleted quicker than any mineral of which I have had experience.

May I ask who was responsible for putting fluorspar, feldspar, vermiculite, etc., in the tax bill for percentage depletion?

And may I ask why was barite left out?

We respectfully ask that we be treated in exactly the same way as the other minerals included in the bill for percentage depletion.

We are small and have no organized lobby to speak for us. Do not discriminate against us because we are small. Treat us just as others are treated and we will continue to produce this essential war material—barite.

This December 6, 1943.

Respectfully submitted.

JOHN S. HALE,
ROBERT F. TURNER,

(for Wolf River Corporation and Magnet Cove Barium Corporation, Jamestown, Tenn.)

Senator WALSH. The committee will stand adjourned until 10 o'clock Monday morning.

(Whereupon, at 5 p. m., the committee was in recess until 10 a. m., Monday, December 6, 1943.)

REVENUE ACT OF 1943

MONDAY, DECEMBER 6, 1943

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

The committee met, pursuant to adjournment, at 10:30 a. m., in room 312, Senate Office Building, Senator David I. Walsh (acting chairman) presiding.

Present: Senators Walsh, Barkley, Bailey, Clark, Byrd, Gerry, Guffey, Johnson, Radcliffe, Lucas, La Follette, Vandenberg, Taft, Thomas, Butler, and Millikin.

Also present: Senators McKellar, Hatch, and Wiley.

Senator WALSH. The committee will come to order.

Senator Gillette, please.

STATEMENT OF HON. GUY M. GILLETTE, UNITED STATES SENATOR FROM THE STATE OF IOWA

Senator WALSH. Are you prepared to present witnesses?

Senator GILLETTE. Mr. Chairman, I have come here at the request of Senator La Follette, the chairman of a subcommittee representing a group of Senators who are very much opposed to this present proposal. I understand that the opponents to this proposal are to have substantially the same time that the proponents had in the presentation of their views.

Senator WALSH. One hour.

Senator VANDENBERG. I do not think they need it.

Senator GILLETTE. I am not going to burden the committee personally, excepting to say it seems to me very unfortunate that a controversial matter that has existed over a number of years and has been presented at various times by opponents and proponents should be dragged into this matter when you are considering a revenue-raising measure.

With that statement I should like to ask Congressman August H. Andresen, of Minnesota, who has been closely in touch with the viewpoint of the dairy interests of the country, to present the matter, that he may present such witnesses as he may have here and in such order as he wishes to present them.

STATEMENT OF HON. AUGUST H. ANDRESEN, UNITED STATES REPRESENTATIVE FROM THE STATE OF MINNESOTA

Senator WALSH. Congressman, will you give your full name for the record?

Mr. ANDRESEN. August H. Andresen, a Representative from the First District of Minnesota.

Mr. Chairman and members of the committee, I am appearing here for a group of Representatives from the dairy States in the Union who are vitally interested in this type of legislation. We feel that if this matter is to be considered it should be discussed as a separate proposal and not attached to the tax bill. The importance of it is of tremendous economic consequence to a large number of dairy farmers and others who have been traditionally engaged in the production of butter. In order that I cover the point that I have outlined, I am going to take the liberty of reading my statement.

I am speaking for a large group of Members of the House of Representatives from dairy-producing States, and I want to make it perfectly clear that we are not fighting the sale and use of oleomargarine. However, we insist that when oleomargarine is sold, it should be sold for what it is, and not as an imitator of butter. Oleomargarine is a synthetic product from vegetable and animal oils, and is not in a class chemically or otherwise with butter—the natural product of milk.

A good deal of erroneous and clever propaganda has recently appeared in magazines, newspapers, and over the radio claiming that consumers are not able to buy oleomargarine because of a 10-cent Federal tax on this synthetic product. The source of this type of misleading information is the oleomargarine lobby which hopes to influence public opinion in favor of the Fulmer and Maybank bills, which proposals seek to repeal regulatory laws enacted, many years ago, to protect the public from deception and fraud in the sale of spurious imitations of butter. Oleomargarine is manufactured by 18 concerns and their subsidiaries.

The question at issue in the oleomargarine controversy is primarily that of "color." According to information received from the Bureau of Internal Revenue and the Department of Agriculture, 99.8 percent of all oleomargarine sold to the consuming public in the United States is uncolored or white in appearance. This oleomargarine bears a Federal tax of one-fourth cent per pound, and not 10 cents a pound, as some people have been led to believe. The tax of one-fourth cent per pound on uncolored oleo is absorbed and paid for by the manufacturer, and is strictly a regulatory tax. If oleomargarine is colored yellow in imitation of butter, the Federal tax is 10 cents per pound. Uncolored margarine is sold at retail to consumers from 17 cents to 29 cents per pound. I do not know as to the margin of profit for the manufacturer of the product, but wholesalers, appearing before the House Committee on Agriculture on the Fulmer bill, stated that they had a margin of 3 cents per pound and retailers about 4 cents a pound. I doubt very much if the price would be any cheaper to the consumer if the one-fourth cent tax is removed.

Consumers are now able to buy all of the oleomargarine that can be produced by the manufacturers under the allocation of fats and oils by the Government. The shortage of fats and vegetable oils is so serious that the O. P. A. recently increased the ration points for oleomargarine 50 percent and butter 100 percent, from 8 to 16 points. There is little likelihood that consumers will be able to buy more oleomargarine, even though the Maybank or Fulmer bills were enacted into law.

I might interject here that the Fulmer bill is somewhat similar to the Maybank bill. The Maybank bill removes the tax for the duration of the war, and the Fulmer is permanent legislation, seeking to remove it permanently.

Senator VANDENBERG. The Fulmer bill is being considered in the House on its own independent basis, is it not?

Mr. ANDRESEN. That is correct, before the Committee on Agriculture. Ten days of hearings were held on the bill. The committee decided in the interest of unity and in the interest of the war effort, to dispense with the further hearings on the Fulmer bill for the duration of the Seventy-eighth Congress.

Senator WILEY. May I interject there? You say if the bill pending in the Senate were to become law, it would mean there would simply be removed one-quarter of 1 cent?

Mr. ANDRESEN. The principal purpose of the Maybank bill is to remove the manufacturer's tax, the wholesale and distributors' tax, and the 10-cent tax on colored oleomargarine.

Senator WILEY. The result would be they could manufacture it and color it like butter?

Mr. ANDRESEN. Like imitation butter, and sell it generally to the public. Due to the shortages of fats and oils there will not be any more fats and oils available for oleomargarine if they did that.

Senator GUFFEY. Mr. Congressman, in your remarks a few moments ago you complained about a lobby for oleomargarine. Do you mean to imply there is no lobby for the butter interests in the State capitals of the different States and here in Washington?

Mr. ANDRESEN. There is no doubt that the dairy interests who number about 5,000,000 dairy farmers are pretty well represented by the Senators and Representatives in both Houses, and they generally let us know just how they feel about things.

Senator GUFFEY. My observation has been that the most powerful lobbies originally were the railroads, and then the public utilities; and now the dairy lobby is the powerful one.

Mr. ANDRESEN. They are not as powerful and they have less money to operate with than some of these other lobbies, which are very vocal and energetic around Congress. I think the dairy farmers of the country ought to have a right to be heard.

Senator GUFFEY. I am not complaining.

Mr. ANDRESEN. I am not here representing the dairy lobby.

Senator GUFFEY. I did not mean to imply that at all, Congressman. Go ahead with your testimony.

Senator WILEY. You are discussing the facts.

Mr. ANDRESEN. I am discussing the facts. I want to call them to the committee's attention.

Senator VANDENBERG. Was the action of the House Agricultural Committee unanimous in postponing it?

Mr. ANDRESEN. No.

Senator VANDENBERG. What was the action?

Mr. ANDRESEN. The vote was 11 to 14 for discontinuing or deferring the hearings on the bill for the balance of the Seventy-eighth Congress.

I repeat, we do not object to the use of oleomargarine, but when it is sold, we insist that it should be sold for what it is, and not as an imitator of butter. This product may now be colored green, red, pink or any color other than yellow, by the payment of one-fourth cent per pound Federal tax. But the manufacturers of oleomargarine do not want to use any other color than yellow, which now calls for a 10-cent tax. The Maybank bill seeks to repeal this 10-cent tax for the duration, under the theory that more oleo will be available, but sponsors of the legislation overlook the fact that the sale of

yellow-colored oleomargarine is prohibited in 30 States containing more than 90 percent of the population of the United States. State laws prohibit the selling and coloring of imitation butter in those States. They also overlook the fact that there is a decided limitation on the amount of vegetable oils that can be used for oleo production.

I believe that Dr. Carlson, the main witness for the Maybank bill, let the cat out of the bag, in his testimony before your committee last week, when he said in substance, that milk from dairy cattle should be sold as whole milk to the consuming public, and fortified yellow colored oleomargarine should be permitted to take the place of butter as a spread for the average American home. It is therefore quite obvious that the sole purpose of the oleomargarine manufacturers in demanding the repeal of the tax on oleo colored yellow in imitation of butter, is to attempt a permanent change in the diet of a large percentage of the population from butter to oleomargarine. I am satisfied that they will not succeed in this objective, because there never will be a real substitute for good dairy butter.

Of course, there is a shortage of butter. How could it be otherwise when we consider the discriminatory price levels placed on various dairy products by the O. P. A., plus bungling directives under which dairy producers are compelled to operate or else be subject to prosecution in O. P. A. kangaroo courts. The lowest price ceiling has been fixed for cream used for butter. There is no price ceiling on whole milk powder or cream for manufacturing purposes other than butter. Higher ceilings are provided for whole milk sold in liquid form and used for cheese. The result is that milk and cream are being diverted away from butter, which will cause a large decline of butter production this year and in 1944.

Furthermore, butter has gone to war. We want our fighting forces to have an abundance of butter, but reports from camps and battle fronts indicate that they are not getting much of it. The Government acquired 456,000,000 pounds of butter between February and October of this year—about 35 percent of the entire production, and the Army and Navy bought additional supplies. Hospitals in the United States will get 5,000,000 pounds of this butter, and the balance will go for war purposes and to Russia and other countries under lend-lease. That is why there is a shortage of butter for civilian needs and the reason for the high ration-point value of butter. With the termination of war, there will again be an abundance of butter and other dairy products produced by nearly 5,000,000 American dairy farmers.

Senator LUCAS. What is your authority for that statement?

Mr. ANDRESEN. My authority for that statement comes from boys in the camps of the United States, and also an admission on the part of the agencies distributing food from the War Department.

Senator LUCAS. What boys, just name one that you know about?

Mr. ANDRESEN. I would not want to name any boys here publicly.

Senator LUCAS. What agencies?

Mr. ANDRESEN. Let me finish my statement, Senator.

I would not want to name any boys publicly as criticizing what the War Department will do, because you know what happens to those boys.

Senator LUCAS. What agencies?

Mr. ANDRESEN. The agencies down here are the War Food Administration, the Food Distribution Administration, and from boys coming from overseas who say that instead of getting butter they are getting something else, or no butter at all, and they are wondering what is happening to the butter.

Senator LUCAS. You say the War Food Administration told you that the boys overseas are not getting butter?

Mr. ANDRESEN. Yes, sir. Well, they are getting some butter.

Senator LUCAS. What other agencies?

Mr. ANDRESEN. Let me point this out to you in that connection, that 456,000,000 pounds of butter were purchased by the War Food Administration from February to October 1 of this year. That is about 35 percent of the entire production. It was assumed by them, I trust that this butter was to go to the men in the armed forces, but the distribution of it has not taken place as we had anticipated, because we want our boys to have butter, and I am sure that the Senator agrees on that.

Now, there was some complaint that the hospitals were not getting the butter while 5,000,000 pounds of this butter had been allocated to the hospitals of this country from October 1 to March 1, and 210,000,000 pounds of this 456,000,000 was assigned to the armed forces. Some was assigned to offshore areas like Puerto Rico and Hawaii.

Senator LUCAS. What happened to it?

Mr. ANDRESEN. I hope they are eating it, but some of the butter that they purchased has spoiled.

Senator LUCAS. How much?

Mr. ANDRESEN. For instance, some butter that was shipped to Australia had deteriorated in quality and it was sold at 12 cents a pound in the retail stores in Australia, for the consumption of the public.

Senator LUCAS. How much of it?

Mr. ANDRESEN. I cannot give you the amount of it, because I have been unable to get the exact figure, but the news item was published in the West Australia newspaper saying that the ladies in Australia were very happy over the fact that they could buy American butter to be used for cooking purposes at 12 cents a pound.

Senator LUCAS. You are interested in the oleomargarine tax proposition, are you not?

Mr. ANDRESEN. That is what I said when I first started. This fight or controversy is on the question of color.

Senator Lucas, you are making a political speech against the O. P. A. and the Administration. I would suggest that you might confine your remarks to the question that is before the committee.

Senator BUTLER. He is simply answering your questions, Senator.

Senator LUCAS. I am just making that statement for whatever it is worth.

Mr. ANDRESEN. I am certain that I have not strayed from the line of my argument.

Senator LUCAS. When you make a statement that the boys from overseas are complaining because they cannot get the butter you make this other statement with respect to the spoiled butter in Australia and about the bungling regulation of the O. P. A. I do not think that has anything to do with this tax. I am with you on this tax.

Mr. ANDRESEN. I am glad to hear that.

Senator LUCAS. I do not like to hear political speeches made before the committee.

Mr. ANDRESEN. I believe the Senator interrogated me on those questions and those were my responses. I had no intention except to answer the Senator's questions.

Senator GUFFEY. You mentioned the lobbies. What about the oleomargarine lobby?

Mr. ANDRESEN. There is no question about that.

Senator GUFFEY. There is no question about the lobby for the butter people, the dairy people.

Mr. ANDRESEN. I agree with you.

Senator GUFFEY. The most influential lobby in Pennsylvania is the Dairy League up there. I could give you some evidence on that, and some illustrations, but we will not put that in today.

Mr. ANDRESEN. A part of this 456,000,000 pounds of butter is used to send to Russia and other countries under the lend-lease program.

Now, a representative of the Restaurant Association also appeared before your committee in behalf of the Maybank bill. The motive of his support of the legislation was so apparent that it needs no comment. Naturally, he would like to serve yellow-colored oleo because it is cheaper than butter, without telling his customers about it. This is deception.

Before I conclude, I want to point out that oleomargarine is now largely manufactured from vegetable oils. Soybean oil and cottonseed oil are presently the main ingredients. But the products can be made out of other vegetable oils, and generally the manufacturers use the cheapest oil in production.

Oleomargarine has its place, but we want it to be sold for what it is, and not as an imitator of butter. I, therefore, urge that the Maybank bill be not considered as a part of the tax bill.

At least forty members of the House have asked to be heard in opposition to the Maybank bill. Limitation placed on time will not permit the members to appear this morning.

There are two representatives of the dairy industry here, Dr. H. A. Ruehe, of the American Butter Institute, representing the dairy farmers of the country, and Mr. Charles W. Holman, executive secretary of the National Cooperative Milk Producers Federation, who will appear against the Maybank bill.

I will now call on Dr. Ruehe to proceed with his testimony.

Senator WALSH. Congressman, I do not know that it is especially important, but I notice that Senator Maybank said the action of the House Agricultural Committee was by a vote of 14 to 11.

Mr. ANDRESEN. That is correct, sir.

Senator WALSH. I thought you said 14 to 4.

Mr. ANDRESEN. No; 14 to 11.

(The following letter was submitted for the record:)

HOUSE OF REPRESENTATIVES,
Washington, D. C., December 1, 1943.

Hon. WALTER F. GEORGE,
United States Senate, Senate Office Building,
Washington, D. C.

MY DEAR SENATOR: I am informed that some attempt will be made to include the oleomargarine legislation in the tax bill which your committee is now considering. May I state that I represent nine counties in northeastern Wisconsin, residing in Green Bay, Wis., myself; that, speaking for my constituency, we are unalterably opposed to any legislation of this kind being tacked on to a tax bill.

I believe a fair and full hearing was had before the Committee on Agriculture in the House, which refused to report out the bill. Personally, I can think of nothing that would antagonize the Midwest farmers more than to permit legislation of this kind to be considered now.

I am informed that oleomargarine production is curtailed by the war needs for vegetable oils. Consequently, passing any legislation affecting the oleomargarine tax will not permit greater production in this field. Therefore, it is quite evident that special interests are attempting to procure certain advantages under the stress and strain of the war program.

Please include my letter of protest in such hearings as you may have on this matter.

With kindest personal regards, I am

Sincerely yours,

LAVERN R. DILWEG.
Member of Congress.

Senator WALSH. You may call the next witness.

Mr. ANDRESEN. Dr. Ruehe.

STATEMENT OF DR. H. A. RUEHE, EXECUTIVE SECRETARY, AMERICAN BUTTER INSTITUTE, CHICAGO, ILL.

Senator WALSH. Your full name, please.

Dr. RUEHE. H. A. Ruehe.

Senator WALSH. Whom do you represent?

Dr. RUEHE. I am executive secretary of the American Butter Institute. I have a statement concerning myself [handing].

(The statement referred to is as follows:)

Dr. Ruehe was graduated from the College of Agriculture, University of Illinois, June 1911, and granted the master of science degree in dairy husbandry by the University of Illinois in June 1916. The degree of doctor of philosophy was conferred upon him by Cornell University in June 1921.

He taught dairy manufactures in the University of California from August 1911 to July 1912. In July 1912 he joined the staff of the University of Illinois as instructor in dairy manufactures, and continued as a member of that department until February 1, 1943. During these years Dr. Ruehe was promoted in academic rank and appointed professor in July 1921 and made head of the department of dairy husbandry, University of Illinois, and chief in dairy manufactures in the Agricultural Experiment Station.

He obtained a leave of absence from the University of Illinois February 1, 1943, and since that time has been executive secretary of the American Butter Institute.

Dr. Ruehe is author and coauthor of many circulars and bulletins published by the Illinois Agricultural Experiment Station, and many papers published in scientific publications, some of which were published in Italy and in France. He is the author of several hundred articles appearing in trade journals.

Senator WALSH. You may proceed.

Dr. RUEHE. The American Butter Institute, a trade association representing more than 500 commercial creameries scattered throughout the United States, opposes the passage of the Maybank bill (S. 1426), either as a single bill or as an amendment to the internal-revenue tax bill. It is the opinion of the American Butter Institute that the passage of this bill will eliminate the present 10 cents per pound tax on colored oleomargarine for the duration of the war plus 6 months. The removal of this 10-cent tax is retrogression in legislation in the production and control of a food product which is manufactured as a substitute for butter. Removing this tax will open the door to the fraudulent practices of selling an imitation product to the unsuspecting public as the wholesome dairy product, butter.

It should be pointed out clearly that the reputable oleomargarine manufacturers are honest and their integrity is not questioned. Even

though the product were not taxed, the reputable manufacturers would not stoop to fraudulent practices, but fraud will develop in the distribution of this product. It is only necessary to go back to the era when oleomargarine was not taxed to discern the malpractices which would develop. Previous to 1886, when oleomargarine was not taxed, the practice of selling oleomargarine colored to imitate butter ran rampant in many areas where food-control measures were lax, and in most instances consumers in lower income brackets were most greatly imposed upon.

In 1886 a 2-cent tax was placed upon colored oleomargarine, but experience shows clearly that the 2-cent tax on colored oleomargarine was not sufficient to discourage fraud and the malpractice of selling oleomargarine colored as butter continued. The Federal authorities found it necessary to increase this tax on colored oleomargarine to 10 cents per pound in order to properly control the merchandising of this product and to discourage fraudulent practices. Should the acts of Congress which created these protective measures be eliminated or modified so as to eliminate the 10 cents tax on colored oleomargarine, there is no question but that there would be a rapid development of "social termites" who have a thorough disregard for law and the rights of other people, and unquestionably these law and order violators who are now promoting black markets would also turn to the fraudulent practice of merchandising colored oleomargarine as butter. It is possible that this activity might destroy both the reputable butter and oleomargarine industries.

Provisions are now made for the licensing of the manufacture of oleomargarine and for the taxing of uncolored oleomargarine to the extent of one-quarter of a cent per pound and colored oleomargarine at ten cents a pound The one-quarter cent tax is not a prohibitive one; it merely provides a method by which the production and sale of this commodity can be checked from its source of production to the purchase by the ultimate consumer, thus safeguarding the public. The addition of coloring matter to oleomargarine does not increase nor improve its food value. It merely makes it possible for the product to appear as something which it is not—butter.

The natural color of butter is golden yellow. The degree of intensity of this color varies somewhat with the breed of cattle which produces the butterfat and the feeds which the cattle consume, but yellow is Nature's color of this product. There is a correlation between the intensity of the yellow color of butter and the carotin content, and carotin is the precursor of vitamin A. It is one of Nature's sources of this essential vitamin.

The chief sources of the raw materials for oleomargarine are various vegetable oils. These products are liquid fats at normal room temperatures, and consequently it is necessary for them to be subjected to hydrogenation in order to change their chemical composition so that they will have a melting point simulating that of normal butterfat. It must be pointed out, however, that these hydrogenated vegetable oils are not and cannot be made chemically identical to the natural fats existing in butterfat. They consist primarily of what the chemist terms "long chain fatty acids" and hydrogenating does not in any way shorten the chains or their molecular structure. The natural color of these hydrogenated oils is white or an off-white color. Butterfat is composed of glycerides of a number of fatty acids, an appreciable amount of which are short-chain fatty acids. Milk fat

is the only natural fat which contains these short-chain fatty acids, but they do appear in the milk fat of milk of various animal species, including the human. This is singular. Undoubtedly the great Creator, in His wisdom, has had a justifiable reason for having such short-chain fatty acids present in the fat which he created for the nourishment of the young of the species, which our modern chemist has failed to determine with his present knowledge and ability. The great Creator has performed many miracles which chemists have spent lifetimes of service trying to understand. Undoubtedly the necessity of short-chain fatty acids in the diet of the infant is one of these which, up to the present time, remains unsolved by the scientist.

During recent years oleomargarine manufacturers have been fortifying oleomargarine with synthetic vitamin A, and it is claimed by some that 9,000 units of synthetic vitamin A per pound of oleomargarine are equal nutritionally to the vitamin A content of a pound of butter produced during winter months. It is true that the vitamin A content of butter produced in winter is lower than that of summer-produced butter, but much of it contains more than 9,000 units of vitamin A per pound even in the winter. It must be realized that up to the present time no scientist has proved that 9,000 units of synthetic vitamin A in a pound of oleomargarine are nutritionally equivalent to 9,000 or more units of natural vitamin A in winter-produced butter when these products are included in the diet of human beings. Such claims are based primarily upon experimental work carried on with experimental animals. Everyone realizes that the life of a laboratory animal—the white rat, for instance—is vastly different from the life of a human being, and there is no evidence that oleomargarine fortified with synthetic vitamin A, fed to a human being from infancy to senility, will be equivalent to the feeding of equivalent amounts of natural butter through the same span of life.

There is no evidence to prove that the potency of synthetic vitamin A in oleomargarine is retained in that product from the time of its manufacture to the ultimate consumption to the same degree that the potency of natural vitamin A is retained in natural butter. Consequently, there is a question as to the validity of the claims of many, including some scientists, as to the veracity of their statement that synthetically fortified oleomargarine is nutritionally equivalent to butter.

During the last two or more decades, from 35 to 40 percent of the milk produced in these United States has been marketed in the form of butter. Butter is the balance wheel for the dairy industry. In fact, it is the balance wheel for a large portion of the agriculture of this country. The removal of the controlling tax on colored oleomargarine opens the doorway for fraud. It goes further—it opens the doorway for the destruction of the market for from 35 to 40 percent of the milk produced in this country. If this tremendous market is destroyed, it means a vast curtailment in the dairy-cattle population of this country. This would be serious if considered only from the standpoint of dairy products, but the seriousness becomes multiplied when we realize that dairy cattle furnish a large portion of the supply of veal and beef in this country, as well as hides for leather and hair for various commercial uses. Such an elimination of essentials would be catastrophic, but this is even more far-reaching. Dairy cattle supply an extremely important market for the byproducts—soybean,

linseed, and cottonseed meals, as well as other crops which are important items in the agricultural production program of this country.

It is realized that at certain times cottonseed oil is used as the basis for oleomargarine, and other times soybean oil or linseed oil or a mixture of these are the products used in the manufacture of the hydrogenated fats for oleomargarine. However, these are not the only sources for the raw oils, as history points out that copra fat and the oils from various nuts may serve as the basic ingredients for vegetable oleomargarine. It should be pointed out that the sources of materials for the manufacture of oleomargarine are selected on the basis of their cost and availability—that is, economic rather than nutritional factors.

From newspaper comments, it is evident that certain phases of agriculture have been misled into thinking that the elimination of the 10 cents tax on oleomargarine would greatly improve the market for the oils from the seeds of certain crops. This has been especially true in the case of soybeans. It should be pointed out clearly that if a large portion of the market for the meals of these seeds was destroyed by the elimination of 25 or 30 percent of our dairy cattle, the growers of these crops would be in a dilemma. One might go further and state that soybeans, for example, are a soil-depleting crop, and consequently, to maintain fertility and productivity of our soils, certain chemical elements—especially nitrogen, phosphorus, and potassium—must be returned to the soil. Experience has proved that feeding these seed meals to dairy cattle and returning the manure to the land is not only one of the most economical methods of maintaining soil fertility, but it is also one of the most satisfactory. Consequently the elimination of 25 or 30 percent of the dairy cattle population of this country because of the destruction of the market for butter, would undoubtedly raise a grave question concerning the maintenance of the fertility of the land which is basic to the supply of human food for the population of this country and our lend-lease neighbors.

It might be well to interject here the thought that there may be a change in our scheme of tariffs in order to carry out a good-neighbor policy, and whereas we may now think that the source of materials for oleomargarine will come from crops grown within the United States, we must not lose sight of the fact that a few changes in tariffs may eliminate a large part of the market for cottonseed oil, linseed oil, and soybean oil produced in this country, and open the door for vegetable oils produced by our neighbor countries.

On October 13, 1943, in speaking before the Minnesota Creamery Operators and Managers Association in St. Paul, Dr. T. G. Stitts, Chief of the Dairy and Poultry Branch of the Food Distribution Administration made the following statement:

> Butter is one of the most talked of things in the country today. It affects more people more intimately than almost any other war or civilian commodity. That's why butter production in Minnesota makes not only the St. Paul and New York papers but the Moscow papers as well.

From this statement, it seems clear that the Food Distribution Administration realizes the importance of butter, not only from the standpoint of its nutritional value, but also because of its morale-building importance. Any legislation which would let down the bars for the destruction of the market for this important commodity and thus discourage its production, would be sabotage to the war effort. It is only

necessary to look back to a few months ago when some camps were unable to supply the soldiers stationed there, with butter, in order to get a slight appreciation of dejected morale caused by a lack of butter. In talking with soldiers they have been asked whether or not they considered oleomargarine equal to butter, and invariably the answer has been, "Hell, no." Such an answer is short but emphatic, and is only a microscopic example of what the sentiment of a large portion of our armed forces and civilians would be if the same question were put to them.

Great demands are being placed on the dairy industry for dairy products to meet the requirements of our armed forces, allies, and civilian consumers. It is only necessary to compare butter production for 1943 with butter production for 1942 to realize that there is a gradual decrease in the supply of this commodity. For example, according to Government reports, the October 1943 butter production was 13 percent lower than for October 1942 and 17 percent lower than the 10-year average (1932–41). Any legislation which would in the slightest degree give butterfat producers the thought that butter was to be faced with the unfair competition of a substitute product, would undoubtedly have a demoralizing effect which would result in an immediate decrease in the production of milk and butterfat, and this would still further complicate a bad economic situation which has confronted many dairymen during 1943.

The American Butter Institute protests legislation which would remove the 10-cent tax on yellow-colored oleomargarine and thus open the gateway for the fraudulent marketing of a substitute product as butter, and protests the consideration of legislation which would have a discouraging and demoralizing effect upon the dairy farmers of these United States, the result of which would be a reduction in the basic food commodities which are greatly needed, and especially during the war emergency. The effort of the American Butter Institute is not directed toward eliminating or hindering the manufacture and sale of oleomargarine but rather to retain the proper controls so that the product—oleomargarine—will be sold for what it is and on its own merits.

Senator WALSH. Very well, sir.

Senator GUFFEY. On the question of the soldiers, I am sorry the senior Senator from Missouri is not here, because he would answer that question, "Hell, yes."

The CHAIRMAN. The next witness.

Mr. ANDRESEN. Mr. Holman, of the National Cooperative Milk Producers Federation.

STATEMENT OF CHARLES W. HOLMAN, EXECUTIVE SECRETARY, NATIONAL COOPERATIVE MILK PRODUCERS FEDERATION, WASHINGTON, D. C.

Senator WALSH. Will you give your full name?

Mr. HOLMAN. My name is Charles W. Holman. I am the executive secretary of the National Cooperative Milk Producers Federation, with headquarters at 1731 Eye Street NW., Washington.

Senator WALSH. You may proceed.

Mr. HOLMAN. Mr. Chairman, I have just gotten off the train from the closing of our annual meeting held in Chicago last week where

the first action of the meeting was to pass a resolution, a copy of which was wired to Chairman George. Unfortunately, I do not have a copy of the resolution with me, but I ask permission that it be filed in the record as a part of my remarks.

Senator WALSH. That may be done.

Mr. HOLMAN. The general purport of the resolution and of our official position is to ask that this whole question of oleomargarine legislation be deferred for the entire duration of the war. I know of nothing in this country that has so disturbed the growing relationship of friendliness between the North and South and East and West in agriculture as the revival at this time by a few corporations of an issue that more nearly resembles a fight between members of a rural community or a village about two rival banks.

This is far deeper than the economics involved, because in the one case a great industry of at least 3,000,000 farmers who sell a large part and sometime all of their cash crops off of the farm, are engaged in a fight literally for survival, while in the other case a few corporations are buying a product and manufacturing it for their profit.

Now, we do not criticize them for doing that, but the idea that there is any added profit, added price, for example, to the price of cottonseed through the diversion of cottonseed oil from its other edible uses into oleomargarine, I think I can, with some authority, assure this committee, is groundless. There is an available market for every pound of domestic oils and fats produced in this country, and at times the importation even of cottonseed oil has been much greater than the utilization of it by the oleomargarine industry. Those are matters of fact which I have at times placed before this committee in connection with oils-and-fats discussions.

The same thing is true of soybean oil. The facts are that the pricing system in the marketing of these crude oils and fats has not advanced to where there is a difference according to the use classification. In other words, the same tank of oil that is bought in the South may go into salad dressings, or vegetable shortening, or it may go into oleomargarine, but so far as I know, the blind broker system of selling oil still prevails in my home country in the South and the seller of it, the cottonseed mill, does not know for what use it is put or who the buyer is until after the broker has arranged the sale.

At this particular time, with the prospect of importation of the oils and fats narrowing somewhat, the relative scarcity for edible purposes becomes more intense. An illustration of that is that right in the middle of the hearings on the Fulmer bill the O. P. A. made an official announcement that the point-rationing system on oleo would have to be advanced from 4 points per pound to 6 points per pound because of the very real situation that there was little or no opportunity for increasing the availability of oleomargarine at the present time. It was just as necessary to restrict its consumption as it was to restrict the consumption of butter. Those are matters of official record, placed in the hearing, and I have a copy of the O. P. A. official statement on that. Now, it is possible that there may be some additional supplies made available for oleomargarine during the year 1944. That would depend upon the vagaries of the weather and of the shipping, but no one can predict it.

I will say this, though: It is my belief that the real purpose behind both the Fulmer bill and Maybank bill is a post-war purpose.

Senator CLARK. It is a fact, is it not, Mr. Holman, that in normal times, I mean times aside from war, that neither cottonseed oil nor soybean oil can actually compete with the coconut oils and other oils brought in from the tropical countries?

Mr. HOLMAN. I was just coming to that.

Senator CLARK. I came in a little late myself. I thought perhaps you had touched on that.

Mr. HOLMAN. I am glad you raised the question.

The post-war purpose lies in this direction: Remove the coloring tax in the Federal law, remove as much of the coloring restriction as you possibly can.

Then, you come back to the known buying habits of the manufacturers of the fats. They buy their oils where they can get them the cheapest. They did it in the past, they will do it again in the future, and a variation of so much as a quarter of a cent a pound on the crude oil or refined oil, whichever you please, will cause a shift in the utilization of the oil by either the shortening manufacturer or the oleomargarine manufacturer.

It is a well-known fact that most of the oriental oils can be bought at times cheaper than can the domestic products. That would be particularly true if we should go into a period in which the processing taxes and import duties are either lowered or removed.

Senator CLARK. What you get here is a double deal, isn't it? They come in to take the tax off of coloring the oleomargarine so they can change the consuming habits of the American people during the period of the emergency, and then when the war is over and oleomargarine has come into common use and they find they cannot compete with the cottonseed and other oils, they will ask for a tax on the other oils to protect the infant industry?

Mr. HOLMAN. I think our producers in the South and West would ask for the tax, but I think the oleomargarine people would ask for free trade.

Senator CLARK. The only way in normal times in which the cottonseed and soybean oil people can be protected would be by a prohibitive tariff on coconut oil, otherwise the coconut oil gets the whole oleomargarine trade.

Mr. HOLMAN. I led in that fight for 25 years before this committee, for a protective tariff of a moderate character for the South and Middle West, for the protection of these oils, and I think I know what I am talking about. Let us assume they have got the duties down and the processing taxes off and they are being allowed to make yellow oleomargarine without the 10-cent tax, what will happen?

It is estimated this year's total production of oleomargarine will pass 600,000,000 pounds, and will be about 650,000,000 pounds. Of that, about 20 percent is being shipped abroad. What it will be for next year, we do not know, but I can tell you this, gentlemen, that under normal competitive conditions when oleomargarine gets up to around 700,000,000 pounds of annual production, that is equivalent to one-third of the total fats in butter, then the economic effect of the lower-priced fat as compared to the higher-priced fat will begin to show itself, just as in the earlier years of price competition between the vegetable shortening and lard made itself effective, so that both in time came to the point where one guided the price of the other. The price of one either dragged down or raised the other.

So, here you have a fat which at the present time is averaging about 24 cents a pound retail to the consumer, against a fat that is running somewhere around 50 cents a pound retail. You take off your coloring tax, and then there would be no oleomargarine produced in this country that is not colored, except in those States where there is a color protection under the State law. Then, your volume goes up and up, and the oleomargarine people have told me and they have told others publicly that their first objective is a billion pounds of consumption per year. That would drag down the price of butter to some point, maybe 10 cents a pound above the price of oleomargarine.

But where is the profit in this to the oleomargarine people? At the present time, there is little or no production of colored oleomargarine for anything except the Russian use, but if all of the oleomargarine is colored, I predict there will be a general rise in the price of oleomargarine of perhaps 4 or 5 cents per pound. Witnesses before the House committee have testified that the maximum cost of coloring was about 1 cent a pound, and I do not think it is over one-quarter of a cent a pound. So you have got a pretty big profit there on all of the white oleomargarine which can be colored, in other words, a half billion pounds with say 5 cents a pound added price on the same cost, and you have a nice objective for asking for the removal of this particular coloring tax.

Senator CLARK. You mean coloring increases the price of oleomargarine entirely out of proportion to the cost of the manufacture of the colored product?

Mr. HOLMAN. Exactly. The removal of the coloring tax will enable them to collect the tax for themselves instead of the Government collecting the tax. That is, of course, what we believe to be an unfortunate condition.

Now, in the Middle West country there are hundreds of thousands of producers of butterfat for separated cream purposes. These people will not be able to continue in existence, they will have to go out of existence, and then the total shrinkage in the volume of butterfat may put us in the unnatural position of furnishing the fat only for those of moderate income and the higher-income groups, and the fat will be denied to the people who have a lesser income, all due to the fact that hundreds of thousands of butterfat producers will have to go out of business.

Now, Mr. Chairman, I could go on here for hours, but the point is, representing our dairy farmers we ask that for the duration of this war this particular controversy be laid aside. The farmers of this country, in the North and South, have many other things in common that they want to fight for and I know that they do not want to be divided by this particular controversy at this time.

I desire to thank the committee.

Senator LUCAS. Mr. Holman, how many concerns in this country are interested in the making of oleomargarine?

Mr. HOLMAN. There are 72 plants. I think that the witnesses in the House said 18 companies.

Senator LUCAS. Eighteen companies control the entire industry in the country?

Mr. HOLMAN. Yes, sir.

Senator LUCAS. And it is a product that has to be made through a plant of some kind?

Mr. HOLMAN. Oh, yes; it is made in a plant, and the products are bought from somewhere else, either from the South or from the Middle West. The formula of ingredients can be shifted and changed according to the market price. It simply comes into the plant, is made into the product, and goes out somewhere else.

Senator GUFFEY. How many cooperatives in Pennsylvania belong to your association, can you tell me?

Mr. HOLMAN. The Interstate Milk Producers Association of Philadelphia, which covers the eastern part of the State, the Allentown organization which covers the Lehigh Valley, the Dairymen's Cooperative Sales Association with headquarters in Pittsburgh covering a considerable portion of the western counties, and the Dairymen's League which covers the northern tier of counties. That is all of our membership in that section, sir.

Senator GUFFEY. Mr. Chairman, may I correct a mistake that I made when I quoted Senator Clark? When I said he would say "Hell, yes," I would like to correct that to "Hell, no."

Senator CLARK. Mr. Chairman, I made the remark here the other day that I eat oleomargarine three times a day. I would like to explain that I do that not because I like to eat it or want to eat it or because it is as rich in nutrients as butter, but because the doctor wanted to put me on a diet because it was less rich in nutrients as he compelled me to eat oleomargarine instead of butter.

Mr. ANDRESEN. We have two Representatives from Wisconsin here. I would like to first call on Mr. Reid F. Murray.

STATEMENT OF HON. REID F. MURRAY, UNITED STATES REPRESENTATIVE FROM THE STATE OF WISCONSIN

Mr. MURRAY. Mr. Chairman, my name is Reid F. Murray, Representative of the Seventh District of Wisconsin.

Senator WALSH. You may proceed, Congressman.

Mr. MURRAY. I do not want to go through all the reasons why we should postpone this little controversy until after the war. I would just like to call the attention of the members of this committee to one fact, and that is that anytime the Congress changes this oleomargarine tax and opens up the floodgate for oleomargarine, that its handmaiden known as filled milk will be the next thing we will have to face.

This product is based on the same principle of extracting the butterfat, evaporating the skim milk, adding the vegetable fat, and then selling it on the market at the present time for as much as the natural evaporated milk would sell for. This little can here [indicating] costs 9 cents on the retailer's shelf, and last Saturday I bought three cans of White House—normal evaporated—milk in the chain store, in Washington, for 26 cents, and that was the advertised price. So, I say, if we take the tax off of oleomargarine, we might just as well be ready to shake hands witth the fluid-milk people and evaporated milk people and say, "We are going to change the law which has been on the statute books for some 20 years and which our distinguished Senators took one of the leading roles in having it put on the statute books, because at that time it was demonstrated clearly that by putting in the vegetable fat it tends to produce rickets and the children suffer in

this country from it. So, this is the next step, if we remove the tax on oleomargarine, we will have the filled milk on the market and deceive the people of the United States.

Mr. ANDRESEN. Congressman Hull of Wisconsin is also here for a short statement.

Senator WALSH. Come forward, Congressman.

STATEMENT OF HON. MERLIN HULL, UNITED STATES REPRESENTATIVE FROM THE STATE OF WISCONSIN

Senator WALSH. Congressman, will you identify yourself for the record?

Mr. HULL. Representative of the Ninth District of Wisconsin.

Mr. Chairman, I represent a dairy district in Wisconsin. I have not the time nor the opportunity to go into this important question to any length. I would say, however, that the six Northwestern dairy States produce about 45 percent of all the butter in this country. about 1,000,000 goes into butter and the rest for various other purposes.

We have been fighting this oleomargarine fight there for 60 years or more. We realize our butter section—and I am from a butter-producing section—cannot face oleo competition if the tax is taken off the colored oleomargarine and the oleomargarine companies are permitted to go into the market and sell their product as butter. We had many instances before we commenced the enactment of antioleomargarine laws of frauds committed by the companies which then operated. Of late years Wisconsin has practically barred the sale of oleomargarine. I think there are some 30 States that have similar laws. Some 11 States of the Union have laws against the sale of oleomargarine which is made in part of foreign oils or imported oils. If it is made of domestic oils, the tax does not apply.

I want to call attention to another matter in the short time that I speak, and that is that only a few months ago this committee had before it a bill to take off the revenue tax on imported copra or coconut oil. The purpose was to permit the importation of about 200,000,000 pounds of coconut oil, which was in the hands of a syndicate, and which could be imported into this country. The argument made by the vegetable-oil interest at that time before this committee was that the Government needed that extra 200,000,000 pounds of copra or coconut oil in order to obtain glycerin for our ammunition plants. It was stated at that time that the coconut oil would yield about 12 to 13 percent of glycerin, while vegetable oil such as cottonseed or soybean oil, possibly linseed oil, would yield only about 7 percent. So we permitted the importation of that product without the excise tax and made a gift to certain soap companies of approximately $2,000,000 on that importation.

Now then, just recently there has been a statement issued from the administrative bureaus here calling for the saving of 200,000,000 pounds of kitchen fats in order to supply glycerin to the ammunition plants. At that percentage, it was mentioned in the hearings here that would be approximately 14,000,000 pounds of glycerin. There is being used in the manufacture of oleomargarine approximately 300,000,000 to 400,000,000 pounds of vegetable oils. That apportionment of vegetable oils is now made by the War Food Administration. Probably it will not be increased whether or not this bill passes, but the amount

of vegetable oils now being used for oleomargarine, at the ratio stated at the hearings before this committee, would include about 21,000,000 pounds of glycerin which the Government needs for military purposes now being diverted to the oleomargarine trade, where it is more profitable.

I haven't time to go any further, but I want to say that we in Wisconsin, Minnesota, Iowa, Nebraska, and the two Dakotas, and out into Montana, are strongly opposed to tinkering with the oleomargarine-tax laws at this time. We hope the committee will not give this amendment consideration. We hope the matter may at least go over until after the war, and then we shall continue the 50-year fight to keep the tax on.

Senator WALSH. Does this close the hearing on this subject?

Mr. ANDRESEN. That is all.

Senator WALSH. The hearing on this subject is closed.

The committee will hear the witnesses on the renegotiation provision of the House bill.

Will those witnesses who are appearing on renegotiation come forward and sit in these seats near the desk?

The members of the committee will find on their desks a pamphlet entitled "Comparison of the Renegotiation Act before and after its amendment by the revenue bill of 1943 as passed by the House of Representatives," by Mr. Stam and his staff.

The Under Secretary of War.

STATEMENT OF ROBERT P. PATTERSON, UNDER SECRETARY OF WAR

Senator WALSH. You may go forward, sir.

Mr. PATTERSON. Mr. Chairman and gentlemen, I have asked for the privilege of appearing before you to direct attention to some provisions of title VII of this bill which, in the opinion of the War Department, will require revision if the price adjustment law is to be operated to best advantage. Before comment on those provisions, I should like to submit some general conclusions about price adjustment.

With more than 3 years of experience in purchasing munitions and supplies for the Army, I am convinced:

First, there was need for legislation in 1942 to bring about a downward adjustment of prices in war contracts made by the War Department—this as a check against enormous profits being made by many war contractors.

Second, the abnormal conditions still prevalent make it necessary to continue such legislation.

Third, the administration of price adjustment by the War Department has been fair and reasonable, and in that connection there is still an incentive to contractors to reduce their costs of production.

Fourth, war production has not been delayed or impeded by price adjustment.

Fifth, there is no merit in the suggestion frequently made that in adjusting prices the War Department should look only at the profits remaining to the contractor after taxes, or in the suggestion that account should be taken of reserves for post-war reconversion.

Senator WALSH. In general, Mr. Secretary, are the changes made in the House bill satisfactory to the War Department?

Mr. PATTERSON. Yes, sir; except as to certain administrative features. In April 1942, when Congress passed the first price adjustment statute, everyone recognized the necessity for some measure which would protect the Government as far as possible against profiteering. The disclosures of enormous profits being made by some contractors made legislative action imperative. The War Department was conscious of the fact that it could not prevent excessive profits even by the most careful purchasing that was possible. There was an absence of normal competitive conditions. There was also a lack of information on which to base reliable forecasts as to production costs, because the items to be made were new and because the results of mass production were unknown. These factors made sound pricing in advance of production virtually impossible. Prices were simply too high, and profits of contractors too large. An adjustment of prices in the light of actual cost experience seemed to offer the fairest and most practicable method of meeting this problem. At the same time, the size of the task involved in administration of this law was formidable.

Eighteen months of experience with this law have convinced me that it was and is necessary wartime legislation. The law has been a safeguard not only to the interests of the Government but also to the legitimate interests of industry. American industry as a whole does not want to come out of this war with the label of profiteer fastened to it. Had the price adjustment law not been available, I am convinced that other measures would necessarily have been taken which might have been harmful to war production.

Price adjustment operations to date have resulted in saving the Government $5,300,000,000—$2,500,000,000 in case which the procuring agencies have recovered or will recover, under agreements arrived at for delivery to the Treasury Department, and $2,800,000,000 in reductions in prices for future deliveries under existing contracts. That is a notable achievement.

Senator VANDENBERG. Mr. Secretary, what is your comment on the oft-repeated statement that 80 percent of that $5,000,000,000 would have been recovered anyway by the excess profits?

Mr. PATTERSON. I think 72 percent would have been recovered or might have been recovered. I think there is a minimum there of 28 percent that could not have been recovered. I think I will comment on that in a few moments.

At the same time contractors have been left with profits that are fair and reasonable. It should be said to the credit of industry that in most cases these savings to the Government have come about by voluntary agreements between Government and contractors. We have found that the majority of contractors do not desire to retain excessive profits.

These figures I gave, of course, apply to all procurement departments, not only the War Department.

Senator WALSH. Would they all voluntarily return the excess profits had this law not been on the statute books?

Mr. PATTERSON. Not so many of them, but some would. In fact we were making arrangements at the time of the passage of the law on en entirely voluntary basis with some contractors, some large contractors, for returning some of the moneys that had been paid and for a reduction of forward prices.

Senator WALSH. Was there any money returned before this law was enacted?

Mr. PATTERSON. We had a case pending just about that time, I remember, with Continental Motors. Whether that had been consummated before the passage of the law or after I am not sure. General Clay thinks it was before, but I am not sure of that. It was very evident that the price paid to that contractor was too high, and the contractor admitted it.

Senator VANDENBERG. Do you think it is a fair statement to say that these agreements are all voluntary agreements?

Mr. PATTERSON. I know the charges that are made in that connection, Senator. I think in the main they are voluntary. I certainly have never swung a big stick on any of them.

Senator WALSH. They know, of course, that they were going to be renegotiated.

Mr. PATTERSON. It is charged, of course, by few that we would not have gotten it unless we had been in an advantageous position.

Senator GUFFEY. Judge, don't you think some of the members of your local committees or on the final appeals board threaten some of these people?

Mr. PATTERSON. No, sir.

Senator GUFFEY. I can give you an instance in the Budd Co. of Philadelphia. Mr. Peterson said in that committee, in the presence of four of us, if Mr. Budd did not accept it, he would break them. If that is a voluntary contribution, I do not know what a voluntary contribution is.

Mr. PATTERSON. I question whether that has been accurately reported, Senator.

Senator GUFFEY. Four of us were there. I heard the man say it.

Mr. PATTERSON. In any event, Mr. Budd came down and we had a hearing in my office. He certainly would not say, in the finality of it, that any such threat or intimation was given to him. Most of these concerns we want to continue to do business with, we have to continue to do business with. They are valuable sources of production to us. We could not break it off, and do not want to.

Senator GUFFEY. You did sustain, though, the findings of the committee on the Budd Co. matter when they came to you, did you not, Judge?

Mr. PATTERSON. Yes, I did.

Senator GUFFEY. That is all I wanted to hear.

Senator VANDENBERG. What would happen to a contractor if he did not accept one of these voluntary agreements?

Mr. PATTERSON. We would pass what we call a unilateral order advising him that we had found that his prices were too high and his profits were too much by such and such an amount and we would withhold that out of amounts due him in the future or take all necessary measures for collection. That is what we would do. We normally would not be in any position, Senator, to threaten him, that we would cut off all future business with him on any reasonable basis, because we need his production and his services.

Senator VANDENBERG. You do not think there is any duress in that unilateral sentence that you just stated?

Mr. PATTERSON. Well, it is unilateral. He did not consent to it, but that is the authority, I think, given us under the act. The real thing in all of these cases I think is how did the contractor come out. What was he left with? Did we pare him down to a degree that he

did not have a fair profit left? Now, I have heard many charges made that we did pare them down that way and they had nothing left, we took their shirts and all that kind of thing, and yet in every case that has come to my notice—a good many of them, too—it seemed to me very clear that the contractor had no real complaint that he was left with earnings far in excess of what he had made before in base years in the 1930's, and that he made earnings on his net worth, good earnings, and that the contract as revised was eminently fair to him.

Now, we had quite a number of cases on this very measure in the House Ways and Means Committee, and the facts of the cases, as portrayed by some contractors disturbed the members of that committee, and we put to them the entire facts of each case, boiled down, and so far as I know not a single member of that committee, after that was done, had any question at all about the fairness of the result of those proceedings. Nothing further was said after the whole facts were developed.

Senator WALSH. Was that in executive session, or is that in the record?

Mr. PATTERSON. That was a confidential print, Mr. Chairman. I will be glad to leave copies of it with you. That was a paper that I submitted to the House Ways and Means Committee.

Senator WALSH. I suggest that the members be given copies.

Mr. PATTERSON. That was a paper that we submitted to the House Ways and Means Committee on the fact of the cases, on each one of these executives and contractors that testified that they had been given a raw deal.

Senator WALSH. Was that a report on every case that was presented in the nature of a complaint to the Ways and Means Committee?

Mr. PATTERSON. Yes, sir; that is right.

Senator LUCAS. May I ask one question?

Senator WALSH. Very well.

Senator LUCAS. Assuming a contractor disagreed with the decision of the War Department, what is his remedy?

Mr. PATTERSON. I have always conceived that he had the right to take the case to the Court of Claims on a showing that the action of the War Department was arbitrary, unfair, unreasonable, just as he would have a right to do that on a decision by the Secretary of War in the interpretation of a contract. Those cases are familiar cases. Now, that is not expressly provided for under the present statute, but I have always assumed that that right existed. As I said, I had no objection to its being written expressly into the law.

Senator BYRD. None of these cases have been taken to the Court of Claims as yet, have they?

Mr. PATTERSON. Not to the Court of Claims, that I know of. I think there is some litigation pending in one of the district courts involving the Navy. I do not know of any involving the Army.

Senator BYRD. Would you have objection to permitting them to take an appeal to the Court of Claims?

Mr. PATTERSON. I would welcome it, provided we could do it in a way that would not overtax our administration of the Act, and I think that can be done. We have no desire here to have the last word or any arbitrary power in this matter. I think under proper conditions, that would assure a fair review by a court; it would be a good thing to give an express court remedy.

Senator VANDENBERG. That protest would not prejudice the contractor's chance to get another contract?

Mr. PATTERSON. No, Senator. The only thing we would do on a future contract would be this: If the source of production was limited, as it is on many munitions of war, of course we would need his facilities and we would be anxious to enter into a renewal of the contract with him on fair terms. If we had one of the other cases where, we will say, there are more sources of production than you need, then of course in making a new contract for a quantity of those supplies we would place that contract where we could get the most reasonable price. Now, if this very man with whom we had the controversy had the most reasonable price and quoted us a figure lower than anybody else, I am sure he would get the business, but if his figure was higher he would not.

Senator VANDENBERG. How big an organization is it across the country, in numbers, that has the power of decision in respect to these matters?

Mr. PATTERSON. Well, we have, I think, five agencies, and it differs with the agencies. We have the Jesse Jones companies, the Procurement Division of the Treasury Department, the Maritime Commission and the Navy, in addition to the War Department. I think all of those organizations are centralized in Washington except the Navy may have a few outside, a few subagencies around the country.

In the War Department the volume of work made it necessary for us to organize regionally, and our first organization is the top board here in Washington. Under that we have the different technical services like the Ordnance Department, the Quartermaster, and so on, each of which have their own price-adjustment section, and then they have price-adjustment sections in each of their procurement offices—14, for example, in the Ordnance Department—in Detroit, Chicago, Cleveland, and so forth. Those field agencies, if you might call them field agencies, have authority to make final agreements, to adjust agreements, voluntary agreements, with concerns in cases where the contractor's annual volume of business with us is under $10,000,000 a year. In cases above that they report here to Washington for a review. That, in general, is the administrative lay-out under the Act.

Senator VANDENBERG. Are you under any difficulty in getting adequately experienced business personnel to handle the rather large responsibility?

Mr. PATTERSON. We have built up an organization over the last year and a half that is quite efficient. We submitted to the House Ways and Means Committee a summary of the experience of those men and that submission to the House Ways and Means Committee appears on pages 901 and following of the House hearings on renegotiation of war contracts. It starts here and goes right down into the districts; it tells who the people are, what their background has been. I might say, in general, that they have a wide and varied commercial and industrial background. A great many of them have been engineers in industry and commerce. There are some lawyers and accountants. They are not schoolboys and they are not crackpots. They have had a thorough background in industrial matters, commercial matters, and I believe are thoroughly qualified. I am going to speak in a few moments here of the commendations on the personnel not only in the War Department but in the other agencies engaged in price renegotiation work, commendations made by the Truman committee that made a thorough inquiry

into this business last spring, and by the House Naval Affairs Committee that last summer went very carefully and thoroughly into the whole organization on this work and commented upon the high caliber of people that the Government had enlisted for the discharging of this very important work.

Senator GUFFEY. Judge, may I ask one more question?

Mr. PATTERSON. Surely.

Senator GUFFEY. What would happen to the payment due the contractor if he filed an appeal to the Court of Claims? Would they be held pending final decision or be paid in part?

Mr. PATTERSON. We would try to collect, and then, if he won the appeal, he would get it back.

Senator GUFFEY. Suppose a man had $1,200,000 that was in dispute? Suppose he paid back $9,700,000 that was not in dispute, you would hold that that is all right, but what would happen to the other $1,200,000? Would he have to wait to get that until the whole thing was decided?

Mr. PATTERSON. As I understand it, he would get his payments except the payment due him that we had decided we had a fair claim for. Those would be withheld. He could go to court, and if the court held that we had gone too far in the matter, he would get the money back. I think what you mean is: Is everything stayed or enjoined?

Senator GUFFEY. That is right.

Mr. PATTERSON. While he is seeking the court remedy?

Senator GUFFEY. Yes.

Mr. PATTERSON. No, it is not. Like any other lawsuit, he would try to get some money out of the defendant.

Senator GUFFEY. You would withhold all payments, would you not, on his contract?

Mr. PATTERSON. Not all payments, Senator, but the ones in dispute.

Senator LUCAS. Whatever the War Department thought was due and owing the man is unchanged, the War Department would pay that amount, and then the controversy on the balance would go into court?

Mr. PATTERSON. Yes. There would be no sense in our holding any more, unless we wanted to punish someone, and that is not our policy.

Senator GUFFEY. I am glad you said that. It was not clear to the members of the committee. However, in this case that I mentioned of the Budd Co., he certainly said he would break the company. He made that statement in the presence of three witnesses and myself. What I am trying to find out, if he goes to a court what will happen to the payment that your committee has withheld from him? What would happen to the 1.1 percent of the manufacturer's profits?

Mr. PATTERSON. If you send me a letter with the name of the man in our organization who threatened to break anybody I will follow the matter up.

Senator GUFFEY. I will give you the name and the four witnesses, too. I will send it to you tomorrow.

Mr. PATTERSON. Yes, sir; I would like to have it. That is contrary to policy, of course.

Senator WALSH. Mr. Secretary, we have anticipated a great many of these questions. Perhaps we might save time if you proceed with your statement, subject to a limited number of questions.

Mr. PATTERSON. Yes, sir. I come now to the question I think that Senator Vandenberg raised.

A large part of the 5.3 billion dollars would have come to the Treasury on excess-profits taxes if there had been no price-adjustment law. But by no means all. At the very least, 1.5 billion dollars have been saved that would not have been touched by taxes.

There are two contentions that have been made before this committee and elsewhere which I would like to discuss in greater detail. The first contention is that the powers conferred by the price adjustment law have been exercised in an arbitrary and unfair fashion. The second is that the need for this legislation no longer exists. I take it both of those are live questions.

ADMINISTRATION OF THE STATUTE

The charge that this statute has been administered in a manner unfair to contractors is a charge that cannot be sustained. It is true that the statute confers an extraordinary power, a power which could only be justified by war conditions. The War Department has fully recognized the extent of the power placed in its hands and has taken every precaution to make sure that it would be exercised fairly. I believe that it has been so exercised and that any investigation would establish that fact.

At this point I quote from the report made by the Committee on Naval Affairs of the House of Representatives, dated October 7, 1943. As you know, that committee made a most thorough investigation of the administration of the price adjustment statute, and their conclusions are, I submit, entitled to great weight. The majority report contains the following statement:

> It would be unfair to the price adjustment boards not to refer to the fact that, without exception, every business executive who appeared before the committee whose companies had been renegotiated had nothing but praise for the fair and equitable treatment which they had received from the price adjustment boards. They had no quarrel with the boards as such, or with their members; such complaints as they had were directed to provisions of the law which particular contractors deemed unfair or inequitable. We, too, were impressed by the members of the boards who appeared before us, by the sense of fairness and the feeling of responsibility to both the public and indust which they exhibited, and by the careful reasoning upon which their judgments apparently rested.

A minority report was also filed which contained the following statement:

> No representative of industry who appeared before the committee had any criticisms to offer with respect to the personnel of the various price adjustment boards, or to the manner in which they had handled any of the actual conferences with the contractors. It appears that the personnel of the price adjustment boards have performed a difficult task in a highly exemplary manner. For this performance of duty high praise is deserved.

Naturally there are many contractors who resent any effective control over their prices or profits. Some of them have recently been accusing the War Department of arbitrary treatment. Before the Naval Affairs Committee, I said that I would be glad to present the facts in any case in which the conduct of the War Department has been

questioned and to let the committee judge whether or not that conduct had been fair. In fulfillment of that undertaking I should like now to give you the facts in the case of the Timken Detroit Axle Co., about which Mr. Rockwell testified here last Thursday.

I have some discussion here about years, and in order that there should be no confusion about these years, I should say this company, down until 1940, had a fiscal year corresponding to the calendar year, and since 1940 the fiscal year has been the year ending June 30, So, if I mention 1942 here, I mean the fiscal year ending June 30, 1942, but for the period prior to 1940 it is the calendar year. I do not think there is any confusion from that standpoint.

Senator WALSH. He insisted that you misrepresented the amount of dividends his company paid in a given year.

Mr. PATTERSON. That is right.

Senator WALSH. That is the reason you just stated there may have been a misunderstanding?

Mr. PATTERSON. Yes; there was a mistake made in that way in the letter which I wrote Mr. Rockwell after the decision had been made, but it had no bearing at all on the decision, Senator.

During the years of 1936 to 1939 the Timken Detroit Axle Co. realized average annual profits of $2,116,000 before Federal taxes—and that means the fiscal year ending June 30, 1942. That represented 10½ percent on its average net sales. In the year 1942 the company's profits, before Federal taxes and renegotiation, amounted to $39,839,000. The profits on renegotiable business alone amounted to $16,572,000, before renegotiation and before taxes. That represented a percentage of profit on net sales of 33⅓ percent.

Senator WALSH. That is sales to the Government?

Mr. PATTERSON. That is renegotiable business.

Disregarding entirely business not subject to renegotiation, much of which was war production business completed prior to April 28, 1942 and thus not subject to the statute, we find that Timken was making three times the rate of profit which it had made in the base years, on two and one-half times the volume of business.

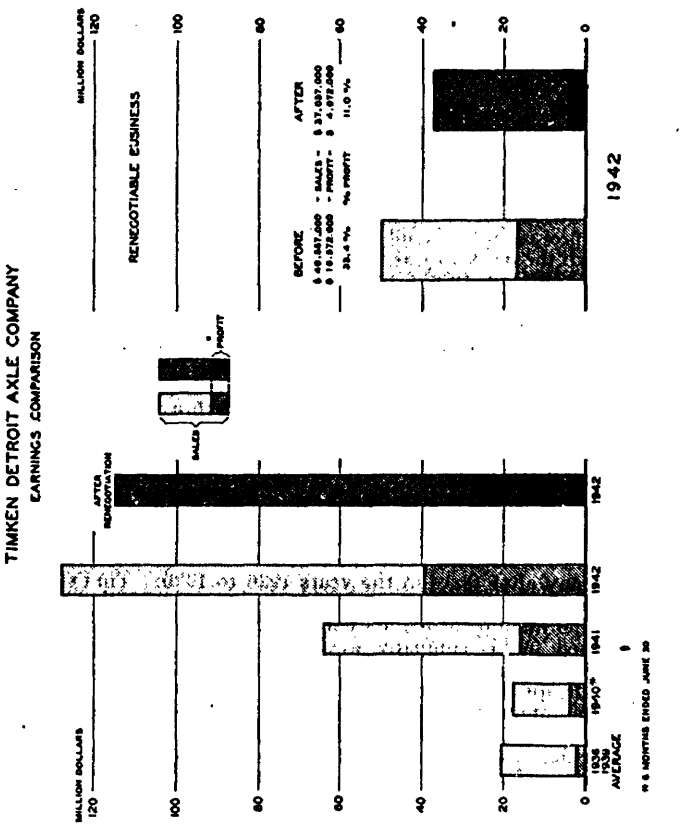
After renegotiation, Timken's profits on its renegotiable business were $4,072,000. This represents 11 percent on the adjusted net sales of approximately $37,000,000. That dollar profit is almost double the average dollar profit earned by Timken in the base years.

Those are the figures on which I based my conclusion that the War Department Board had been entirely reasonable in its handling of this case. For that reason I approved the Board's decision.

In the light of Mr. Rockwell's statement that he has been compelled to reduce his company's dividends because of renegotiation, I think that I should also call your attention to the total net profit of the company for the fiscal year 1942 after renegotiation and after taxes. That profit is $5,070,000—more than two and one-half times the average of the normal years after taxes and 32.4 percent of the total book net worth of the company.

I think those facts alone right on their face prove there was no rough business of any kind in the result of the renegotiation that we conducted with the Timken-Detroit Axle Co., and his company was left with a liberal sum for profits, whether measured on total sales volume or on invested net worth, either way you take it.

(The following chart was submitted for the record:)



Senator VANDENBERG. To complete the record, are the figures available as to the relative volume of business upon which this profit comparison is made?

Mr. PATTERSON. Yes, Senator; we have a work sheet that shows the whole thing [indicating].

Senator VANDENBERG. Thank you.

Senator LUCAS. How much did Rockwell claim was due and owing him?

Mr. PATTERSON. Beg pardon?

Senator LUCAS. How much did Rockwell claim his profit should be in 1942 after renegotiation?

Mr. PATTERSON. As I understand it, the controversy between him and the War Department was this: The local section out there in

Detroit recommended a refund of $10,000,000 for 1942. He made no complaint about that. That figure down in Washington here, by the Price Adjustment Board, was raised to $12.5 million dollars, and that was his grievance.

Senator WALSH. I think that is what he stated it to be.

Mr. PATTERSON. I think so.

In his testimony here, Mr. Rockwell made two points. First, he said that my decision was based on mistaken information furnished by the Board relating to the dividends paid by the company and the salaries paid to officers. It is true that such information was contained in a letter which I wrote to Mr. Rockwell, in reply to a letter from him written after he had been advised of my determination of excessive profits, but it is not true that this information was the basis upon which the decision was reached.

On the contrary, to the best of my recollection, the question of dividends and salaries was not brought up during the renegotiation. It certainly was not brought up during the part of it that I was in personal attendance on.

Now that such a commotion has been made of the matter, it seems proper to point out that during the years 1936 to 1939 the Timken Detroit Axle Co. paid common dividends which averaged $1,477,000 a year. In 1942 those dividends amounted to $4,216,000, nearly three times the average of the base years. In fact, the amount in dollars, $4,216,000, is more than half as much as was paid to the company's stockholders in the whole 10 years ended December 31, 1939. Even more significant is the fact that the dividends paid by the company during the year 1942 that is the fiscal year again amounted to more than twice the amount of the average earnings of the company after taxes in the years 1936 to 1939. That's average annual earnings.

The other main point made by Mr. Rockwell was that the percentage allowed to his company was less than that allowed to High Standard Manufacturing Co. I think the committee will readily see that the question cannot be measured by percentages. I shall be glad, if the committee so desires, to place the facts with regard to the High Standard case in this record. I believe that the committee will recognize that the dollar profit allowed to High Standard in the light of its performance was not unreasonable and that there is no discrimination of which Timken is entitled to complain.

No one in the War Department has ever denied the substantial contribution to war production made by Timken. In fact, at the hearing in my office I specifically mentioned it as being noteworthy. On the other hand, in comparing its contribution with that made by other companies, it should be remembered that Mr. Rockwell's company was working on substantially the same products as in former years; that it did not have to convert its peacetime plant for the manufacture of a product unfamiliar to it, and that its manufacturing processes and problems were thus less complex than those of many others engaged in war production.

Finally, I should take note of the remarks which Mr. Rockwell made about the personnel engaged in renegotiation and in the manner which his case was handled. I have said that I take pride in the men who have been engaged in this work, and I have no reason now to modify that statement.

In this connection, I can properly quote the statement of the Truman committee in the report which they filed on March 30, 1943, that the administration of the renegotiation law had been characterized by the—

assembly in Government of an unusual group of able, conscientious, and patriotic lawyers, accountants, and businessmen as administrators of renegotiation.

I might also refer to the qualifications and experience of the men engaged in this work for the War Department. Their backgrounds are set forth in detail in a statement that appears on pages 901 and following of the House Ways and Means report.

That is this paper I referred to a few moments ago. It goes in quite detail into the background of these men here in Washington and out in the field, and I will be very glad indeed to have their work judged on the basis of their experience and background. There are people out in the Detroit district that are men of comparable business with that of Mr. Rockwell, both as to the Army Air Forces force out there and as to the Ordnance Department force out there. I think that the personnel engaged in this work is of the very highest caliber that we could recruit.

So I say that the records show that the case was handled in a fair manner. It is true that the renegotiation covered a long period. This was due to a number of factors, including the time required for the closing of the company's books and for careful consideration of all aspects of the company's operation. Some seven meetings were held with company officials prior to the meeting in my office. Every contention of the company was carefully considered, and all the data and statements of the company were carefully reviewed before final conclusion was reached.

I believe that the statement which I have made will satisfy you that the War Department, in this case, did not act in an arbitrary or unfair way. I wish I had time to go into every other case which may have been brought to the attention of any member of this committee. I think that I could satisfy them that there has been no unfair treatment in any of those cases.

Senator BYRD. Judge, may I ask about the composition of this board in Washington? It is composed of representatives of the Army and Navy and what other agencies?

Mr. PATTERSON. I think you refer, Senator Byrd, to the joint board?

Senator BYRD. Yes.

Mr. PATTERSON. There is a joint board with respesentatives of each of the five agencies on it, and also a representative of the War Production Board. That is to say, Mr. Jones has a representative, the War Department has one, Mr. Forrestal has one, the Treasury Department has one, and the Maritime Commission has one.

Senator BYRD. That is the final board?

Mr. PATTERSON. That is the final board. They only lay down programs, policies, principles, and interpretations to try to keep the treatment of contractors alike no matter which agency they may come before. That final joint board, that has been set up about, I believe, 3 months ago, does not have particular cases come before it. That board is not described in this report that I just referred to. We have one man on that board, that is, Mr. Joseph Dodge. In fact, he is chairman of the joint board.

Senator BYRD, This board establishes the regulations?

Mr. PATTERSON. Yes, sir. It is supposed to keep the different agencies in step with one another.

Senator BYRD. What is the final board that passes on specific contract?

Mr. PATTERSON. In the War Department it is called the War Department Price Adjustment Board, and the chairman of that is Mr. Dodge.

Senator BYRD. The action of that board is final?

Mr. PATTERSON. No; it comes to me.

Senator BYRD. You have the final say?

Mr. PATTERSON. In any impasse case where they cannot agree they have the right to carry it to me, and they have done so in a number of cases. If there is a bilateral agreement made voluntarily, the action of that board is final.

Senator BYRD. Can the contractor take it to you as a matter of right?

Mr. PATTERSON. Yes, sir. I heard them for quite a number of times, myself, and then they got to be kind of frequent for a while, and I asked Mr. Amberg in my office to hear those matters. They are heard either by him or by me at the present time.

Senator BYRD. The same procedure exists in the Navy Department?

Mr. PATTERSON. I believe so. I am not sure of that. In the War Department, if I have time I do it myself.

Senator WALSH. Mr. Forrestal is not here. He will be here this afternoon.

Senator BYRD. I would like just a little further information about the authority of this other board that represents these different departments. Does the Ways and Means Committee bill make any changes in it?

Mr. PATTERSON. Yes, sir. It proposed that it be the final administrative board to review cases, to personally review cases. We do not believe that that is a change that should be made.

Senator BYRD. This is a board known as the War Contracts Price Adjustment Board?

Mr. PATTERSON. Yes, sir. What we call the joint board.

Senator BYRD. The bill passed by the House provides that that Board can be a board of appeals?

Mr. PATTERSON. Yes, sir.

Senator BYRD. You do not think that is wise?

Mr. PATTERSON. We do not. Take the War Department alone, I suppose our procedure is the most complex, because it has the biggest volume of business. We have about 60 percent of the whole load. Take a case in Detroit, it is heard there first and initiated by the Detroit Ordnance Department Board, if it is an Ordnance Department case. Then, it comes down to the office of the Chief of Ordnance here in Washington; then, it goes to the War Department Price Adjustment Board. I am speaking of cases of a serious character where there are some disputed points, and the contractor does not think the local people out in Detroit have understood it. Then, it comes to me, if he wants to do it. Now, there are four stages. I think that ought to suffice, so far as administration is concerned. If he wants a court review, that is something else. I think if you had a fifth one up on top of that, we are just going to have too long a delay, and I do not think fair treatment of contractors requires that additional step.

It would also require a thing that they do not have now, that is a large administrative staff, upon that joint board. That joint board is a consultative body now. It just lays down uniformity. That is a very valuable thing to do.

Senator LA FOLLETTE. In effect, Judge, would it not mean in the last analysis you would have to duplicate the organization that you now have in the agency, to put the final determination up to this joint board?

Mr. PATTERSON. I am afraid so.

Senator LA FOLLETTE. You would not, really, in any substantial degree, alter the ultimate decision, so far as the administrative agencies are concerned, because it has to be assumed, has it not, that much of the same personnel will be drafted and put up on this final board?

Mr. PATTERSON. That might be the result. There is one other phase of the thing that is apt to cause confusion, I think, if the final top joint board is given authority to review specific cases, and that is this: At the present time in a case part of the job is to recover some money paid, but an equally important part of the job is to reduce the prices, if that is indicated, on forward deliveries under contracts in existence. It may be on the purchase of a machine gun the original contract called for $300 a gun, and as the result of renegotiation it developed that the contract price ought to be reduced to $250 a gun. Now, that part of the work on renegotiation comes very close to the pricing functions of the people engaged in procurement, and that part has to be carried out by me or the people in the purchasing division of the Army Service Forces. I think it is valuable to concentrate final authority, so fer as the administrative agency is concerned, in a body like the War Department Price Adjustment Board that can effectively carry out both of those matters.

Now, if you have the joint board up on top, not in the War Department at all, with power to review cases, it may be that that could be worked out, but it offers difficulties.

Senator GERRY. Mr. Secretary, if the cases were referred to the joint board would that make for greater uniformity of decisions between the different departments on these variety of cases?

Mr. PATTERSON. I think there is good uniformity now. I doubt if the vesting of power to review cases in that board would result in any greater uniformity than now prevails.

Senator GERRY. Would you rather leave it to the Court of Claims on disputed cases?

Mr. PATTERSON. Yes, sir.

Senator GERRY. That is not in the present act, is it?

Mr. PATTERSON. They have The Tax Court named as the final court of review. In other words, the bill as it comes from the House provides two reviewing bodies in addition to those that now exist under our regular practice. You would have that final joint board with administrative review, and then you would have The Tax Court as a court of review. I am not opposed to a court of review.

Senator WALSH. Mr. Secretary, in the House bill the language makes it possible, does it not, for an appeal to be made to the tax board in every case that has already been adjusted, even voluntarily adjusted?

Mr. PATTERSON. Yes; it does. That is another measure in the House bill that, from our point of view, at any rate, we prefer to see eliminated.

Senator LUCAS. Mr. Secretary, how many agencies have the power to renegotiate contracts?

Mr. PATTERSON. Five, provided you rolled two or three of Jesse Jones' companies up into one.

Senator LUCAS. Has there been any complaint at all on the lack of uniformity in the renegotiation of contracts?

Mr. PATTERSON. I know of none, but I will say at the same time, that at one time last winter when the Truman committee was investigating renegotiation, I think there was a thought that the Army and Navy did not handle the thing alike, or did not view the thing entirely alike. Since that time we have, I believe, arrived at a common ground on all points with the Navy, and I have not heard any such criticism made. I would say, "No; I know of no such criticism," but I think, in all fairness, I have got to direct your attention to some comments that were made last winter by the Truman committee. I am not sure it appears in their final report, but there was some talk about that—I recall that.

Senator GERRY. Mr. Secretary, I understand your testimony to be you prefer it to go to a court rather than the Tax Bureau?

Mr. PATTERSON. Yes, sir.

Senator GERRY. The Tax Bureau is no court at all.

Mr. PATTERSON. I believe that the Treasury Department and the Department of Justice do not relish appeals going to The Tax Court. They know, however, more about that than I do, and I go along with them.

Senator WALSH. There is a representative of the Department of Justice here who will present their view to the committee. You may proceed, Mr. Secretary.

Senator HATCH. It happened I was on the subcommittee that considered this matter before the Truman committee. We did have complaint about lack of uniformity to the extent that we did recommend that a single price adjustment board be created.

Mr. PATTERSON. Yes.

Senator WALSH. Proceed, Mr. Secretary.

Mr. PATTERSON. It was, of course, I think, due to your recommendation, Senator Hatch, that we set up our joint board. Now, whether that has enough powers or not is another matter. The report has been set up since the report of the Truman committee.

Senator HATCH. That is correct.

Senator WALSH. Proceed, Mr. Secretary.

Mr. PATTERSON. The need for the statute still exists. I now come to the second general point which I would like to discuss. That is the contention, repeatedly made, that there is no longer any need for this statute. Most of those who advance this contention concede that the statute should remain applicable to profits during the fiscal year 1943. Considerations of elementary fairness seem to require this. Under existing law prices on many current contracts have been adjusted downward in cases of those contractors who have concluded renegotiation. In addition, such contractors have in many instances accepted new contracts at substantially lower prices. The elimination of the statute would result in substantial discrimination against such contractors, in comparison with those who have not had their contract

prices reduced or who have received new contracts at relatively higher prices than those granted to their competitors with whom renegotiation proceedings have been completed.

On the other hand, it is contended that the statute should be cut off at the end of the fiscal year 1943. I do not believe that such a limitation would be wise. The exigencies of war still call for changes of design and for production of new and experimental items. There are still many contracts in which costs are uncertain. Furthermore, many contracts call for performance over a long period of time, and contractors are apprehensive of a rise in the price level. The volume of commitments that many contractors are being asked to take in relation to their working capital is another factor which tends to increase their fears. In consequence, there are strong incentives for contractors to load their prices against contingencies, to guard against contingencies, to guard against the risks which have been outlined.

The War Department is making every effort to eliminate such contingencies from contract prices. Substantial results in this direction have been achieved. We have developed contract forms designed to protect the contractor against such risks by providing for upward revision of contract prices under proper safeguards. That is, of course, revision in the course of performance. However, business cannot be induced overnight to rely on the power of the contracting officers to increase contract prices as its sole protection against future increases in labor and material costs. In spite of our best efforts, many of the fixed prices now being negotiated will include cushions against the risk of events which may never happen, with the inevitable result that the contracts will yield excessive profits.

If the apprehensions which I have expressed prove unfounded, it will be time enough later on to repeal the statute. The War Department is not anxious to keep the responsibility which this statute places upon us longer than necessary. As a matter of fact, every step which the War Department has taken has tended to keep the operation of the statute within practical bounds. In this connection, I should like to make reference to the exemption from renegotiation of those contractors whose total renegotiable business does not exceed $500,000 during a year. That is, renegotiable business. I realize, of course, that excessive profits can be made on a small volume of business as well as on a large volume. As a matter of fact, some studies have been made by the Price Adjustment Board which indicate that fact clearly, and if the committee desires them I shall be glad to place them in the record. On the other hand, I cannot believe that any great damage will be done to the country or to the prosecution of the war by the profits which will escape as a result of this amendment. That is, the raising of the limit from $100,000 a year to $500,000 a year. We recognize that it is physically impossible to prevent all excessive profits. Undoubtedly some companies as well as some individuals will emerge from this war with more profits than they deserve, no matter what efforts are made to prevent that from happening. In view of that fact, it would seem to be the wiser course to recognize the impossibility of preventing all excessive profits and to concentrate our efforts on the task which is limited in such a manner as to be possible of accomplishment.

Senator LUCAS. Mr. Secretary, right on that point, what percentage of the total business is less than $500,000?

Mr. PATTERSON. Not a very big proportion in dollar volume, but quite a good sized proportion in number of contractors. I believe it has been estimated, and it is our best guess, that if the limit is raised up to $500,000 a year, it will eliminate about 20 percent of our contractors. That is just in the number of concerns we do business with. It would be nothing like that in the dollar volume of business done.

Senator LUCAS. It would be very small?

Mr. PATTERSON. Yes, it would.

Senator LUCAS. It would eliminate a tremendous amount of administrative work?

Mr. PATTERSON. That was the entire reason that we asked for this amendment. We asked for it this last summer for that reason. It would enable us to concentrate our attention on the more important cases.

Senator WALSH. Can you give the committee the number of contracts that have been renegotiated where excess profits have been found and the number where excess profits have not been found, where there have been losses?

Mr. PATTERSON. I could find that. I haven't got that according to profits and losses, but I have the number of cases that have been settled. The figures I have show that some 13,000 cases have been cleared and settled; that some 5,800 are in progress at the present time.

Senator WALSH. Have excessive profits been found in all those 13,000?

Mr. PATTERSON. I could not say that, Senator. Those are the cases that were cleared. I do not have these broken down.

Mr. McIntosh advises me that about one-half of those 13,000 cases that have been settled were cleared and found to have no excessive profits.

Senator RADCLIFFE. Just how much has that amounted to in dollars and cents? I mean the reductions that resulted from the renegotiations?

Mr. PATTERSON. The total figure to date on savings to the Government by recoveries of cash and price reductions on existing contracts has been $5,377,963.

Senator RADCLIFFE. Will you make any estimate as to what that means in regard to future contracts, that scale that you have established?

Mr. PATTERSON. I am glad you brought that out. No one can say, but we believe at least that much again in reduction in prices on contracts made after renegotiation, on new contracts made. The price adjustment work has certainly resulted in a substantial reduction made by the procuring branches of the War Department in dealing with contractors for future deliveries on new contracts being negotiated with them. I think the savings to the Government in that connection, while it cannot be measured, might be just as much again.

Senator RADCLIFFE. It is likely to be an increasing amount?

Mr. PATTERSON. I do not know.

Senator RADCLIFFE. That would be the natural result you would obtain, would it not?

Mr. PATTERSON. That has been one of the valuable results in the price adjustment work, and that is not reflected in that figure.

Senator BAILEY. In regard to that 5½ billion dollars that you mentioned, how much would you recover by way of the excess-profits taxes as they stood?

Mr. PATTERSON. It is hard to figure it out, but as I said a while ago, of the $5,300,000,000 I believe that at least $1,500,000,000 would not have been touched by excess-profits taxes. How much more I could not say.

Senator LUCAS. Mr. Secretary, a witness by the name of James F. Lincoln appeared before this committee——

Mr. PATTERSON. Let me off, please, Senator Lucas, on that one. That is a Navy contract and they will handle that. I will take Brother Rockwell, but the Navy has got to take Brother Lincoln.

Senator WALSH. It has been suggested here, Mr. Secretary, that a distinction ought to be made in contracts that are the results of competitive bidding and other contracts. Will you discuss that sometime before you finish?

Mr. PATTERSON. I do not think it is in my statement, Senator. We do not believe any distinction should be made. If we are right in supposing that there is now a lack of ordinary competitive conditions due to the fact that the demands are many times greater than the supply, the Government does not get the protection of competitive bidding under public advertising that it would have received, say, in 1938 or 1939. For that reason we do not believe that any distinction should be made in the law between contracts arrived at from competitive bidding and contracts arrived at by less formal negotiations.

Senator JOHNSON. Judge, I have many complaints from contractors because of the uncertainty. They are not renegotiated yet and they anticipate being renegotiated—they do not know where they stand. Is that complaint justified? Is there that slowness and that uncertainty that is going to drag out over several years, that is going to cause a firm not to know where it stands?

Mr. PATTERSON. No. You wrote a statute of limitations on this a year ago, so it cannot be dragged out. He can demand renegotiation within a year after the closing of his books on any fiscal year. I cannot deny at all that there are no standards laid down in the act in cases that the Secretary may consider excessive. So there is a degree of uncertainty. You cannot just take 6 or 5 percent and calculate something else. I think that is inherent in the case. I cannot see any way of curing it. There is not the long continued uncertainty on account of the limitations laid down in the act, time limitations, but you cannot calculate it out with a yardstick, that is true.

Senator JOHNSON. I have another complaint from a small firm that had a loss of $40,000 because the contract was repeatedly changed by the Navy and they are unable to renegotiate and have that loss recovered. You do not renegotiate losses at all, or make any adjustment?

Mr. PATTERSON. Only in one case, and we did that not under the renegotiation law at all, but under the First War Powers Act where we anticipated underproduction.

Mr. Marbury reminds me if we make changes in the contracts of course we have to make adjustments in price on that. The case I mentioned was under the First War Powers Act as a matter of anticipated underproduction. That was for a critical item and we needed deliveries of it. In that case, we raised the price in order to carry out the contract and get the deliveries. That is the only case.

Senator JOHNSON. I have one other complaint, and that is your renegotiations are subject to renegotiations.

Mr. PATTERSON. No, sir.

Senator JOHNSON. That is not true?

Mr. PATTERSON. No, sir. We can make a final agreement on renegotiation that in the absence of fraud will not be upset. We cannot string the thing out. That would be utterly intolerable.

Senator HATCH. Mr. Chairman, there was one question I wanted to ask the Secretary in line with what Senator Johnson asks about the statute of limitations, because I think the committee ought to understand it.

I think we developed, Mr. Secretary, that under the statute of limitations that it exists that the only thing the Government would have to do would be to give notice of intention to renegotiate and that would stop the running of the statute of limitations and it might drag on several years after that as a matter of law. Is my memory correct on it?

Mr. PATTERSON. You mean administratively?

Senator HATCH. Yes.

Mr. PATTERSON. Yes; that would be possible.

Senator VANDENBERG. Mr. Secretary, in regard to the $1,500,000,000 which, in your opinion, could not have been caught by the excess-profits tax law, is that the failure of the excess-profits tax law or is it due to a failure in the staff.

Do you think it would be impossible to write an excess-profits law that would catch it all?

Mr. PATTERSON. It is possible, but I do not know how wise it would be to do it, I am not a tax expert. You could, of course, say 100 percent, but I think the renegotiation is a better policy.

Senator JOHNSON. The tax law would be general and renegotiations are specific. A tax law that would cover everything would hit everyone.

Mr. PATTERSON. Yes, sir. I have this in mind. Of course, the higher you raise the figure on excess-profits taxes, the more wasteful contractors are going to be. "What is the difference?", they will say. "Let's double everybody's salaries," they will say, or something like that; "the Government is going to get it anyway." We try, in renegotiation to leave an incentive to contractors to lower their costs of production. If a contractor has had a remarkable record or outstanding record, on lower cost production, an able management of his business, we try to take that into account in renegotiation and allow him to keep more than he would otherwise have kept as a profit. So there is that difference between the two instances.

Senator BARKLEY. What would be the relative element of justice and fairness between the present method by which you are recapturing a billion and a half that you could not recapture under present tax laws and the suggested 100 percent that would recapture that billion and a half and maybe a lot more that, in some cases, ought not to be recaptured? As between the two situations, which has the greater element of justice to all parties in the country?

Mr. PATTERSON. I think there is more justice and better economy in the price-adjustment system. I might say on the collection of that sum, whether you call it the gross $5,300,000,000, or, we will say, the net $1,500,000,000, the evidence shows they have done that at an estimated cost of administration of less than $5,000,000. My arithmetic may be faulty, but I think that is about 5 cents for $1,500, is it not?

Senator BARKLEY. I will take your word for it.

Mr. PATTERSON. I am trying mentally to cross out digits.

Senator MILLIKIN. Mr. Secretary, how many cases have you pending—or have been pending for more than a year?

Mr. PATTERSON. I do not think we have any.

Senator MILLIKIN. I mean when does the notice of negotiation come? How many of those notices have you out, in other words?

Mr. PATTERSON. We have it classified here, Mr. Senator. 13,000 cases settled; 5,800 in course of progress, and a total number of cases assigned of 20,000. That means assigned by the assignment body, which used to be in the War Department and is now under the joint board. There is no agency for renegotiation.

Senator WALSH. Are these all departments?

Mr. PATTERSON. All departments.

Senator MILLIKIN. Have you any statistics as to the times involved, when commenced, and how long pending?

Mr. PATTERSON. Those could be furnished, Senator. I do not have those in the paper before me.

Senator MILLIKIN. I thought Senator Johnson's point was very pertinent. What are the delays in this thing? How much uncertainty is there?

Mr. PATTERSON. I haven't any statistics to bear on that. Mr. McIntosh, who is the attorney for the War Department Price Adjustment Board would like to make a statement on that.

Mr. MCINTOSH. As the organization has been built up over a period of time, the rate of progress has increased, so at the present time somewhere in the neighborhood of 500 cases a week are being closed. According to the present schedule, substantially everything that was assigned for renegotiation that started before September 1 will be closed by the end of January at the latest. Most of it will be closed by the end of December. At the present rate of progress in all of the agencies, if it will be continued next year, we will be able to renegotiate most of the 1943 business by the summer of 1944. In other words, the pace has been accelerated as the organization has been built up, the numbers increased and the procedures standardized.

Senator MILLIKIN. I think it would be interesting to have some statistics on it.

Mr. MCINTOSH. We can very easily supply that.

Mr. PATTERSON. The apprehensions that we felt last winter, when the Truman committee were inquiring into our ability to swing the case load, have been very considerably eased. The case load is going upward with pretty good progress.

Senator MILLIKIN. I was very much interested in Senator Johnson's question about renegotiating excess profits but not renegotiating excess losses. Will you give us a little philosophy on that?

Mr. PATTERSON. I think I said, in answer to Senator Johnson's question, that there is a type of case where we adjust a price upward, where it is indicated that the contractor has not only suffered a loss but is going to go out of business as the result of that and where we need the product.

Senator MILLIKIN. The loss is just as necessary to be adjusted as any other type of case, is it not?

Mr. PATTERSON. No; I do not think it would be sound policy for the Government to guarantee everybody a profit.

Senator MILLIKIN. I think if you limit the profit there is quite a little argument on the point that you should limit the loss.

Mr. PATTERSON. Well, it is arguable, but I do not like it.

Senator VANDENBERG. Is there any doubt in your mind, Judge, about the constitutionality of this act?

Mr. PATTERSON. Certainly, nothing as to any transactions entered into after April 1942. I take it you mean the tougher question of contracts, say, made in 1940 and 1941?

Senator VANDENBERG. Yes.

Mr. PATTERSON. My opinion on that is not of any real value.

Senator VANDENBERG. It would be to me.

Mr. PATTERSON. I would have to study it.

Senator LUCAS. May I ask one question further?

Senator WALSH. Yes.

Senator LUCAS. Assuming the Congress continues the power of renegotiation, do you believe it is possible we might lay down a yardstick or standard that could be of any assistance?

Mr. PATTERSON. I doubt it.

Senator LUCAS. It might complicate it rather than help, is that your opinion?

Mr. PATTERSON. We discussed that a good deal more than a year ago; we discussed it with representatives of the Truman committee last winter. I have personally discussed it with Mr. Baruch about a year ago, asked his views on it, and it did not seem possible to lay down a yardstick. The cases all vary. We try to do justice and fairness in the individual case.

Senator MCKELLAR. Mr. Chairman.

Senator WALSH. Senator McKellar, would you like to ask a question?

Senator MCKELLAR. I would like to ask this question: That question was also discussed when the legislation was being heard before the Senate the first time; you will recall that there were several plans of making a percentage reduction, and the Department was very much opposed to it, they said they did not think it would be workable, it would do vast injustice, and the Senate committee finally agreed to that, and then this bill was substituted for that proposal. Do you recall that?

Mr. PATTERSON. Yes, Senator McKellar. I think this law took its inception first in a proposal that I think passed the House called the Case amendment, which would have limited all contractors to a fixed percentage of profit on volume of business and it was to be the same for all alike. We saw grave objections to such a system that would measure the profits for all contractors, no matter what their situation might be, no matter how difficult the item they were making, how long it took to perform a contract. One contractor can perform his contract in a month and another man take 2 years, and if you had a fixed percentage, the man who performed it in a month could make the same percentage by a very slight effort on his part as a concern that took as long as 2 years to make the item. There were many other objections, too, but my recollection is the same as Senator McKellar's on that.

Senator RADCLIFFE. Mr. Secretary, may I ask you a question?

Mr. PATTERSON. Yes.

Senator RADCLIFFE. It is my impression that the suggestion was made that one of the reasons why the renegotiation of contracts was desirable was because of the abnormality in production cost, and it was extremely difficult to forecast what they would be due to shifting conditions.

Mr. PATTERSON. Yes.

Senator RADCLIFFE. Do you consider that situation has changed in the direction of stabilization?

Mr. PATTERSON. I think it has changed in the direction of stabilization but not enough to warrant discontinuance of the law. Our contracting officer, when he negotiates a price for some piece of munitions with a contractor, he gets to talking price, he asks the contractor for an analysis of the figure he quotes, why he quotes that figure to him, and he tries to break it down and show what the anticipated costs are going to be, and of course quite properly he takes into everything, every factor that he can think of that is likely to effect his cost in the performance on that contract. It may take over a year. Now, all of those things do not happen. Some of those costs that he put into his break-down are never incurred. For his own protection he estimates them on the high side, of course. We have not come to the point, in my opinion, where the contracting officer can make a careful enough analysis of the cost break-down that the contractor furnishes to dispense with price adjustments later on in the light of what the contractor's actual cost experience may prove to be.

Senator RADCLIFFE. Do you think that point is in sight?

Mr. PATTERSON. It might come before the end of the war. I would not say. I do not think it has arrived. We are not tenancious of our powers under this act. I would not for a minute say it ought to be a permanent policy of the United States Government. It certainly ought not to continue beyond the war period. Maybe it could be terminated before the end of the war, but I do not know as to that. I am sure it has not arrived yet.

Senator BYRD. Judge, do you have access to the income-tax records?

Mr. PATTERSON. Yes, sir.

Senator WALSH. Proceed, Mr. Secretary.

Mr. PATTERSON. In conclusion, I might point out that no better evidence of the necessity for the continued operation of this statute could be afforded than the case of the Timken-Detroit Axle Co. The facts in that case make it clear that taxes have not been effective to prevent excessive profits. The articles are of a type similar to the normal products of the business in peacetime. The conduct of the hearing has, I think, been entirely fair and considerate and the result most reasonable for the company. Finally, in the matter of new procurement, this company has shown itself quite unwilling to limit itself to reasonable profits. Mr. Rockwell in his testimony referred to a contract which is now under consideration by the War Department. I have asked General Clay to come here to tell you about that contract.

With the committee's leave, I will interrupt and let General Clay give you the facts on that matter. I simply say that because the impression was left by Mr. Rockwell that we were trying to punish him by withholding a contract from him that he was entitled to and he felt that we, just out of spite or something worse, were trying to indulge in a little punishment. With your leave, General Clay who sits here will make a statement on that.

Senator WALSH. You will resume your statement after General Clay finishes?

Mr. PATTERSON. Yes, sir.

Senator WALSH. Very well. General Clay, we will hear you.

STATEMENT OF MAJ. GEN. LUCIUS D. CLAY, DIRECTOR OF MATÉRIEL, ARMY SERVICE FORCES, UNITED STATES ARMY

General CLAY. Mr. Chairman, at a hearing before this committee last Thursday, Mr. Willard F. Rockwell made the assertion that the War Department was threatening to cancel a contract which he had made with the Ordnance Department on behalf of the Timken-Detroit Axle Co. I think it fair to say that he tried to give you the impression that coercion was being used to punish Timken because of differences of opinion which had arisen over the renegotiation of the company's business for the fiscal year 1942. I should like to say most emphatically that there is not the slightest basis for any such charge against the War Department.

About 3 weeks ago Gen. Albert J. Browning, who is the Director of the Purchases Division, Army Service Forces, brought to my attention a contract with Timken which had been presented to his office for approval. Under established regulations which have been published in the Federal Register and are available to all War Department contractors, no award of a War Department contract for an amount in excess of $5,000,000 can be made in the field without the approval of the Director of the Purchases Division, Army Service Forces. Furthermore, Timken had submitted this contract to the Office of Price Administration for approval. That Office has withheld action because of apparent excessive profits provided for by the contract and has asked the War Department for comment. Accordingly there is no question of the War Department's repudiating or canceling a contract. The question is whether the War Department should approve it and recommend favorable action by the Office of Price Administration.

The proposed contract provides for the procurement of axles, transfer cases and spare parts for heavy duty trucks. These are critical items and the War Department is making every effort to expedite their production. At present all companies experienced in the manufacture of these items claim to be working to capacity, and it is therefore necessary to increase existing capacity. This can be accomplished if experienced producers like Timken are willing to make their experience available to new producers in the field. Arrangements were made to have Standard Steel Spring Co. enter the field with the aid of Timken. Mr. Rockwell, who appeared before this committee, is chairman of the board of both these companies, so that the combination could work out well from the production standpoint.

This contract with Timken will be in the amount of $89,468,910.72—that is, $24,000,000 for 9,600 sets of axles for 4-ton trucks; $50,400,000 for 14,400 sets of axles for 6-ton trucks; and a balance of $15,068,910.72 for spare parts. As stated in a letter from Timken to the Office of Price Administration, Timken proposes to subcontract the entire manufacture under a contract under which Standard Steel, the principal subcontractor, is to be allowed all of its costs in the production of the items called for under the contract plus a fixed fee. Timken will undertake to deliver the axles, furnishing designs, drawings, manufacturing assistance, and "know how," supervision and direction of manufacture; it will not itself engage in production. Standard

Steel will do the assembling but it is proposed that the major portion of the manufacturing will be done by numerous subsubcontractors to be put into that business by Standard Steel.

Under the proposed contract Timken demands an initial unit price of $2,500 for the lighter axle and $3,500 for the heavier axle. However, the prices at which Timken has been selling the same items produced in its own plants are, respectively, $1,525 and $2,184.25 before adjustment as the result of renegotiation. Thus the increases of price provided in the proposed contract are, respectively, $975 and $1,315.75.

According to the price break-down shown in the contract the proposed prices will result in a fee to Timken of about $155 on each of the lighter axles and about $200 on each of the heavier axles. We have not determined with complete accuracy what profits Timken is making on the same axles manufactured in its own plants, but the following analysis is suggestive: Timken received 33.4 percent of profit on its net renegotiable sales during the fiscal year ending June 30, 1942. After renegotiation it was left with a profit of 11 percent on the adjusted net renegotiable sales. If Timken's prices on axles manufactured by it are adjusted to give effect to this renegotiation, its prices would be $1,141.18 for the lighter axle and $1,634.51 for the heavier axle, and it would have a profit of $125.53 on each lighter axle and $179.80 on each heavier axle. Yet it now demands in the proposed contract profits of $155 and $200, respectively, for the same products, the manufacture of which it proposes to subcontract 100 percent.

But the subcontractor is also going to make a profit, and a profit higher even than Timken's. The subcontractor's profit is estimated at $210 on each lighter axle and $300 on each heavier axle.

Looking at the end results, we find that Timken proposes a fee for itself of $4,368,000 for providing supervision and direction of manufacture of axles by a subcontractor. (If the same proportion of fees is maintained on spare parts, Timken will make an additional fee in excess of $800,000, making a total fee of more than $5,168,000 for Timken.) At the same time it is estimated that the subcontractor will receive a fee of $6,336,000 on axles alone.

Under the proposed contract the aggregate payment for axles would be $74,400,000, while at Timken's prices for its own products the aggregate payment would be $46,093,200. At Timken's basic prices adjusted to reflect statutory renegotiation, as above indicated, the aggregate payment would be $34,492,272.

This leaves out of consideration the cost of additional facilities which must be provided at the expense of the Government when a new producer is brought into the field.

Senator CLARK. General, do I understand the figures to mean that the Timken Co. is asking bigger fees for merely subcontracting and supervising subcontracts that they charge on axles that they actually manufacture themselves?

General CLAY. Yes, sir; there is a provision in the contract for a redetermination of prices after 40 percent of the work has been completed, and that the agreement must be mutually agreed upon by the contractor and by the Government, otherwise the contract is terminated on the basis indicated.

Senator BAILEY. It is not a matter of renegotiation?

General CLAY. Sir?

Senator BAILEY. It is not a matter of renegotiation; it is a matter of execution of the contract?

Mr. PATTERSON. It comes in only collaterally.

Senator BAILEY. He seems to come down here and ask us to interpose. We have nothing to do with the contracts you make.

General CLAY. Absolutely.

Senator CLARK. Colonel Rockwell wept all over the place and beat his breast, claiming he was robbed.

Mr. PATTERSON. And we are prosecuted in the future if we refuse to make a contract.

Senator BAILEY. It does not have any bearing on the prosecution of the contract, does it?

General CLAY. I think it does have, Senator, for this reason: If we cannot adjust this contract we have still got to go ahead and let it, because we have got to have the axles.

Senator BAILEY. That is what I would do; I would go ahead and let it.

Senator LUCAS. What reason did he give for that exorbitant profit?

General CLAY. One reason is they are not really interested in getting the business. I think that is part of the case. It is an additional load, it requires a new facility for a heavy type of axle that is required just for the war.

Senator LUCAS. He wants an exorbitant charge because he does not want the business?

General CLAY. Partially that; yes, sir.

Senator GUFFEY. Can you get the axles elsewhere?

General CLAY. We are trying very, very hard to find some other manufacturer of the axles at the present time. We have had no luck as yet.

Senator JOHNSON. Senator Millikin and I know about a contractor that had an axle which we think is far superior, which tests in Nebraska proved were far superior, that the War Department ruled out and gave Timken the option on that particular axle. It is very interesting to have this testimony here from you. I am glad you brought it in, because it helps our case a whole lot.

Mr. PATTERSON. Are those heavy-duty axles?

Senator JOHNSON. Yes, heavy-duty axles. We have finally gotten around to the point where the War Department is going to try the axle at the Aberdeen Proving Grounds.

Senator WALSH. Proceed, General.

General CLAY. The new facilities required by Standard Steel are in excess of $15,000,000 and one of Standard Steel's subsubcontractors also requires substantial additional facilities. It also leaves out of consideration the fact that the Government will be obligated under the terms of the contract to make advance payments to Timken up to 40 percent of the value of the contract.

These high prices might be less remarkable if Timken and Standard Steel were taking any substantial risk, but the contract which is proposed pretty much eliminates all risk. Timken's contract provides that it will not be responsible for any delay of Standard Steel which results without fault or negligence of Timken. Furthermore, the contract provides that after 40 percent of the items called for by the contract have been delivered the prices will be adjusted by negotiation,

and if Timken is not satisfied with the new prices it can then terminate the contract. Timken's rights upon termination are not entirely clear because the contract is not clearly phrased, but there is room for the argument that under the contract Timken could claim its estimated fee on each item delivered as well as its entire cost including cost and profit to the subcontractor. If that is what the contract means it amounts to a guarantee of cost plus profit to Timken. The contract between Timken and Standard Steel contains similar provisions so that Standard Steel is apparently also guaranteed its cost plus a fee on delivered items. Incidentally, Standard Steel's fee will range about 10 percent of estimated costs. Even if the contracts should be construed as not guaranteeing all costs the original prices have been fixed at such a high figure as to make it practically impossible for either company to suffer a loss.

In the light of these facts, General Browning and I came to the conclusion that the proposed contract ought not to be approved and Mr. Willard F. Rockwell was so advised. As a result I had an interview with Mr. Walter F. Rockwell, the president of the Timken Co., in which we went over the whole matter. He complained of unfair treatment by the Price Adjustment Board and I told him that that was a matter which had been passed on by the Under Secretary and that it had nothing whatsoever to do with the contract now under consideration.

I regret to say that I have not been able up to this time to get Timken to agree to any modification of its demands. At present we are exploring the possibility of obtaining these axles through other sources. We are also considering whether this would be an appropriate case for the use of a mandatory order. However, for various reasons, we may in the end be confronted with the necessity of signing this contract with Timken simply because we must have the goods and cannot be sure of getting them in any other way. This will be done only as a last resort.

In conclusion I should like to say that the only connection I can see between this transaction and the subject of renegotiation is that the transaction indicates to me the protection afforded the Government by the Renegotiation Act. We must have war matériel and we must accept the transactions essential to obtaining required equipment. Some other contracts may have to be entered into to get the materials we require for the prosecution of the war.

Senator MILLIKIN. General, your complaint in this case is not that Timken wants the contract, your complaint is as to the amount of the profit; is that right?

General CLAY. We want Timken to be the prime contractor. They have the know-how. Timken can make these axles.

Senator MILLIKIN. In connection with that particular matter let me suggest you look up the files on the Coleman Motor Truck Co., which for more than a year has been suggesting to you how you can get the entire supply much quicker than by the method you are following.

General CLAY. Coleman?

Senator MILLIKIN. The Coleman Motor Truck Co.

Senator WALSH. Mr. Secretary, you may proceed.

STATEMENT OF HON. ROBERT P. PATTERSON—Resumed

Mr. PATTERSON. In other words, gentlemen, we want to make a contract with Timken. The matter is regarded by us as an urgent one on account of the production we need of heavy-duty axles. The only adjustment about the proposed new contract is on the terms which we believe are too onerous, the terms that have been submitted to us.

After listening to General Clay I am sure that you fully understand that the difficulties in making a new contract with the Timken-Detroit Axle Co. have nothing whatsoever to do with their attitude toward renegotiation. The Army has pressing need of the services of that company, and we are anxious to make a contract with it. But the terms demanded by Timken are utterly unreasonable. They are terms that the Government should never yield to.

We have developed the facts in this case in some detail, not only because it was necessary to refute charges in the open hearing last week, but also so that you would have a clearer understanding of the actual renegotiation process. We are willing to rest our case for renegotiation upon the Timken-Detroit Axle proceeding. We believe that the case is typical of the small number of cases in which we have been unable to reach a mutually satisfactory bilateral agreement, and in which we have been accused of being arbitrary, unfair, and unreasonable.

In this connection I should like, at this time, to submit for the record a copy of a confidential committee print, which we filed with the House Ways and Means Committee, giving specific facts and figures with reference to the cases of those contractors who appeared before that committee for the purpose of complaining with respect to the treatment accorded them in renegotiation. This statement is necessary to an intelligent consideration of the charges made by those witnesses. Whether or not it should be considered as part of the public record here I will leave to your consideration. That gives the facts on actual cases that were brought up before the House Ways and Means Committee as cases of harsh and unfair treatment, and we heard nothing more on those cases after the full facts were revealed.

Senator RADCLIFFE. Mr. Secretary, a contractor does assume some liability in the case of subcontractors. What kind of liability would a contractor have?

Mr. PATTERSON. Unless he gets an exception in the contract by specific inclusion of a clause in it, he has a liability just the same as if it was for his own performance, as to speed of delivery and also quality of product. I do not know how common it is to include such a clause. Can you say that, Mr. Marbury?

Mr. MARBURY. It is not common.

General CLAY. Not very common.

Mr. PATTERSON. It is not common, I am told.

Senator RADCLIFFE. Then he has about the normal liability of a prime contractor.

General CLAY. In this specific contract the prime contractor is specifically excepted from any liability of the subcontractor.

Senator CLARK. Let me ask you, why would the War Department under any conditions treat this outfit as a prime contractor? It is not the only company in the country that has the "know-how."

General CLAY. It is not the only concern, but it does have the plans and drawings for making these axles. It has the plans available, it can make the engineering knowledge available quicker to the subcontractor than anybody else.

Senator CLARK. Substantially the same kind of situation happened in the last war. I mean, du Pont held up the construction of the Old Hickory Co. for several months, at a time of vital necessity, haggling with the Government as to the management fee. These people hold-out on the basis of having the "know-how," they have possession of these drawings that are vitally essential for the making of the equipment here.

General CLAY. That is right, sir.

Senator BARKLEY. How long can the War Department in the war effort fool around while they are holding you up on that basis?

General CLAY. We cannot fool around very long. If we do not find any contractor in the next few days we have to press him for the contract, either by awarding it under the terms he seeks or through the use of mandatory order. We doubt the applicability of the mandatory order because the facilities to build here are no longer in existence. In other words if the facilities are there we can order him to produce and have the cost determined after production.

Senator BYRD. You can renegotiate?

General CLAY. Yes.

Senator CLARK. If you are held up making the contract the renegotiation statute is the only protection the Government has, is it not?

General CLAY. That is the only protection; yes.

Senator WALSH. Proceed, Mr. Secretary.

Mr. PATTERSON. If there are any other companies concerning which you would like to have additional information, whether in connection with witnesses who have appeared before your committee, or before the House Ways and Means Committee, we shall be glad to furnish any data.

I have always said, and I here repeat, the only way to test the character of the administration of this statute, is through examination of the facts and figures applicable to individual cases. Generalities are misleading, and frequently, as we have seen in the case of the Timken-Detroit Axle Co., not borne out by the record. We will welcome an investigation of the proceedings of the War Department in connection with any or all of the cases which we have handled.

CHANGES IN HOUSE BILL

Before closing I should like to comment briefly upon certain provisions of H. R. 3687, title VII, which we respectfully suggest should be modified or amended.

Review of closed arguments: In the first place I call your attention to the fact that the proposed bill provides for court review of closed

bilateral agreements. Thus, subsections (e) (1) and (e) (2), pages 119 to 122, specifically provide for review of determinations—

made prior to the date of the enactment of the Revenue Act of 1943 with respect to a fiscal year ending before July 1, 1943, * * * whether or not such determination is embodied in an agreement with the contractor or subcontractor.

This provision would render subject to court review thousands of voluntary bilateral agreements under which total refunds and price reductions (without giving consideration to the effect of taxes) will aggregate upward of $5,000,000,000, including excessive profits refunded and to be refunded and specific price reductions on articles delivered or to be delivered in the future. This provision would create a potential administrative burden which might be impossible of effective accomplishment. It might also be construed to invalidate the bilateral character of the agreement in such a manner as to jeopardize the right of the Government to retain the refunds which have been made and to collect the refunds which are to be made thereunder.

There might also be placed in jeopardy the provisions of the agreement providing for past and future price reductions. Many renegotiation agreements include clauses providing generally for the elimination of excessive profits likely to be realized in the future through price reductions without specifying the amount of the reductions to be made on specific articles or contracts. The total reductions and refunds under such clauses exceed the total of specific refunds and price cuts already referred to.

The refunds and price reductions provided for under these voluntary agreements were made as a part of repricing policy which was in fact inaugurated some time prior to the passage of the original Renegotiations Act of April 28, 1942. If the act had not been available for this purpose, the War Department would have endeavored to effect similar results through the use of other war powers relating to placing and cancelation of contracts. In no case has the War Department accepted agreements which are made conditional on the validity of the renegotiation statute or which under their terms could be affected by subsequent legislation or court decisions. Of course, any legislation you see fit to pass will affect them all right, but we do not see fit to put into the contract a specific clause.

Quite a number of contractors wanted to put in that kind of clause, but we always declined to do that.

Senator LA FOLLETTE. If this provision would remain, would the progress that has been made in cleaning up the backlog be lost, and more, too?

Mr. PATTERSON. I do not know how many people who signed voluntary agreements might now think they had a ground for a lawsuit against us.

Senator LA FOLLETTE. In any case, you would be opening up the door, you would be making it possible for these cases to be reviewed, and if any large percentage of them should take advantage of this provision, your progress would be completely wiped out; would it not?

Mr. PATTERSON. Yes, sir; it is absolutely unique, as far as I know, to say a man who has signed an agreement in the absence of fraud, or holding a pistol to his head, or something like that, has a lawsuit against you. It can only be justified, I suppose, on the general theory that everybody who signed a voluntary agreement with us did so under the gun, and that just is not so.

Senator VANDENBERG. That would be the only theory where voluntary does not mean voluntary.

Mr. PATTERSON. Yes; that it was actually involuntary, that they did not want it, but they could not help themselves, they got gypped in the process.

Senator BARKLEY. They might be induced to sign an agreement, get it out of the way, and then go into the courts in a hurry so as to thresh it out there.

Mr. PATTERSON. We do not think such a provision as that is called for or is wise legislation.

Senator BYRD. Judge, you say that is The Tax Court?

Mr. PATTERSON. Under the House bill, the final resort for court review is to the Tax Board.

Senator BYRD. Why did they single out the Tax Board?

Mr. PATTERSON. I do not know. I think it was discussed a good deal. I do not mean by any means that it was a snap matter, but what reason there was for it, I do not know. I was not present at the conference.

Senator VANDENBERG. Judge, can a certified public accountant practice before the Court of Claims?

Mr. PATTERSON. I should not think so. I should think probably they have to be members of the bar.

Senator VANDENBERG. That might have something to do with the decision; I do not know. Many of these calculations are essentially accounting problems, are they not?

Mr. PATTERSON. Yes. As a general rule, we take the break-down tendered by the contractor.

Senator VANDENBERG. I was wondering if you did not have a narrower battle there.

Mr. PATTERSON. We did not send a lot of auditors and accountants probing around their books. They found the records kept by the contractors are pretty generally reliable. They come in and tender us the figures, and then it is a question of exercising judgment upon those figures.

Senator VANDENBERG. The only question I am raising is one that has been raised to me, that in the settlement of many of these cases it is essentially a problem for a certified public accountant, and with the lack of manpower even in that field today there might be some question whether the resources would be available to pursue these claims and that they all would have to go out of the accountant's hands and into lawyers' hands was possibly the reason why they did not choose the Court of Claims.

Mr. PATTERSON. I cannot say whether that was the factor that caused the introduction of the Tax Court into this matter or not.

Senator VANDENBERG. Even the Tax Court is getting around to a point where it is going to be just a court and slowly but surely putting the accountants on the outside.

Mr. PATTERSON. I think Mr. Paul of the Treasury Department here can probably tell you about whether this matter of accountants has anything to do with it, or not, as to whether they should be there.

Mr. PAUL. That did not come up, as far as I know, Senator Vandenberg, in the discussion. The presiding judge of the Tax Court was called before the Ways and Means Committee and asked if he

was willing to undertake the job. There was some correspondence between him and the committee. Naturally, the presiding judge of the court said he was willing if the Congress wished to give the court the job. I think he also made some other points, that it would hamper the work of the court. Whether or not specifically the ability of accountants to practice before The Tax Court as distinguished from the Court of Claims had anything to do with the ultimate decision, I do not know. As you know, I objected on the part of the Treasury on the ground it would have an adverse effect on the collection of the Treasury to place that responsibility in The Tax Court.

Senator CLARK. The whole theory of having a judicial review is having a review by the court. The Tax Court is not a court at all. We just changed the name, called it the Court, and the members are calling themselves judges. The members of the Board of Tax Appeals call themselves judges.

Senator WALSH. Mr. Secretary, if you proceed, we may be able to finish your testimony before lunch.

Mr. PATTERSON. I will just say a few words, if the committee pleases, on one other feature in the bill as it came from the House, and that is the provision for double review.

Senator WALSH. Have you amendments prepared for the committee to consider?

Mr. PATTERSON. Yes, sir; we have, sir.

Senator WALSH. Submit them with your testimony?

Mr. PATTERSON. Yes, sir.

Mr. Dodge has those and he is here.

These agreements represent closed transactions between the departments concerned and the contractors. They should not now be reopened.

Provision for double review by the Joint Board and by the courts:

The proposed bill gives the contractor an absolute right to require review by the newly created Board, known as the War Contracts Price Adjustment Board, and the act specifically provides that the Board may not delegate "the power, function and duty to review orders determining excessive profits" [subsection (d) (4), page 118]. In the light of contemplated provisions providing for review by a court in those cases where no agreement can be reached, it is entirely unnecessary and would constitute a very real administrative burden to provide for another review by the War Contracts Price Adjustment Board. The requirement that such a Board should review all orders determining excessive profits would require the creation of a large administrative staff, and would impose burdens and duties upon the individual members of the Board which would interfere with the performance by them of their duties in connection with current renegotiations in the various departments for which they are responsible.

SCOPE AND METHOD OF JUDICIAL REVIEW

I have repeatedly stated that I had no objection to the making of some statutory provision for judicial review and, in fact, have expressed the opinion that there is such right of review under existing law. There have recently been brought to my attention the strong

objections of the Treasury Department and the Department of Justice to the proposed granting of jurisdiction over recognition review to The Tax Court of the United States. I am satisfied that jurisdiction over appeals from renegotiation determinations should be assumed by the Court of Claims in order that The Tax Court of the United States may be kept free for exclusive attention to tax matters.

With respect to the scope of review, I agree with the position of the Department of Justice, as expressed to the joint board, that it would be helpful if determinations of the secretaries of the departments or of the proposed War Contracts Price Adjustment Board should be final and conclusive except to the extent that the contractor can establish (on the basis of the record made by the contractor in the court review proceeding) that the determination was the result of a mistake of law, fraud, arbitrary or capricious action, or was so grossly erroneous as to imply bad faith.

This proceeding would afford protection to a contractor who could show that he had been arbitrarily or unfairly treated and at the same time would give due weight to the determinations of the departments and avoid possible danger of overburdening the courts with a large volume of difficult and burdensome cases.

There are a number of other suggestions for the improvement of the bill pending before your committee which have been considered and approved by all of the departments interested in renegotiation. The War Department is particularly interested in the suggestions that all authority relative to current repricing for renegotiation of individual contracts should be centered with the several departments rather than with a joint board, and that there should be eliminated from the act any mandatory requirement relative to the insertion of a particular repricing or renegotiation clause in all contracts regardless of their size and character. These will be presented to you by Joseph M. Dodge who is Chairman of the recently created Joint Price Adjustment Board, as well as Chairman of the War Department Price Adjustment Board.

I would prefer to leave the elaboration of that to the Department of Justice. They are much more familiar with those matters than I am, and they advise me that this is the regular, accepted scope of review from the action of administrative agencies like that done by the Price Adjustment Board.

We do believe, too, that that review should be made on the basis of the record. We want to avoid the formality of findings of fact and conclusions of law up and down the line in our own organization, which I would think would be a very serious impediment to the speed of the work that we have placed upon us.

The Price Adjustment Board passed a resolution or took formal action on this matter, and Mr. Dodge is prepared to present that. It does represent the view of all five departments concerned, and also, I understand, the view of the Department of Justice which, while it is not a procuring agency, is, of course, interested, vitally interested in particularly the court review aspect of this matter.

Senator WALSH. We appreciate, Mr. Secretary, having your able presentation.

Mr. PATTERSON. Thank you.

(The following statement was submitted for the record:)

SUPPLEMENTAL STATEMENT OF WILLARD F. ROCKWELL OF THE TIMKEN-DETROIT AXLE CO.

RENEGOTIATION

On Monday, December 6, 1943, the Under Secretary of War appeared before the Senate Finance Committee accompanied by his assistants, and made several statements extremely derogatory to my companies. Individuals who attended the hearing advised me and I immediately wired Senators Walter F. George, David I. Walsh, and Arthur Vandenberg for an opportunity to reply in an open meeting. Senator George was ill, but I received telegrams from Senators Walsh and Vandenberg advising that the hearings were closed but that they would see that my statement or brief is placed in the record.

In my appearance before the House Ways and Means Committee on Friday, September 17, and before the Senate Finance Committee on Thursday, December 2, I was treated with the utmost courtesy and consideration by all Members of Congress, regardless of party affiliations. This was in vivid contrast to the ruthless and arrogant treatment accorded me by persons holding lesser positions in the Government. When I appeared before these committees, it was the first time I had ever met Congressman Dingell of Detroit, Chairman George, or Senator Vandenberg, of Michigan, where the main plants of the Timken-Detroit Axle Co. are located. This should prove that I am neither a politician nor a lobbyist who seeks special favors.

When the so-called Renegotiation or Price Adjustment Act was passed, I accepted it as the law of the land. If it is administered by capable, honest, experienced and efficient men, it will prevent war profiteering; and because I do not believe it is so administered, I have given my testimony. I regret that all testimony before these committees is not given under oath, and I am willing to repeat my testimony under oath at any time.

Government witnesses testifying before your committee have immunity from slander and libel suits but when the prominence of the Government witnesses and the sensational charges against an individual or a company appeal to the news sense of editors we are most effectively slandered and libeled with complete immunity for the witnesses.

I am chairman of the board of three companies listed on the New York Stock Exchange, and president and director of several other companies. When called upon, each of these companies has submitted its figures, reached a settlement at the Renegotiation Boards' convenience, and promptly paid the sum agreed upon. In one case it was determined that there were no excess profits. In another case, we accepted a settlement allowing us less than 8 percent before taxes, or less than 2 percent after taxes; and I heartily agreed in the acceptance on the assurance that we were being given full approval as patriotic contributors to the war effort without any taint of profiteering. Businessmen will understand that more completely integrated companies must have more profit than fabricators. The Timken-Detroit Axle Co. was assigned to the very competent Renegotiation Board in the Detroit ordnance district. A mutually satisfactory agreement was reached and signed, and a check was forwarded to make a refund of $10,000,000, with their assurance that we would never be charged with profiteering. Businessmen looked on the Renegotiation Act with grave doubts but welcomed the assurance that mutual agreement with a responsible Price Adjustment Board and prompt refund would make it impossible for any demagog to apply the epithet of "war profiteer" to him or his company. The Under Secretary says that the Detroit board is capable and responsible and he knows we meet that Board's requirements. In describing members of the Detroit ordnance organization he said—"I think that the personnel engaged in this work is of the very highest caliber we could recruit" (p. 942)[1]

Our check was returned by a Washington board, which demanded another $2,500,000 and asked us to appear before them in Washington. The members of this panel A did not have the data and other material submitted to the Detroit board, which Mr. Maurice Karker and his successor, Mr. Dodge, said are given the fullest consideration in open discussion in determining the contractor's efficiency. When we presented our essential data they refused to discuss the subject further and threatened us with a higher penalty if we did not consent immediately. One of these boards subsequently gave the utterly misleading, slanderous, and libelous misstatements to the Under Secretary, which are contained in his letter

to us of November 9 and which were completely exposed in my letter of November 16. You will observe the Under Secretary admits these errors and takes no exception.

In the document, H. R. 3687, part 7 unrevised, date December 6, 1943, pages 940–941, the Under Secretary says: "First, he [Rockwell] said that my decision was based on mistaken information * * *. It is true that such information was contained in a letter which I wrote to Mr. Rockwell * * * but it is not true that this information was the basis upon which the decision was reached." He also adds, "No one in the War Department has ever denied the substantial contribution to the war production made by Timken. In fact, at the hearing in my office, I specifically mentioned it as being noteworthy." Can we expect a fair decision from star-chamber proceeding which excluded a good record and included a false and damaging one?

After the Under Secretary's other letters and after I was advised that I was to appear before the Senate Finance Committee on December 2, I was not surprised to receive a letter by special messenger from the Under Secretary's office, which contains these very kind and conciliatory remarks: "It is my hope that you will again review the results achieved by your company in connection with war business during the fiscal year ended 30 June, 1942, and concur with me that the proposal made to your company was fair and just." This is preceded by a paragraph in the same letter which says, "The voluntary price reductions to which you refer in your letter made by your company during the fiscal year ended 30 June 1943, and further to be made during the current fiscal year, are noteworthy and will be given full consideration in the renegotiation of those years."

In your Senate Finance Committee hearing 2 hours after receipt of this letter, I said to your committee, "* * * Instead of acknowledging their error now, they are holding out a little promise to me that the next time they come around they will be fair, but I do not think, Senator, we ought to take that. Do you?" To which Senator Vandenberg said, "No." And Senator Guffey added, "I agree with you. We have one case in Philadelphia that is far worse than that" (p. 940).

Senator George, your chairman, made the following remarks to me during the hearing: "Well, Colonel, the truth is that, on the economic front, the only single Congressional Act which conveys absolute and arbitrary power to anybody is the Renegotiation Act. There are no standards under it; there is no remedy under it. Those who contract with the Government are simply bound hand and foot. They must do what they are told to do, or else" (p. 377).

"* * * The Under Secretary of War and the Under Secretary of the Navy and others who are directly responsible for these renegotiations are very good men. It shows you, though, how even good men act when they have arbitrary power and how it will run them utterly if it is continued" (p. 377).

"* * * They say they propose to be fair and just and do the thing in a perfectly fair way. * * * but when they are renegotiating between those contractors and using an arbitrary power without standards and without real restrictions and restraint, they inevitably would make mistakes and create discriminatory favors on one side and harsh discriminations on the other side" (p. 377).

"I agree with you fully on this Renegotiation Act. If I had it in my power, I would throw it out entirely and rely absolutely on the tax laws" (p. 377).

Senator Vandenberg said:

"My experience with the Under Secretary leads me to feel that he wants to be fair * * * in the administration of the law; which I agree with you is undoubtedly unconstitutional" (p. 375).

"There ought to be some kind of distinguished service medal for any businessman who survives the war contracts with the Government" (p. 378).

In my appearance before the House Ways and Means Committee I said, "If the Government should find it necessary to take 100 percent war profits we could not complain, in view of the much greater contributions of and the demand on the fighting men in the armed services. However, we do protest that one company should be asked to give up more than companies which have not made a better showing in essential war production" (p. 708).

I told the Senate Finance Committee (p. 374): "* * * We earnestly beg Congress to eliminate renegotiation and take excessive profits by means of taxes, leaving us enough reserves so that we can design new products and carry on our business and reconvert and rehabilitate when peace returns. If this is not done, we cannot provide jobs for the 9,000 employees now at work and several thousand employees who are now in the armed services."

When Senator Vandenberg said, "Colonel, short of repeal of the Renegotiation Act, are there any changes in the act which would at least partially correct the situation?" I replied, "One change would be to have somebody down here on the Board (Washington) who knew something about the industry, Senator" (p. 375). The Senator then said, "If you had the right to appeal to an independent tribunal it would help you, would it not?" I replied, "I think that would correct the situation, but, of course, if we can only go to The T[illegible] they would just as likely as not say all these people are competent."

In the testimony before the House Ways and Means Committee . 644), Congressman Disney, who is well known for his legal talent, discusses the question of court review and he says, "* * * I never heard of an American court that could not give a reason for his decision and who is required to." Under Secretary Patterson said: "But if the litigant then comes in and says, 'Just how much did you allow for this, and for this, and for this,' the judge tells him to go and chase himself." Congressman Disney replied, "Judge, I am surprised at you, I really am surprised at you; in fact, I am astonished; I am astounded." In the ensuing discussion, Congressman Disney says that if he refused to abide by a decision the Under Secretary could not compel him to accept it; and he would appeal. He asked the Under Secretary what kind of a document he would write up, upon which an appeal could be made. To this, Under Secretary Judge Patterson said; "* * * You do not assign to each factor a certain value, analyze it, break it down. I never knew a court in the world that did that." To which Congressman Disney replied, "I never knew one that did not." This colloquy discloses the fundamental cause of this dispute.

In the testimony of Admiral Land, Chairman of the Maritime Commission (p. 963): "We have not had a single case of unilateral determination, and we continue to receive from industry throughout the country a substantial number of letters expressing approval of our work." Admiral Land never asked my opinion and I never volunteered one on the subject of renegotiation, but I do know that he has assigned this work to a representative who has been able to meet with industry, understand its problems, renegotiate its profits, and finally make a mutually satisfactory understanding in which the contractor is assured that the Maritime Commission will never permit anyone to say that the contractor has profiteered.

When I decided to fight against this law because its method of administration was endangering the welfare of 11,000 stockholders and (as of December 10, 1943) over 9,500 employees, to which there are now added several thousand stockholders and several thousand employees of the Standard Steel Spring Co., I was told that two things would happen: First, the opposition would make its appearance at the last moment of the open hearings so that I could not reply in an open hearing; and second, that I and my companies would be really subjected to a thorough smearing and no means would be avoided to blacken my character and hurt my companies. With members of my immediate family in the armed forces prepared to fight for the freedom of this country, I would be ashamed to hold up my head in public if I did not fight against tyranny and petty dictatorship, which threatens the welfare of over 20,000 people for whom I must speak. I have been asked why I did not assign this duty to someone else, and I gave two reasons: First, No one else was acquainted with all of the facts; second, I do not ask another man to do my work when I know he will be subjected to violent abuse and malignant misrepresentation.

The Under Secretary states that he is "willing to rest our case for renegotiation upon the Timken-Detroit Axle Co. proceeding. We believe that the same is typical of a small number of cases in which we have been unable to reach a mutually satisfactory bilateral agreement and in which we have been accused of being arbitrary, unfair, and unreasonable" (p. 957). We beg Congress to accept this challenge after verifying this testimony.

The Under Secretary makes the statement that our profit for our fiscal year ended June 30, 1942, after renegotiation and after taxes was two and one-half times the average of the normal years, but fails to point out that our sales had increased nearly six times; furthermore, his "so-called normal years" period consists of the years 1936 to 1939, and includes the year 1938 which year is not considered a normal year, the Congress permitting us to adjust our earnings for the year under the excess-profit tax law.

In addition, the Under Secretary failed to tell you that our profits after taxes for the year 1940, which was certainly not a war year, were also two and one-half times the average of the "so-called normal years."

During the years 1936 to 1939, the Under Secretary states that the Timken-Detroit Axle Co. averaged shipments of $20,000,000, but 1943 shipments will be approximately $160,000,000, or eight times its so-called base years, which means that its product performance guaranties, its credit risks, its inventory shrinkage risks, and all other contingent risks are at least eight times greater.

The Secretary states (p. 952) "the facts in that case make it clear that taxes have not been effective to prevent excessive profits." We claim the facts prove just the opposite since in 1942 we did three times as much business and made practically the same profit after taxes as in 1940.

In my appearance before the House Ways and Means Committee and before the Senate Finance Committee, I truthfully stated my regard for the regular officers of our Army, whom I have found to be honorable, truthful, and ready to stand up for what is right, while unwilling to take unfair advantage of any opponent. I have known Major General Clay for over a year and I have the very highest regard and esteem for him. I, however, must differ from his interpretation of the contract as he outlined it to you.

General Clay said:

"In conclusion I should like to say that the only connection I can see between this transaction and the subject of renegotiation is that the transaction indicates to me the protection afforded the Government by the Renegotiation Act" (p. 956).

As pointed out above we believe the excess-profit tax protects the Government adequately against profiteering and believe that after renegotiation by the contracting officer under such contract (but without the aid of statutory renegotiation) and Federal taxes, Timken will make no more than $30 per set of four units.

Senator Byrd asked if the Army can renegotiate, and Senator Clark asked, "If you are held up making the contract, the renegotiation statute is the only protection the Government has, is it not?" Generaly Clay replied, "That is the only protection. Yes."

The Renegotiation Act with a unilateral agreement makes it possible to take any and all profit on this contract. This, General Clay assures us, they do not want to happen as they claim we are entitled to a profit. As far as the prices in the contract are concerned, the following quotation from it should answer any question with respect to prices and profits:

"The Government and the Contractor recognize that the costs of performing this contract cannot be accurately estimated at the time of its execution and that the contract prices fixed in article I may, therefore, be either too high or too low."

At no time did anyone consider that this billing would be made regardless of the cost of the units because the contract distinctly provides for renegotiation by the contracting officer and specifically states that before 50 percent of the contract is completed the prices must be renegotiated on the basis of the then existing cost. If the costs are too high and the Government does not wish to pay these costs plus a reasonable profit they have the privilege of canceling the contract. While Timken also has the right of cancelation as pointed out by General Clay, from a practical viewpoint it would never be able to cancel the contract for if the axles were needed by Timken's customers who had sent Timken orders to replace the Government pool order, Timken could not afford to tell its customers that they were no longer interested in building the axles. Of necessity, they would have to get together with the Government and arrive at a mutually satisfactory price.

In the published balance sheet of December 31, 1936, the Timken-Detroit Axle Co. shows property, plant, and equipment including buildings and machinery, at a valuation after allowance for depreciation and obsolescence, of less than $4,850,000. On June 30, 1942, the corresponding figure is over $5,300,000.

General Clay states that the new order is for approximately $90,000,000 and that new facilities required by Standard Steel Spring Co. are in excess of $15,000,000, and one of its subcontractors also requires substantial additional facilities (p. 955). Compare this investment with the $5,300,000 of Timken which produces $160,000,000 worth.

On page 958, General Clay has asked if Timken is the only company in the country who has the "know how"; and the general replies that it is not the only concern, but it does have the plans and drawings for making these axles. You will find proof in my letter to Under Secretary Patterson of November 2, 1943, that in June 1940, "in the presence of, and at the request of, Army officers, we offered our designs and patents to our two principal and direct competitors, both of whom refused to manufacture axles of the standardized design for the War Department."

Before signing a contract with us, the Detroit ordnance district attempted to find others to do the job. They had the matter up with General Motors and to assist General Motors in analyzing the proposition we not only supplied all prints and data they required but prepared at some considerable expense and effort a complete exhibit of all parts (both rough and finished) used in these units. We have never failed to cooperate to promote the expansion of axle production, both of our principal competitors now being subcontractors to us, and one of them making complete axles to our specifications.

In an article which I wrote and which was published in the official May-June issue (1938) of the official Army Quartermaster Review, presenting A Commercial Viewpoint on the Army's Motorization Program, on page 35 I stated that, "In the first year of a major war it has been estimated the Army will require * * * 113,000 trucks in the 2½ ton or over class * * * or 240 percent more trucks * * * than the industry sold during the past year" (1937).

You will see that we warned the Army and that we offered our "know how" to our competitors or anyone else, and you can be sure that if we had the equipment we would not subcontract to anyone.

Senator Lucas asked General Clay why we want an exorbitant profit (and we absolutely deny that we are sure of any profit under this contract); to which General Clay replied, "One reason is that they are not really interested in getting the business. I think that is part of the case. It is an additional load. It requires new facilities for a heavy type of axle that is required just for the war period" (p. 955).

In my testimony before you (p. 373; December 2) I told you that "our facilities are now almost 100 percent in Government use. We are told that the War Production Board is about to permit the production of commercial axles, but they have advised our customers to buy their axles from our competitors who refused to manufacture the standardized Army axles in June 1940. Our two competitors, according to press reports, were permitted to receive a much larger percentage of profit on their business. We ask you if that is fair and if we are not being threatened with confiscation of our business, as well as our profits?"

Does this statement indicate that we are not interested in providing all the axles we can produce by any means so that we may continue to hold our customers' business, whether it is commercial business or trucks for the War Department?

In an article in the Detroit Times on December 8, 1943, there is a fairly complete report of General Clay's testimony and we ask you to record the final paragraph: "Unfortunately, from this writer's point of view, the General offered no explanation of why the Detroit ordnance office agreed to such a contract in the first place."

The Chicago Sun of December 8, 1943, on page 18, in an editorial, says, "The Timken-Detroit Axle Co., according to Army spokesmen and members of the Senate Finance Committee, is 'holding out against a Government order for heavy-duty truck axles, demanding an $89,000,000 price that the Army regards as $40,000,000 too high.'" With many more aspersions on our company, the editorial concludes, "A hold-up by a business firm to enforce its demanded price is in the same category as a strike by labor for higher wages, and public opinion has vigorously condemned wartime strikes."

We have received a written apology for this editorial, which, however, will not close this matter.

I would like to say that, in spite of the threats by Under Secretary Patterson and his assistants, that the contract will be canceled if any other company can be found which will carry it through, we have never relaxed our efforts in either the Timken-Detroit Axle Co. or the Standard Steel Spring Co., although these published threats have made it almost impossible to acquire subcontractors or interest responsible manufacturers. We have taken this great financial risk because we want to produce every axle we can, we want to help the war effort in every way we can, and we have absolute confidence that General Clay and other high Army officers will protect us and give us every assistance when they understand the contract and prove to their own satisfaction that under the present contract neither the Timken-Detroit Axle Co. nor the Standard Steel Spring Co. can make as much as a dollar of exorbitant profit on this contract unless every man connected with our company and the Army becomes incompetent or dishonest.

The publicity given this contract has done untold damage to the Timken-Detroit Axle Co. and to me, because we cannot hope to receive the same publicity for the unvarnished truth that the erroneous statements have received.

For the further amazement and confusion of Congress, we quote the following letter received under date of December 11, 1943, signed by Brig. Gen. A. B. Quinton, Jr., Detroit ordnance district chief.

"I am pleased to inform you that Contract No. W-20018-ORD-816, between your company and the Government, represented by me as contracting officer, has been formally approved by the War Department.

"The delay in obtaining such approval is regretted, and it is hoped that your current operations under the contract have not been adversely affected. Now that the situation has been cleared up, you are urged to proceed vigorously with the prosecution of the work to the end that your contract schedule will be met.

"Thanking you and your subcontractor, Standard Steel Spring Co., for your cooperation with this office."

* * * * * * * *

When Under Secretary Patterson appeared on this case Senator Lucas asked him about the Lincoln affair, to which Under Secretary Patterson replied, "I will take Brother Rockwell, but the Navy has to take Brother Lincoln."

We leave this case in the hands of Congress, confident they can decide who will take what, with complete justice to all concerned.

MEMO ON TIMKEN-DETROIT CONTRACT

A. PRESSURE OF NEED

In the testimony of Under Secretary Patterson and General Clay, statements and allegations were made to the effect that because of the urgent and dire need for immediate production of light and heavy axles the War Department found itself in a position whereby it was almost forced to accept what is alleged to be a contract for exorbitant prices for critically needed truck axles.

This critical need is not the result of sudden changes in needs at the battle fronts nor is it a need that could not have been foreseen had reasonable prudence been exercised by the War Department. In order to prove that this need is nothing new or novel and that the War Department has been aware of this need for a long time, I have listed below the chronological sequence of events of which I, personally, have knowledge with respect to increasing forging capacity absolutely essential to increase production of axles:

1. Sometime in the middle of 1940, Office of Production Management and the Army discussed the increase of forging capacity and the Army was of the opinion that no excess forging capacity would be required.

2. In December of 1941 it became obvious to all that additional forging capacity was of the utmost urgency. Timken-Detroit accordingly proposed to the Ordnance Department of the Army a plan whereby the forging capacity of Timken-Detroit would be enlarged. This proposal was reduced to writing on January 2, 1942.

3. On February 17, subsequent to an inspection trip by General Knudsen, the Army gave Timken-Detroit letters of intent respecting an increase of forging capacity.

4. Peak production of forgings had not yet been reached under this proposal of Timken-Detroit in December of 1941. In August 1943 about 90 percent of the needed machinery was finally on hand and Timken-Detroit was able to start production.

5. Timken-Detroit still has no contract and no lease agreement with the Army with respect to this additional forging capacity.

Any shortage of productive capacity of axles, which now forces the Army to accept this contract, is directly due to Army delay.

B. NEED OF TRUCKS

The truck manufacturing industry has known for a long time that Army requirements for heavy-duty trucks should have been increased. The War Department, however, has apparently not realized that their needs were going to increase. The production of trucks is entirely dependent on production of axles which cannot be made without more forging capacity. Under Secretary Patterson and his assistant left the impression with the Senate Finance Committee that Timken-Detroit is "holding up" the Army because of this particular contract. This is absolutely refuted by the following chronology with which many authorities are familiar:

1. June 19, 1943: The Automotive Branch of Ordnance in Detroit advised that the War Department was shortly going to need trucks two or three times in excess of their present supply.

2. June 25, 1943: The entire truck-manufacturing industry at a meeting in New York was advised of these needs and without exception told the Army that that industry was working to maximum capacity and could not meet an immediate increased demand.

3. July 19, 1943: Another industry meeting of truck producers, after survey of facilities and demand, reiterated the contention that the truck industry was working to capacity and could not possibly meet demands.

4. August 2, 1943: Timken-Detroit formally delivered a proposal to Brigadier General Quinton at Detroit which is the substance of the present contract which Under Secretary Patterson and his assistant ridiculed and condemned. The Detroit ordnance branch advised that they would not, at that time, accept our proposal without further knowledge of availability of capacity in the rest of the industry.

5. August 30, 1943: Detroit ordnance requested Timken-Detroit to negotiate a contract based on our porposal of August 2.

6. October 2, 1943: General Quinton and Timken-Detroit signed the contract which reduced to writing the proposal embodied in the offer of August 2, in which Timken-Detroit made many concessions.

C. THE CONTRACT COMPLAINED OF

1. The contract complained of by Secretary Patterson and his assistant is in essence a target price contract. Specific stipulations and provisions in the contract provide for a recalculation and redetermination of price when 40 percent of the estimated production has been completed. It was the understanding of Timken-Detroit and of the Detroit ordnance center that Timken-Detroit will receive somewhere in the neighborhood of 5 percent of costs after those costs can be determined; the precise profit per unit to be agreed upon when the contract is renegotiated under its terms.

2. Before the Senate Finance Committee, mention was made of the fact that Office of Price Administration has not approved the estimated prices contained in this contract. At the time of discussion of the contract before the Detroit ordnance center, Timken-Detroit was specifically promised that the Army would secure approval of these tentative prices from Office of Price Administration and that filing of Timken-Detroit of a formal request was a mere matter of formality.

3. The figures mentioned in the formal contract signed by General Quinton and Timken-Detroit are top estimated prices based on probable prices of subcontractors, who are not controlled by Timken. The actual prices of delivery of these articles are to be determined as soon as Timken-Detroit and the subcontractors we are seeking, have secured sufficient experience under the contract to determine what the costs are and what the corresponding prices should, therefore, be.

4. This contract was in the nature of a proposal by Timken-Detroit which was intended to solve the Army's difficulties. Timken-Detroit is completely booked for all of its productive capacity and cannot produce these axles itself. It accordingly has promised in the contract to search for and secure the services of the most efficient available subcontractors. It is impossible under the provisions of this contract for Timken-Detroit, or any subcontractor, to make excessive charges which can be passed on as part of the cost to the War Department. There is a specific stipulation in this contract that no subcontract may be let by the prime contractor in excess of $15,000 without specific approval of that contract by the contracting officer. It follows that there can be no exorbitant costs and as a result of the understanding of Timken-Detroit at the time it negotiated this contract (the 5-percent-profit understanding) there can be no exorbitant earnings under this contract.

5. With respect to the alleged amount of facilities, 15 millions, mentioned by Under Secretary Patterson's assistant, it should be specifically understood that these facilities are to be delivered to the subcontractors of Timken-Detroit.

6. Incidentally, Standard Steel, the principal subcontractor under the contract, has been requested by the War Department to produce these axles, with the supervision of Timken-Detroit's engineering staff, in a plant estimated to cost $28,000,000 erected by Defense Plant Corporation in the St. Louis metropolitan area. This new plant which never reached 25 percent capacity will require expenditure of enormous sums of money to be adapted to the production now required by the War Department.

Under the statutory renegotiation requirement, plus our signed agreement to renegotiate, how can Timken-Detroit secure any profit which the War Department considers excessive or unreasonable?

Senator WALSH. Unless there is objection, the committee will stand adjourned to 2:15.

(Whereupon, at 12:55 p. m., the committee recessed to 2:15 p. m., of the same day.)

AFTER RECESS

(The committee resumed at 2 p. m., pursuant to recess.)

Senator WALSH. Do you want to proceed before the rest of the committee gets here, Admiral?

Admiral LAND. Mine is very brief, Mr. Chairman. It is more or less seconding the evidence already given this morning.

Senator WALSH. I believe your views concur with those of the Under Secretary, Mr. Patterson?

Admiral LAND. Generally speaking, I think we are in agreement, and we are particularly in agreement with the recommendations of the Joint Board.

STATEMENT OF ADMIRAL EMORY S. LAND, CHAIRMAN, UNITED STATES MARITIME COMMISSION

Admiral LAND. Mr. Chairman, the price adjustment boards under my direction have a relatively small, though important, part in the over-all administration of the act, but the Maritime Commission Price Adjustment Board alone is closing an average of three agreements daily and recouping through recapture of excessive profits and forward repricing at the rate of about $485,000 daily and effecting additional current voluntary price reductions. Thus far, excessive profits eliminated by the Maritime Commission Price Adjustment Board aggregate $80,955,000 and reductions through forward pricing aggregate $55,753,000, a total in excess of $136,700,000 to December 1, 1943. The amount of saving through price reductions made currently cannot be estimated but may well exceed, in dollar volume, the other recoveries. The Price Adjustment Board of War Shipping Administration has been in operation only since April 1943 and has been engaged in the recruitment of personnel and establishment of organization and procedure to treat with the vast amount of operations peculiar to War Shipping. Reports which I have received from the Chairman of this Board indicate that in the near future its production will be of a relative size and importance comparable to that of the Price Adjustment Board of the Maritime Commission.

Every such agreement has been bilateral. That is, the contractor and the Board's representative have conferred, and with the facts before them, have determined that the contract prices originally fixed were out of line, that a part of the profits realized were excessive, and these excessive profits have been returned to the Government.

We have not had a single case of unilateral determination and we continue to receive from industry throughout the country a substantial number of letters expressing approval of our work. I am convinced, therefore, that the present law has served its purpose with substantial justice to industry, insofar as the United States Maritime Commission and War Shipping Administration are concerned.

First. In view of this experience, I am opposed to the provision in subsection (e) (2) of the pending bill giving to the contractor who has voluntarily entered into a renegotiation agreement the right to a court review of that agreement. To my mind, the very statement of such a proposition implies a contradiction in terms. The present law requires renegotiation of the original contract made by procurement officers because at the time the contract was made neither party knew all the facts. But the new agreement in renegotiation is made with knowledge of the facts. I doubt that Congress would want industry to renegotiate the Government with respect to such agreements.

Indeed it appears to be a great waste of manpower and of Government money to establish Price Adjustment Boards and equip them to investigate the facts and reach bilateral agreements with contractors as to excessive profits and unreasonable prices, only to have that time and effort nullified by a court which is not equipped to get at the facts.

Not only is this unusual provision wasteful administratively, but it carries the threat of enormous refunds from the Treasury. Our renegotiation agreements not only recapture excessive profits already realized by the contractor, but also revise contract prices downward for the future and encourage the contractor to renegotiate himself as he goes by voluntarily repaying to the Government profits on the revised price structure which he believes to be excessive. These voluntary repayments may well exceed in the aggregate excessive profits recaptured. This large saving negotiated by our Price Adjustment Boards should not be jeopardized by permitting the contractor to renegotiate the new agreement.

Of course, if the determination in renegotiation has not been mutual and if the board or the Department head can be shown to have acted arbitrarily or capriciously so as to imply fraud or bad faith or under a mistake of law, then, in such case, there may be justification for allowing the contractor an equitable review. But he should not have two bites at the cherry—one before the board, as provided in subsection (d) (5), and again before the court, as provided in subsection (e) (1).

As to the review procedure and the proper form to which the contractor's petition for review should be directed, I endorse fully the views of the joint board.

Second. I am opposed to the provisions in subsection (c) (1) and (3) of the pending bill which permit renegotiation, contract by contract, only at the request of the Contractor, and, at the same time, require agreement to be reached in renegotiation within 1 year after the proceeding is commenced. In long-term ship construction, renegotiation on a fiscal-year basis, if not impractical, is at least very difficult. We have many types of contracts. We have many undertakings involving a group or groups of separate contracts for the construction of vessels. The independent contracts may be completed in different fiscal periods, in each of which, however, tentative profits are received or accrued. For accounting purposes only, the contractor, at his option, may be permitted to pool his costs and when the last vessel is completed and final audit is made, the actual costs are allocated to each vessel. As the bill is drawn, renegotiation would have to be commenced within 1 year after the close of the fiscal year in which the tentative profits were received or accrued and would have to be completed within 1 year thereafter. In such special situations,

where peculiar accounting problems exist, the board should be permitted to renegotiate contract by contract under such regulations as seem desirable in the circumstances and the 1-year limitation should not apply.

So much for specific objections. It seems unfortunate, in view of the excellent results already achieved under the present law, that so many amendments should receive an attentive ear, which either add to an increasingly heavy administrative burden without corresponding compensation in equity, or, by enlarging the field of exemption, actually multiply inequities in the application of the principle of renegotiation.

Third. For example, the pending bill requires (subsec. (c) (1)), even in cases where the contractor and the Government have executed presumably final agreements, that the board prepare and give the contractor a written statement of the facts and reasons upon which the excessive profits theretofore agreed upon were determined. The preparation of such a statement at first blush seems innocuous. In fact, it is extremely difficult and burdensome administratively, in view of the many intangible factors which must be weighed, and when all is said and done it proves no useful purpose whatever. In the case of a unilateral determination, such a statement may be in order, but surely in the case of closed agreements, it is unwarranted and should be stricken from the bill.

Fourth. The proposed definition of subcontracts retains for purposes of renegotiation only those items which actually enter into the end product or a component part thereof. A partial survey indicates that the Maritime Commission Price Adjustment Board recovered approximately $13,800,000 on renegotiable sales in 1942 of $95,600,000 from various subcontractors who furnish equipment used in connection with the production of articles incorporated in ships. This is exclusive of contractors furnishing machine tools, pipe fittings, valves, and so forth. All of this business would be excluded from renegotiation in 1943 by the new definition of subcontract. In fairness to other manufacturers, such excessive profits should be recaptured. It offends my sense of equity to subject to renegotiation a shipbuilder and also the subcontractor who supplies the steel to the shipbuilder and to recapture excessive profits from both and to revise the price structures with respect to both and yet to exempt from renegotiation the subcontractor in between, who provides the equipment for prefabrication of that steel and to permit him to retain substantial excessive profits.

With respect to these and similar provisions of the bill, I am in complete accord with the position of the joint board and commend its views for your favorable consideration.

The details are simply suggestions as to clarifying certain minor points in the bill which can be much better handled by the joint board.

Senator WALSH. Are the amendments which you proposed in keeping with those of the Under Secretary?

Admiral LAND. Yes, sir.

Senator WALSH. And I understand all the Department heads are in accord as to the changes which should be made in the House provisions?

Admiral LAND. I believe that is correct.

(The statement of the Joint Price Adjustment Board follows:)

JOINT PRICE ADJUSTMENT BOARD,
Washington, D. C., December 8, 1943.

STATEMENT OF THE JOINT PRICE ADJUSTMENT BOARD FOR THE INFORMATION OF THE SENATE FINANCE COMMITTEE WITH RESPECT TO THE PROVISIONS OF THE PENDING REVENUE ACT OF 1943 (H. R. 3687) EMBODIED IN TITLE VII—RENEGOTIATION OF WAR CONTRACTS

The Joint Price Adjustment Board, comprising representatives of the several departments concerned with renegotiation of war contracts and authorized by the Secretaries of War, Navy, and Treasury Departments, the Chairman of the Maritime Commission and Administrator of the War Shipping Administration, and the Reconstruction Finance Corporation Price Adjustment Board to formulate and adopt statements of purposes, principles, policies and interpretations binding on the several Departments, has carefully considered the provisions of H. R. 3687 title VII, renegotiation of war contracts, and submits the following comments with respect thereto for the information of the Senate Finance Committee:

(1) *Scope and method of judicial review.*—The departments concerned with renegotiation have repeatedly stated that they had no objection to the making of some statutory provision for judicial review and, in fact, have expressed the opinion that such right of review exists under the present law. There has recently been brought to the attention of the Joint Price Adjustment Board the strong objections of the Treasury Department and the Department of Justice to the proposed granting of jurisdiction over renegotiation review to The Tax Court of the United States. The strength of these arguments is recognized by the other departments concerned and in the light thereof the Joint Price Adjustment Board agrees that jurisdiction over appeals from renegotiation determinations should be assumed by the Court of Claims in order that the Tax Court of the United States may be kept free for exclusive attention to tax matters.

With respect to the scope of review, the Joint Price Adjustment Board agrees with the position of the Department of Justice, as expressed to the Joint Board, to the effect that any determinations of the Secretaries of the departments or of the proposed War Contracts Price Adjustment Board should be final and conclusive except to the extent that the contractor can establish on the basis of the record made by the contractor in the court review proceeding that the determination was the result of a mistake of law, fraud, arbitrary, or capricious action, or was so grossly erroneous as to imply bad faith. This is the traditional procedure which has been adopted in connection with court review of similar governmental determinations.

(2) *Review by the War Contracts Price Adjustment Board.*—The proposed bill gives the contractor an absolute right to require review by the newly-created Board, and the act specifically provides that the Board may not delegate "the power, function, and duty to review orders determining excessive profits" (subsec. (d) (4), p. 118). It is respectfully submitted that in the light of contemplated provisions providing for review by a court in those cases where no agreement can be reached, it is entirely unnecessary and would constitute a very real administrative burden to provide for another review by the War Contracts Price Adjustment Board. The Joint Price Adjustment Board, created by voluntary action of the interested departments, is now functioning satisfactorily for the purpose of setting up uniform purposes, principles, policies and interpretations, and there is no reason why a similar Board should not be established by legislative action. But the requirement that such Board should review all orders determining excessive profits would require the creation of a substantial administrative staff, and would impose burdens and duties upon the individual members of the Board which would interfere with the performance by them of their duties in connection with current renegotiations in the various Departments for which they are responsible.

(3) *Review of closed agreements.*—The proposed bill provides for court review of past and future determinations of excessive profits (subsecs. (e) (1) and (e) (2), pp. 119 to 122). Included in this review are determinations "made prior to the date of the enactment of the Revenue Act of 1943 with respect to a fiscal year ending before July 1, 1943, * * * *whether or not* such determination is embodied in an agreement with the contractor or subcontractor." (Italics supplied.)

This provision would render subject to court review thousands of voluntary bilateral agreements under which total refunds and price reductions (without giving consideration to the effect of taxes) will aggregate upward of $5,000,000,000,

including both excessive profits refunded and to be refunded, and specific price reductions on articles delivered or to be delivered in the future. It is estimated that the maximum cost to the Government of such refunds after allowance for taxes could amount to $1,500,000,000 on the basis of current tax rates and this figure might be materially increased if lower tax rates were in effect in the year in which the refunds were made available to the contractors. This provision would not only create a potential administrative burden which might be literally impossible of effective accomplishment, but might be construed to invalidate the bilateral character of the agreement in such a manner as to jeopardize the right of the Government to retain the refunds which have been made and to collect the refunds which are to be made thereunder.

There might also be placed in jeopardy the provisions of the agreement providing for past and future price reductions. Many renegotiation agreements include clauses providing generally for the elimination of excessive profits likely to be realized in the future through price reductions without specifying the amount of the reductions to be made on specific articles or contracts. It is estimated that the total reductions and refunds under such clauses would represent an additional amount substantially in excess of the total of specific refunds and price cuts included in the $5,000,000,000 referred to above. The status of such clauses would be necessarily uncertain and the proposed review of closed agreements could thus possibly affect refunds and price reductions aggregating upward of $10,000,000,000 (before taxes).

The refunds and price reductions provided for under these voluntary agreements were made as a part of a repricing policy which was in fact inaugurated some time prior to the passage of the original Renegotiation Act of April 28, 1942; and, if the act had not been available for this purpose, there is no doubt that the departments concerned would have endeavored to effect similar results through the use of other war powers relating to placing and cancelation of contracts and the subsequent modification thereof. In no case have the departments accepted agreements which are made conditional on the validity of the renegotiation statute or which under their terms could be affected by subsequent legislation or court decisions. These agreements represent accepted transactions between the departments concerned and the contractors. It is respectfully submitted that it would be clearly prejudicial to the interests of the Government if such agreements should now be reopened and the rights of the Government thereunder subjected to review and possible modification or extinction.

In addition to the foregoing matters which involve major questions of policy, there is attached hereto as exhibit A a list of certain additional suggested revisions which it is believed are consistent with the general purpose and intent of the bill but which would operate to clarify or improve, from an administrative standpoint, certain specific provisions of the bill as noted.

JOINT PRICE ADJUSTMENT BOARD,
By ——— ———, *Chairman.*

Exhibit A. Administrative or clarifying amendments of title VII Renegotiation of war contracts of the revenue act of 1943, H. R. 3687, suggested for consideration of the Senate Finance Committee by the Joint Price Adjustment Board

A. *Centralization of all repricing authority under the Secretaries of the departments.*—The provisions of the act defining the powers of the Secretaries, as distinguished from the powers of the Board, with respect to all matters affecting repricing should be modified so that the Secretaries would be given all powers relating to repricing or exemption of individual contracts and subcontracts. The proposed bill creates a clear distinction between repricing of individual contracts with respect to which authority and responsibility is centered in the Secretaries of the departments and over-all retroactive renegotiation with respect to which authority and responsibility are vested in the War Contracts Price Adjustment Board. The suggested revisions make it clear that this distinction or division of responsibility should be maintained in all of its phases and, in this connection, it is further suggested that it should be expressly provided that unless specifically exempted adjustments of prices made from time to time under the repricing power should not preclude the Board from considering profits derived from such contracts in connection with subsequent over-all renegotiations on a fiscal-year basis.

B. *Raw material exemption* (subsec. (b), p. 124, 125).—In order to make it clear that this exemption does not prohibit the renegotiation of management or operating contracts for Defense Plant Corporation plants to be used for processing, refining, or treatment of exempted raw materials, it is requested that the following clause should be added at the end of the raw material exemption (p. 125,

line, 3, after the word "use"): "except that this provision shall not be construed to eliminate from renegotiation any contract or arrangement otherwise subject to renegotiation with one of the departments (a) for services performed on a fee or cost-plus-fixed-fee basis with respect to any such products or (b) for the use or operation of a plant or facility by a department for the production, processing, treatment, manufacture or transportation of any such products."

C. *Special cost allowance in the case of integrated producers.*—The attention of the committee is further directed to an apparent error in connection with the provision of the bill relating to the allowance of market value as an element of cost in the case of a producer processing an exempted product "to or beyond the first form or state" (p. 126, lines 14 and 17) at which the exemption terminates. It is believed that the word "and" should be substituted for the word "or" in the above-quoted phraseology so that it would be clear that the allowance of market value would apply only to the producer who processes the exempted product to and beyond the exempted stage and would not apply to a producer who purchased the product at the exempted stage at a cost which might vary materially from the market value at the time of its use.

D. *Authorization of individual contract renegotiation under special circumstances.*—It is believed that the provisions of the act requiring over-all renegotiation on a fiscal-year basis (subsec. (c), p. 109, 110) should be modified in order to give the board authority to require renegotiation either on an individual contract basis or on the basis of classes or types of contracts. This provision will be necessary in the case of certain classes or types of contracts or subcontracts, such as shipbuilding or other long-term construction contracts, various types of profit-limitation contracts, or contracts which have not been completed during the fiscal year in question or with respect to which it is not practicable for accounting or other reasons to conduct renegotiation on an over-all fiscal-year basis.

In this connection attention is further directed to the fact that there should be some provision for the relaxation of the provision of the bill requiring completion of renegotiation within 1 year from the date of commencement where the nature of the contract is such that it is impossible to reach an accurate and final result on the basis of a yearly fiscal period. Long-term shipbuilding contracts are an example of contracts falling in this category.

E. *Limitation of mandatory requirement for insertion of repricing clause in all contracts* (subsec. (b), p. 107).—The bill in its present form directs the Secretary of each department to insert in all contracts entered into after 30 days after the enactment of this act certain terms which are specified in the legislation. It is suggested that the insertion of such terms should be made mandatory on the Secretaries only in the case of contracts in excess of $100,000 as provided in the existing law, since it is manifestly impracticable to include such a clause either directly or by reference in the many thousands of small contracts and purchase orders which constitute a large proportion of the total number of contracts entered into by the departments although representing in the aggregate only a relatively small dollar volume.

It is suggested that consideration be given to the possible elimination of the provision specifying the type of renegotiation clause to be inserted in all contracts, since the bill specifically provides that the required contractual provisions shall be "binding, only if the contract, or subcontract, as the case may be, is subject to subsection (c)" (p. 109, lines 1, 2) and if subsection (c) is valid there would appear to be no necessity for a supplemental contractual commitment.

F. *Retroactive application of new exemptions and related provisions.*—It is suggested that the exemptions of charitable contracts (subsec. (i) (1) (D), p. 125, line 25) and of subcontracts under exempt prime contracts (subsec. (i) (1) (E), p. 126, line 3) and the provision for special cost allowances at the exemption line in the case of exempted products used by integrated companies (subsec. (i) (3)) should be added to the list of provisions of the act which are made effective as though they had been made a part of section 403 on the date of its enactment, April 28, 1942 (see subsec. (d) effective date, p. 130, line 7).

G. *Exemption of seasonal canners.*—Since the Committee on Ways and Means completed action on the bill, an investigation has been made of the possible effect of the provision which would exempt "any contract or subcontract for canned, bottled, or packed fruits or vegetables (or their juices) which are customarily canned, bottled, or packed in the season in which they are harvested." This investigation indicates that substantial excessive profits may have been realized in this field and that such contracts should not be included in the agricultural exemption (subsec. (i) (1) (C), p. 125, lines 10–13).

H. *Definition of subcontracts.*—The attention of the committee is directed to the fact that the definition of "component article" embodied in subsection (5) (A) (ii)

(p. 104, line 21) does not clearly evidence the intention of Congress with respect to products, portions of which do not actually appear as a part of the end product ultimately acquired by the Government because of the fact that they either disappear or are reduced as the result of intermediate processing, refining, or treatment. If it is the intent of Congress that contracts for all such articles which enter into the end product or a component part thereof at any stage of the manufacturing process should be subject to renegotiation, it is suggested that the phrase "in whole or in part, directly or ultimately, or in the same or some other form" should be inserted immediately following the word "which" in the second line of the definition of "component article" (line 22, p. 104).

The attention of the committee is further directed to the fact that the revised definition of "subcontract" embodied in the proposed bill will result in the exclusion from renegotiation of a very large field of subcontracts for both durable products used directly for war production purposes, such as all types of machinery and equipment and also large volumes of expendable supplies and equipment, such as grinding wheels, acetylene torches, and all types of mill supplies. It is estimated that the total recoveries of excessive profits from contracts of this character subject to renegotiation under the existing law were very substantial for fiscal periods ending on or before the proposed effective date of the new act, June 30, 1943. There is attached hereto an exhibit setting forth a number of refunds secured from companies which would be exempted under the new provisions. These examples indicate the increased cost of the war which will necessarily result from this exclusion from renegotiation of large numbers of contractors who have profited largely and directly from war business. The exemption of these contractors is also going to make it more difficult to close voluntary agreements with other contractors who will necessarily feel that there has been some discrimination based on artificial concepts of subcontract rather than on participation in the war effort.

I. The attention of the committee is directed to the requirement that the Board, at the request of the contractor, furnish him with a statement of the determination of excessive profits, of the facts used as a basis therefor, and of its reasons for such determination (p. 110, lines 24–25, and p. 111, lines 1–6).

In complying with this requirement it will be necessary to set out in writing to the contractor a statement of the facts and factors, unfavorable as well as favorable, of his efficiency, ability, contribution to the war effort, risk, and other elements necessary in the determination of excessive profits. This material cannot be flattering in all cases. We can anticipate a greater dispute and dissatisfaction from the detail of reducing these criteria to writing, even though they may be generally understood as between the contractor and the renegotiators in informal discussion, than over the amount of settlement itself. We do not believe this requirement, on balance, will be of sufficient benefit to contractors to outweigh the harm it may do in impairing the informal atmosphere in which these renegotiation proceedings are conducted and agreements are reached in the great majority of cases.

J: *Miscellaneous technical changes.*—In addition to the foregoing, it is believed that the bill would be clarified and that administrative problems thereunder considerably lessened if the following changes are made:

1. Page 102, line 5, strike out the word "raw". There is no reason for confining this factor to the use of raw materials.

2. Page 102, line 8, strike out the word "and", and in line 9, after the word "earnings", insert "and comparison of war and peacetime products". A contractor now manufacturing a product substantially different from his peacetime product should have this important factor fully considered.

3. Page 103, line 15, after the word "subcontract", insert "or to such contracts or subcontracts as a group". This change would clarify the situation where the costs in question are not chargeable to any particular contract or subcontract but like items of overhead are chargeable to a broader scope of business done.

4. Page 103, line 25, after the word "agency", insert ", established prior to January 1, 1942". This change would prevent the abuse of this provision by the nominal establishment of such an agency solely for the purpose of avoiding this test.

5. Page 111, line 12, after the word "them", insert ", through whichever of the following methods the Secretaries or any of them so directed seem desirable". While the Board is given the power to determine the excessive profits, the Secretaries have the obligation to eliminate the excessive profits so determined. Because of the Secretary's close familiarity with the situation in the various cases it would seem best to allow him to choose the method best suited to the facts in each case.

6. Page 112, lines 18 and 19, strike out the word "determining" in line 18 and insert in lieu thereof "eliminating"; and in line 19 strike out "to be eliminated" and insert in lieu thereof "determined". This change is necessary to correct a technical error. Under the bill, the Board determines the excessive profits while the Secretary eliminates them.

7. Page 121, line 9, change "(d)" to "(c)". This change is necessary to correct an erroneous cross-reference.

8. Page 126, lines 4 and 5, strike out "exempted from the provisions of this section, or". The present language is ambiguous. The change is needed to make it clear that the subcontracts to which the provision relates are only those under prime contracts or subcontracts exempted by reason of subsection (i) (1).

9. Page 119, line 24, after the comma, insert "or after the entry of the order of the Secretary under subsection (f), as the case may be,". This clerical change is needed to clarify the time limit in which a petition to The Tax Court may be filed in a repricing case.

Senator WALSH. Mr. Shea, your name is Francis M. Shea?

Mr. SHEA. That is right.

Senator WALSH. And you are Assistant Attorney General?

Mr. SHEA. That is right, sir.

Senator WALSH. And you are representing the Department with regard to the provisions of the renegotiation laws that are in the bill?

Mr. SHEA. That is right, sir.

Senator WALSH. Very well.

STATEMENT OF FRANCIS M. SHEA, ASSISTANT ATTORNEY GENERAL

Mr. SHEA. Mr. Chairman, the various departments have discussed this matter, and I think they are in general accord about it. What I want to speak of, and largely confine myself to, are the questions of review of renegotiation proceedings.

I think it is useful at the outset to attempt so far as one can to narrow down the issues to the real points in controversy. In the last few days there have been a number of representatives of contractors with the United States who have appeared here to register complaints regarding the manner in which renegotiation is carried on by the Army and Navy and to suggest, on the basis of these complaints, revisions of the legislation. One of the complaints which has been reiterated is that contractors have been coerced into renegotiation agreements by one form of threat or other. So far as I know the business of my clients, the Army and Navy, I doubt that there is substance in these charges. But whether or not there is substance in them, all departments of the Government are agreed that there should be an appeal to the courts to set aside agreements which are imposed upon contractors by coercion.

A second complaint which has been stated is that the Army and Navy are arbitrary and capricious with contractors in carrying on renegotiation proceedings. Again I am inclined to doubt the substance of the charge. But whether or not it has substance, all the departments are agreed that contractors should be able to go to the courts and have unilateral orders upset if they are able to show that the Army or Navy or other agencies involved were arbitrary in carrying through renegotiations. One of the charges falling under the general head of arbitrary action on the part of the Army and the Navy is the charge that they have been unwilling to consider relevant material offered by contractors which should have been considered in arriving at any fair determination of amounts to be recaptured pursuant to re-

negotiation. I am inclined to doubt the substance of this. But again whether or not there is substance in the charge, all the departments are agreed that the Army and the Navy and the other agencies charged with renegotiation should receive and should consider whatever materials contractors wish to present, relevant to the issue of what properly should be recaptured under the Renegotiation Act. In short, there is no one on the Government's side who urges that if any relief is needed on these scores, such relief should not be provided by the Congress. The only question, the only difference which exists between contractors and the Government departments is what are the efficient, the practicable ways of affording guaranties of fundamental rights and at the same time making it possible for this tremendous job to be done and done well.

I am sure that every member of this committee feels as certainly as I feel that fundamental rights can be as readily smothered by too much process as they can be impaired by too little process. I am sure you will all agree that a remedy which it would take a man a dozen years to get is generally as bad as and frequently worse than no remedy at all. I rather fear that the amendments proposed by the House are guilty of both sins. I think that their provision for three, probably four, full administrative hearings, each independent of the other, provide what I once heard Mr. Chief Justice Hughes from the bench characterize as undue process. On the other hand, by attempting to stop short of court review and make the last hearing a trial de novo in The Tax Court, which is but a part of the executive branch of the Government, they are guilty of depriving the contractors of procedural due process, which entitles them to court review of any claimed deprivation of fundamental constitutional rights. But now let me turn to the primary concern of my Department in this legislation.

The Department of Justice's primary concern in these amendments to the renegotiation statute is that whatever task be put upon it be one that is feasible to do and do well. We understand that in excess of 9,000 contractors have already been renegotiated by the War Department alone. These renegotiations with 9,000 contractors involve, of course, many times that number of contracts. Approximately 56 percent of such renegotiations were closed by determinations that no excessive profits appeared to be involved. Approximately 44 percent were terminated by voluntary agreements. Unilateral determinations were necessary in only a few cases. To date, the War Department alone has had in excess of 15,000 contractors assigned to it for renegotiation and the number of contracts and subcontracts involved in such renegotiations will undoubtedly run into hundreds of thousands. In addition, there are the thousands of contracts which have been and will be renegotiated by the Navy Department and other agencies. Obviously, in our judgment, if any large proportion of these contracts gets into court on the issue of what is the reasonable profit that should be, or should have been, received under them, no machinery of litigation can do the job. It must break down as a defective instrument. The courts and the Department of Justice will earn ill will for stumbling with a task our litigious procedures are not geared to cope with. If this job of renegotiation is to be done effectively and fairly, the great bulk of it must be disposed of by administrative procedures and not by litigation. More than that, I think the great bulk of it must be done by agreement. The best that the courts can do for the program is to police the adminis-

trative procedures to the extent of upsetting any determinations which are arbitrary or capricious, or so unreasonable in result as to indicate the absence of an honest effort to give fair consideration to the issues, which is but another way of saying that the matter was handled in an arbitrary and capricious fashion.

The amendments which have been proposed to the renegotiation law by H. R. 3687 are very likely to result, in the judgment of the Department of Justice, in substituting the equivalent of a rate hearing in The Tax Court for voluntary agreements or speedy administrative determinations. The counter proposals which we would like to urge upon you would provide that every emphasis be put on arriving at voluntary agreements, and where voluntary agreement fails, a speedy administrative determination, administrative review, and a final court review sufficiently limited to be practicable, while at the same time adequate to the protection of fundamental rights. What the Department proposes is that the administrative procedures follow the traditional mold of the equitable adjustment of Government contracts. An official or board in the Department would attempt to negotiate an agreement. If an agreement is reached, it should have finality unless there can be a showing of coercion or that there was fraud involved. Failing agreement, the official or board that carried on the negotiation would make an administrative determination. In the course of negotiation the official or board should receive whatever the contractor wants to present as to his position, provided he is not captious about it. The official or board would thus have ample material before him or them to make an administrative determination. An appeal to the head of the department would be provided, and the head of the department should receive under appropriate regulations such statement of the contractor's position as he wishes to make. The head of the department's determination should be final except for review in the Court of Claims or the district courts limited to issues of constitutionality, arbitrary and capricious conduct on the part of the administrative agency, error so gross as to imply bad faith, fraud, or mistake of law.

Let me now turn and take up in detail the objections to the amendments proposed by H. R. 3687. The most serious objection is that the legislation appears to invite a volume of litigation of the most time-consuming and difficult character. It provides that all agreements voluntarily arrived at through past renegotiation may be upset by a simple appeal to The Tax Court. One can only guess as to how much litigation will result from this provision. I should think some lawyers, if they were advising clients, might discuss the matter more or less in these terms:

> The Secretary of War has decided that your excessive profits are $500,000. The original contract price was $10,000,000. The statute does not allow the Tax Court to consider the statement by the Secretary upon the basis of which he made his determination, but we can get to the Court the amount decided to be excessive by the Secretary. The probabilities are that the Tax Court will not want to reduce what you will get below what the Secretary allows you. It may give you more. In the course of negotiation we had to arrive at compromises. There were various points at which we thought we were right but which were arguable and which we conceded in the renegotiation proceeding. There is at least some substantial ground for believing we could persuade the Tax Court of the rightness of our view in regard to some or many of these items. The question is how much you want to invest in a law suit.

I should think that kind of discussion might not be unlikely and, if not unlikely, a good many clients would feel, "What is there to lose in

starting a suit at least? It might help to work out a better compromise with the Government. It could be abandoned if the decisions of The Tax Court were generally running unfavorable to contractors, and so forth."

If any substantial proportion of the more than 4,000 agreements already made are reopened and a trial de novo had before the Tax Court, I think the Tax Court will be swamped, and it will be very difficult for the Government to manage the litigation expeditiously. Let's look at the kind of a case that one will have to try before the Tax Court. I assume if it is to be a de novo proceedings, and it is not clear from the legislation as to who carries the burden of proof, that either the contractor or the Government will have to state a case in about the following terms: It will have to be shown how much is invested in plant used in the performance of the contract, depreciation of the plant, what part of the investment of plant represents borrowings, the interest rate on those borrowings, some attempt at segregation and allocation of the business involved in the renegotiation and other business being done by the plant, a full story of the cost accounting regarding production under the contracts in question, a showing of what rates are being earned by investments representing similar risks, and so forth. I do not see how the case can be pitched in any other terms than this traditional pattern of a rate case, that is, the ascertainment of value and the reasonableness of the rate. This is one of the most time-consuming and difficult forms of litigation where such facts have to be proved by examination and cross-examination of witnesses, and so forth. To carry through a single case will certainly call for long preparation with numerous witnesses from the war agencies and long testimony by such witnesses before the Tax Court. If the Tax Court had nothing else to do, I should think a thousand such cases would take 10 years to dispose of, and I believe that is a very conservative estimate. As I have said, more than 4,000 renegotiation agreements will be opened up at once to the extent that the contractors care to take an appeal.

In addition, there are many thousands, perhaps hundreds of thousands, of contracts as of the present date which will require renegotiation. The proposed amendments provide that in the case of any renegotiations in the future there will be a determination by some official or board in the agency, a review presumably by the Secretary, final review by an over-all board, and then a trial de novo in the Tax Court if the contractor chooses. It is not predictable what percentage of litigation will arise out of the 4,000 renegotiation agreements already made and the future unilateral determinations. It is, I think, possible to say that the amendments proposed are a temptation rather than a deterrent to litigation and that contractors will feel that, regardless of the fairness and reasonableness of the renegotiation agreement or unilateral determination, no particular risk is involved in attempting to get a better result from a different tribunal.

This, then, is the salient objection of the Department of Justice. We think we can do a good job in handling litigation arising out of renegotiation if the litigation is limited to affording contractors an opportunity to come to the courts on a showing that they have been treated in an arbitrary and capricious fashion or so unreasonably that the court may fairly imply the absence of any fair consideration of the matter by the administrative agency. We are bound to feel, on the other hand, that the courts and the law officers of the Government

must fail in their task if the Congress puts upon them the job of attempting recapture of excessive profits by a series of rate cases. The present amendments proposed by H. R. 3687 in our judgment put upon us that impossible task. We think that contractors may be assured fair dealing by the kind of limited review in the courts which we propose. Indeed, in the final analysis we have no doubt that ultimate fairness to the contractor will be much better served by such limited review as we propose than by the trial de novo provided by H. R. 3687.

I should think contractors themselves, if they were well advised, would be dubious of the ultimate value of the remedy proffered by H. R. 3687. In the end, real justice to contractors must depend on the adequacy and the fairness of the administrative procedures rather than on the remedies had in court. If contractors are to get their money speedily, if they are to get what is fairly due them on time, it will be by efficent, reasonable and fair operations in the Army, the Navy, the other agencies which have primary responsibility for renegotiation. While contractors can take advantage of trial de novo to get more, as I have already pointed out, and while counsel, looking only to what can be recovered, would I think be likely to advise resort to The Tax Court in a goodly number of cases, over-all fairness of treatment to contractors, in my judgment, is not to be found in that direction. If the court's job is to consider independently what the excessive profits have been, rather than how fairly they have been determined by the administrative agency, they are not likely to do as good a job of policing the administrative agency, as if that were the function with which they were immediately charged. In short, if the agency is merely confronted with the possibility of another tribunal arriving at a different judgment from theirs, that is not likely to affect their manner of doing business. Anyone knows that two different tribunals deciding on questions of value and reasonable rate are likely to arrive at different judgments even though they both do their job fairly. Consequently the criticism of the agency is relatively slight in whatever differences may result from such review and the restraint therefore negligible.

On the other hand, if the agency must expect castigation from the court if it has been unfair in its dealing with contractors, then there is a real deterrent in court review to arbitrary conduct on the part of the administrative agency. Moreover, as I have pointed out, many trials de novo will swamp the court, and effective policing of the operations of the Army and Navy now is not to be had by court decisions 10 years from now. There is always danger that too much process may become undue process, and that an overelaboration of resort to the courts may be as bad as attempting to shut off legitimate resort to the courts. I am confident that the kind of review which will afford effective policing of the administrative process is the kind of review which will not only best serve the interests of the United States but will also best protect the rights of the contractors.

There is a second point of vital concern to the Department of Justice which emerges out of the proposed amendments contained in H. R. 3687. I doubt that the Congress can forbid contractors' resort to a judicial tribunal to contest the issue of procedural due process. There is substantial reason to believe that "under certain circumstances the constitutional requirement of due process is a requirement of judicial process." The powers of Congress to withdraw jurisdiction from the

Federal courts is, of course, broad indeed. But that power does not of necessity imply a right absolutely to prohibit judicial review.

Moreover, this bill is not drafted to be effective as an absolute prohibition of judicial review, if the power so to prohibit did exist in the Congress. I am fearful that it will merely substitute injunction suits for the more orderly process of an adequate remedy at law. In short, assuming the right of the Congress to impose renegotiation orders, I doubt that it can prevent resort to some judicial tribunal on complaint of the contractor that the way renegotiation was done was arbitrary and capricious. I doubt that the legislation is drafted effectively to prevent resort to the courts by injunction suits and other means to review that issue. Provision for appeal to The Tax Court very probably does not constitute an adequate remedy at law which satisfies whatever right there may be to judicial process. The Tax Court is a part of the executive branch of the Government. In *Old Colony Trust Co.* v. *Commissioner* (279 U. S. 716), it was so held by the Supreme Court in respect of the Board of Tax Appeals. While the name has been changed from Board of Tax Appeals to Tax Court, no difference in the method of appointing its members or in the general extent of its powers has been provided by the Congress. I do not say that if this bill were properly drafted for the purpose Congress might not thereby constitute The Tax Court one of the lower Federal courts and invest it with powers which would make it a fit tribunal for the satisfaction, by its review, of these fundamental constitutional rights. I do think the Congress would have to go further than it has in this bill to make it a judicial tribunal.

We now have an injunction suit testing the constitutionality of the Renegotiation Act. I feel reasonably confident of the outcome. But I should be concerned by any attempt to put in The Tax Court final review of administrative determinations on renegotiation. I hope for these reasons that the Congress will explicitly provide what I think implied in the present state of the law, judicial review of the limited character I have suggested in the Court of Claims and the district courts of the United States.

There is another objection to the jurisdiction being invested in The Tax Court and an objection which intimately concerns the Department of Justice. The Tax Court is just now climbing out of a morass of undecided cases which have in substantial measure frustrated the adequate administration of the tax laws for some period of years. It has about reached the point where it is current with its business. Without the obligations which these amendments would impose upon it, a tremendous volume of litigation, tax litigation, is bound to fall to its lot before very long. If there is to be adequate handling of tax litigation, The Tax Court should not be overburdened with matters that will divert it from its own primary function of protecting adequate administration of the revenue laws. The Treasury witnesses have elaborated on this point.

I speak of it solely from the point of view of the Department of Justice's responsibility respecting that aspect of the administration of the revenue laws which is involved in the expeditious and adequate handling of litigation. I suppose it may be argued that the Court of Claims and the district courts will be burdened with tremendous other tasks when this war is done. I cannot dispute that. I think the only hope of the Court of Claims and the district courts doing this job effectively is for the jurisdiction conferred to be sufficiently limited so

that there will come to them only that minimum number of cases essential to the adequate policing of the administrative processes. But I make this further point, namely, that in my judgment unless The Tax Court is radically changed in character, trial de novo in that court provided by H. R. 3687 or any other form of proceedings in that court will not preclude litigation about the same matter in the other courts. Therefore, to put such litigation in The Tax Court will not relieve the other courts. The only result I see to such proceedings in The Tax Court is to pile on top of two or three others a further exhaustive administrative hearing. Final disposition of the matter is to be had only in judicial tribunals.

There are two or three other criticisms of the bill that I think I should touch on in passing, though they can be stated with much greater force by other departments than the Department of Justice.

The first of these is a criticism of the provisions concerning the over-all board. I have no doubt of the wisdom of an over-all board to establish uniform policies for renegotiation in the several agencies. There is now such a board. It performs those functions. It should, I think, be continued for the performance of those functions. However the bill will, I think, make it impossible for it to act as a guiding over-all policy committee. It imposes on it actual administration of renegotiation. In fact, it vests in it the primary obligation for renegotiation, permitting it to delegate to the agencies but exacting of it the final review of all renegotiation, to the extent that contractors ask such review.

Obviously, no board of a half dozen men can perform that function if it is to be performed with any expedition, and if there are involved anything like the number of renegotiations which seem reasonably predictable. It will have to delegate those functions to a staff. It will have to build up a very large staff to do the job. However able the staff, there will be less adequate personnel available than is available within the agencies. Further, as I read the statute, and on the basis of probable results which one can predict from existing practice, there will be a triple administrative hearing under this bill. The Navy, for instance, will provide original determination of renegotiation by the Price Adjustment Board. There will then be an appeal to the Secretary or whomever is named to act for the Secretary. A full review presumably will be provided there as it is now.

Finally, there will be a full review by the over-all board. This is obviously a cumbersome procedure. In the final analysis one fair trial and one good appeal is worth any multiplication of the procedure that too abundant caution is inclined to supply. We are fearful in this connection, and to this extent it legitimately concerns us, that the administrative process may prove inadequate, may break down because it is too cumbersome, and that litigation will be brought to resolve controversies which would be disposed of below the judicial level if sound administrative procedures obtained.

A further point which disturbs us on analysis is this: There appears to be an attempt in this legislation to split the renegotiation and repricing functions. It is not carried out with consistency, and I am somewhat at a loss on a reading of the statute as to just how far this splitting is intended to go. It is clear that ultimate jurisdiction of renegotiation is vested in the over-all board. Ultimate jurisdiction of repricing is vested in the secretaries of the various departments

Renegotiation is limited to determinations for a fiscal-year period except as provided in (c) (1) and (c) (4).

Repricing, of course, must be in terms of the contract period or some more limited and tentative pricing period. Were this split process to prevail, it appears to us that large value may be lost by the proposed amendments. Consider what the normal renegotiation procedure is likely to be. Until the war is done the contractor who is up for renegotiation is not a person who has completed his work with the Army or the Navy. He is a man who is continuing the program of supply. The probabilities are when renegotiation is had that the full examination of his costs will indicate not merely need for recapture of excessive profits of the past but readjustment of existing contracts calling for future performance.

If responsibility for both these functions is centered in the same ultimate authority, much more effective results may be expected both in repricing and renegotiation. Whether repricing and renegotiation be done as a single job, or in two steps, it ought to be as coordinated parts of a single over-all process.

This kind of coordination is difficult to get if the ultimate authority is deposited in different heads. For these reasons it is, I think, the opinion of all departments concerned that the powers relating to over-all renegotiation as well as the powers relating to repricing and the exemption of individual contracts should be vested in the Secretaries of the departments concerned so that the whole program may be adequately coordinated.

This is a problem on which the Army and Navy can speak with more authority than the Department of Justice, but it is a point which I feel should be mentioned. It is of concern to us because the prospect of our job being well done depends in large measure on how well the administrative job is done before we are called in for surgery.

There is a final point which I should like to touch upon. Again this is primarily the concern of the services rather than the Department of Justice. I think there is no possibility of having this job done effectively if you swing from what is provided in H. R. 3687 to a scheme of requiring that the administrative proceedings be the equivalent of rate-hearings before the Interstate Commerce Commission.

Whether such hearings be in a court or in an administrative tribunal, the process is endless and the results inevitably meager. The I. C. C. and the Federal Power Commission may effectively regulate a limited number of companies in specialized fields. But I think it clear that no administrative agency could effectively work out recapture of excessive profits from tens of thousands of contractors in every conceivable enterprise by the procedures of regulatory bodies. If this job is to be done, and done effectively, the bulk of the cases must be liquidated by voluntary agreement. The bulk of the remainder must be ended by administrative determinations. Litigation must be confined to a very small percentage and limited to what is necessary effectively to police the administrative proceedings.

We do not need to speak without experience in this regard. One of the great abominations committed against the existence of sound relationship between administrative and judicial responsibility was the holding that trial de novo must be had in the courts of the fixing of rates on the plea that the rates fixed resulted in confiscation. The Supreme Court has recognized and in large manner corrected the farce

which was made of the administrative process by that doctrine. It is our hope that the Congress will not impose a repetition and repetition bound to be more serious because of the vastly greater volume which is involved under the renegotiation acts.

As I have said, renegotiation legislation should be designed to remove temptation of resort to the courts except where necessary to keep the administrative procedures from becoming arbitrary or capricious. It should, so far as it fairly can, throw its weight toward inducing voluntary agreements fairly arrived at as the solution for recapture of excessive profits. It should definitely provide, as I think it now impliedly provides, resort to the courts where there has been unfair treatment of the contractor.

So far as possible the legislation in this regard should follow the forms which are known, established, and of proved satisfactory character. The traditional procedure for meeting the kind of problem here in question is the procedure followed under the standard form of Government contract.

Where work is required because of unforeseen conditions not specifically provided for in the contract, the standard contract provides (1) an attempt at voluntary agreement as to the price, (2) failing voluntary agreement, a determination by the contracting officer of the equitable adjustment, (3) appeal to the head of the department, (4) finality of determination by the head of the department, in the absence of fraud, arbitrary or capricious action, or conduct so unreasonable as to imply bad faith on which grounds court review may be had. This has been in force for years, and there has been no substantial complaint that with the review provided by the Court of Claims and district courts, as above specified, it does not protect fairly the interests of contractors.

Following this traditional pattern it is suggested that the procedures for administrative determinations upon renegotiation and judicial review of the administrative determinations should be substantially along the following lines:

Negotiations by an officer or board of the agency aiming at voluntary agreement. In such negotiations all materials relevant to the question of excessive profits should be received from the contractor. If voluntary agreement is arrived at it should be final in the absence of coercion, fraud, or misrepresentation. If a voluntary agreement cannot be arrived at, then the agency's officer or board should make a determination of the amount of excessive profits, which should be communicated to the contractor.

The contractor should be allowed an appeal to the Secretary or his representative and privileged to present his case orally or in writing under appropriate regulations. The determination by the Secretary should be final in the absence of fraud, arbitrary or capricious action, or error so gross as to imply bad faith. Following that determination there will be either a withholding by the Government or a direction to a prime contractor to withhold, or suit to recover excessive payments which have been made. If there is a withholding by a prime contractor pursuant to direction of the Government, the withholding should be for the account of the United States and no suit should be available to the subcontractor against the contractor. Suit against the United States should be substituted, however, as his remedy.

If suit is had against the United States on account of withholding, it should be in accordance with the Tucker Act jurisdiction in the Court of Claims or district courts. In such suit or in a suit by the United States to recover excessive profits already paid, the court should have jurisdiction of the entire renegotiation. Its review, however, should be limited to the issue above specified of whether there has been fraud, arbitrary or capricious conduct, or error so gross as to imply bad faith. In the event that the court upsets the Secretary's determination on any of these grounds, then it should independently fix the excessive profits.

I believe this to be a wholly feasible way of meeting the problem and that it will protect the interests both of the Government and of the contractor without inviting a volume of litigation and without encountering the difficulties which I feel to be presented by the proposed amendments contained in H. R. 3687.

In conclusion may I call your attention to certain problems that I think are raised by the provisions of H. R. 3687 relating to effective dates. It is provided that the amendments made by the bill shall be effective only in respect of the fiscal years ending after June 30, 1943, except that (1) the amendment inserting subsection (b) which relates to the inclusion of specified provisions for renegotiation in future contracts shall be effective 30 days after the effective date of the act; (2) the amendments adding subsections (e) (2) and (f) which relate to review by The Tax Court of renegotiation and repricing shall be effective from the date of the enactment of the act; and (3) the amendment inserting subsection (i) (1) (C), which relates to the exemption of agricultural commodities, shall be effective as if such subsection had been a part of section 403 on the date of its enactment.

It seems to me that these provisions leave in the area of doubt a number of matters which are likely to be a prolific source of litigation.

1. Where contracts regarding agricultural commodities have been renegotiated in the past and voluntary agreements as to excessive profits made, and those profits recaptured or withheld, is the contractor now to be allowed to recover those excessive profits?

2. Where, prior to these amendments, a provision for renegotiation has been included in a contract relating to agricultural commodities, does that contractual obligation persist and should renegotiation go forward under it?

3. Under the new definition of subcontract, a subcontract relating to machine tools is exempt from renegotiation after the effective date of these amendments. Suppose there has been, prior to these amendments, a specific provision for renegotiation included in such a contract. Does that stipulation persist, and should renegotiation be had under it?

The Department of Justice is not concerned as to how these questions are answered. It is concerned that they should be answered explicitly in the legislation so that they will not be a prevalent source of litigation.

Senator CLARK. If they have five separate hearings here, administrative hearings, they don't get into court at all?

Mr. SHEA. That, I think, is one of the really fundamental defects.

Senator CLARK. None of them are really appeal hearings, when one department can overule a previous determination, and make a final determination?

Mr. SHEA. So far as I can see, Senator, the consequence is going to be three or four duplications of full administrative hearings, without any provision for court review, and the gist of what we want to propose is that adequate remedy is not a multiplication of procedure; it is one good trial and one good appeal on the administrative side, and a hearing by a court of those issues which should properly be reviewed by a court.

Senator CLARK. Where the administrative agency is the final determining agency, it doesn't make any difference how many there are; it does not mean that he has had his day in court.

Mr. SHEA. That is right.

Senator CLARK. The essence of a review is a review in court, not by any other administrative agency?

Mr. SHEA. I think that is really the case.

Senator CLARK. And this administrative agency was formerly the United States Board of Tax Appeals?

Mr. SHEA. It was known as the Board of Tax Appeals, and you didn't change the method of appointing its members or the general scope of its functions. That is one of the things we are bothered about, and one of the things we fear in this.

Senator MCKELLAR. Does the provision that you suggest for a court review provide a review of the bilateral agreements that have already been made?

Mr. SHEA. No, sir. That is one of the primary things that we feel is wrong with the amendments which have been proposed by the House. Here you have, I am informed, about 9,000 contractors who have been renegotiated by the various Government agencies, and I think approximately 56 percent of those 9,000 contractors were cleared; that is, there was a determination, at least a temporary determination, that there was no excess of profits involved; and, of course, the 9,000 contractors involved many times that in the way of contracts; it was probably hundreds of thousands of contracts. Renegotiations with about 4,000 have been concluded by voluntary agreement. In very few instances has there been any need for a unilateral order.

These amendments propose, in respect of those voluntary agreements, that they may be opened up by a simple appeal to The Tax Court. Certainly there is no justification for that, unless there was actually coercion in the making of these agreements, and we say if there was actually coercion let there be a court review on that issue. If the contractor can come in and show there was coercion, then let the matter be reopened and then let the redetermination be made, but in the absence of a preliminary showing that there was coercion in the making of those voluntary agreements, we say that there is no possible justification for opening them up.

But more than that, we say if you do open them up, and you go into The Tax Court, de novo, with any large percentage of these, you are going to swamp The Tax Court, and put on the legal officers of the Government a burden they just can't possibly carry.

Senator CLARK. It is your proposition that these cases can be reopened on a showing that coercion in fact had been resorted to by the Government in making the previous settlement?

Mr. SHEA. I think as the law now stands that relief can be had, but if you have doubt about it, let that be written into the statute,

but let it be limited to that kind of issue which is the appropriate issue for a court to review.

In short, the feeling which the Department of Justice has is that the job cannot be effectively done if you try to substitute litigation for administrative procedure. We feel also there is no possibility of your getting this job done unless the bulk of it is done by agreement.

Senator CLARK. How would that work? According to your proposal, the Tax Court has jurisdiction, and on allegation by the contractor that there has been coercion in the settlement——

Mr. SHEA. Not The Tax Court. I would say a real court.

Senator CLARK. I am saying now that The Tax Court has it. You would confer jurisdiction by the bill. That would present a special issue for the court to determine, as to whether or not there had been coercion, and if they found there had been coercion, then they would go into the merits of the case.

Mr. SHEA. If there had been coercion.

Senator CLARK. Otherwise, they wouldn't go into it?

Mr. SHEA. Otherwise there is an end to it.

Senator RADCLIFFE. Isn't the fact that there is a possibility of unilateral action being taken—is that in itself any evidence of coercion? I mean, if you are in the shadow of a unilateral agreement, would that possibly be any evidence of undue pressure on the parties to come to a bilateral agreement?

Mr. SHEA. Well, that has to be answered——

Senator RADCLIFFE. I mean, if the parties are all acting in perfectly good faith.

Mr. SHEA. Yes; and I want to answer that question.

Senator RADCLIFFE. I mean the bare fact of the existence of that shadow.

Mr. SHEA. I suppose it might have some such effect, Senator, but if it was felt by a person sitting down to negotiate a bilateral agreement that he was not being fairly treated, I assume he would sit back and say, "Make a unilateral determination and I will seek its review, and if you don't treat me fairly, and if you make a determination which is unfair and outrageous, I will go to the courts on it."

I assume that would be the attitude.

Senator RADCLIFFE. I didn't mean to suggest that either party would attempt that, but I just urge the existence of that right.

Mr. SHEA. Sir, when the Government goes out and tries to buy a piece of land, I suppose that the fact that the Government can condemn might or might not affect the amount of consideration, as to whether a man will sell a piece of land or won't sell a piece of land.

Senator RADCLIFFE. It might have some weight.

Mr. SHEA. It might or might not. It would depend on a great variety of other circumstances in respect to the particular negotiator, his appraisal of all kinds of factors. But certainly one can say that this is not to be considered as coercion within the ordinary meaning of that term or as affording a basis for invalidating the transaction.

Senator RADCLIFFE. But in the case of a condemnation you would have a jury, which would not apply in the case of a unilateral contract.

Mr. SHEA. That is true, but if you have an adequate administrative procedure, you get procedural due process. I have suggested you have a full hearing before the administrative agency, and have a chance to present your case, and that there has been no arbitrary or

capricious action. If the action has been arbitrary and capricious, then I think there is available a proceeding——

Senator CLARK. Take a case such as Senator Guffey was talking about here, where it was alleged a Government official told these people, "Either take this, or we will put you people out of business." If that was properly alleged, that would confer on the court jurisdiction to try the question as to whether those facts did exist, and if they did exist, it would confer jurisdiction on the court to review and reopen the case and try it all over?

Mr. SHEA. Certainly, permit that issue to be tried out, and if it was established, all right.

Senator CLARK. And if it was established, then the court could go into the whole matter?

Mr. SHEA. But I would not throw into The Tax Court or any other court all of these proceedings for a new independent determination of any one of them, just because there might be a possibility of that kind of thing happening in a few instances. I would make the remedy fit the kind of thing you are aiming at. If you attempt to pile up a series of independent determinations, the result is that you will not get really effective review.

Senator CLARK. You defeat your own purpose and don't give effective relief to anybody.

Mr. SHEA. It seems to me if I were in an administrative agency, the way I would feel about it is, if I thought there was going to be a completely new hearing in The Tax Court, and it might arrive at a different opinion from mine, my attitude would be, on those issues of valuation or appropriate rate, that any two tribunals which sit on a thing are going to come out with a different answer, and I don't believe I would be terribly concerned about the fact that they came out with a different answer. I would know that in every rate case that has ever been tried, where a court comes along with an independent review, it comes out with a different answer. But I would be concerned if a contractor was going to court with the possibility of that court's action being to castigate me if I had not been fair in my procedures, or if I had been coercive in my action. That kind of a determination on the part of the court would certainly be a deterrent to anything in the way of arbitrary conduct on my part.

Senator RADCLIFFE. I didn't have in mind any extreme case of that sort. I was wondering whether or not the existence of that arbitrary right would not in itself have some weight, at times might have some undue persuasive weight.

Mr. SHEA. I think one needs to know the whole ambit of this thing in the action of administrative processes better than I do to make a decent judgment on it, but I don't mind discussing it. My hunch would be, you have here contractors who are men with intelligent counsel, and who are pretty independent fellows, men of some standing; they are not going to turn tail and run because the statute says an administrative order may follow if they don't come to an agreement. You talk to the Army and Navy people and you will get a better judgment about what actually happens in practice, but I think citizens generally, citizens well represented by counsel, do not get too scared because there is a possibility of an order in the offing. I think they sit down and can hold their own in the course of negotiations.

Senator RADCLIFFE. I didn't mean to suggest any abuse at all. I was questioning what might be the effect of that somewhat arbitrary and rather powerful right.

Mr. SHEA. I don't think the right is an arbitrary one. It is powerful, of course.

Senator RADCLIFFE. Well, the right to make a unilateral agreement is arbitrary.

Mr. SHEA. Unilateral determination.

Senator RADCLIFFE. Yes.

Mr. SHEA. It is not arbitrary if there are reasonable standards, and the Congress might properly fix reasonable standards, and if there is a reasonable chance to be heard on whether there is anything arbitrary in the proceedings, and where the consequences are that it might be overturned by an appeal to the courts. That is traditional administrative proceedings.

Senator RADCLIFFE. Where you have concrete standards it might be the right way to handle it, but you haven't any yardstick.

Mr. SHEA. That is true as regards any mathematical standard or yardstick. The statutory standard of "excessive profits" is analogous to the standard of "equitable adjustment" in the usual form of Government contract.

Senator RADCLIFFE. The exercise of unilateral discretion can be carried out——

Mr. SHEA. That is true, but it is nevertheless procedural due process. The thing might be fair, there might be a fair hearing, there might be a fair determination. One can have a fair determination in an administrative tribunal as well as in a judical tribunal.

Senator RADCLIFFE. Undoubtedly.

Senator CLARK. Your statement is it is not arbitrary unless it is arbitrarily used, isn't it?

Mr. SHEA. No. What I am suggesting is we feel there ought to be means of reviewing the question as to whether it has been arbitrary or not, but you do not need completely independent consideration and determination in The Tax Court, which is just piling on another administrative procedure, and that you should not have it in the court—that the court review should be limited to something the court could do.

Senator BARKLEY. In other words, where these agreements have been entered into, unless coercion can be shown, it ought to be determined, that ought to be the end of it, and the courts ought not to be allowed to open it up just on the merits of the controversy.

Mr. SHEA. I should think that was clear, sir. The point I was starting to develop was I don't think this remedy could possibly be an effective remedy, if you have hearings in a tax court or any other court which are trials de novo. Just look at the kind of proceedings you are going to have. I don't see how the issue could be tried except in the traditional form of a rate case. The problem will be one of establishing the value and the reasonableness of the rate. It must be in these general terms: How much was invested in the plant, how much borrowed from the Government, how much borrowed from other persons; what is the interest which is being paid; a complete story of the cost accounting, and so forth, and so forth; what is the normal return on investments from this kind of risk, and so forth?

All of you gentlemen know what a rate case is. The fact we are going to have rate cases in The Tax Court ultimately determining these

matters, if you get 1,000 in there, I would wager—and that is a very conservative estimate—that they would not reach the last of that thousand for 10 years. That is not going to be a fair remedy, an effective protection of the rights of contractors. Such protection is going to be in really fair procedures in the agencies themselves, and there should be left to the courts, and it ought to be the real courts, not an administrative tribunal like The Tax Court, the policing of the administrative procedure to see that it is fair. And the counterproposal which the Departments are suggesting is that that is the kind of thing which ought to be aimed at.

We have a concern, not alone with The Tax Court being swamped, but because if it is swamped there is not going to be a fair handling and expeditious handling of revenue measures, and the Treasury Department is deeply concerned about it, and the Department, to the extent it has responsibility over tax litigation, is deeply concerned about the prospect of that court being smothered with this kind of business. It has just climbed out of a morass of undecided cases, and if it is tossed back to that kind of a morass, it seriously endangers the handling of tax measures.

Of course, it will be swamped, and indeed any other court will be swamped, if you put upon the court the job of trial de novo.

What we are urging is that you do not put upon the courts the job of trial de novo, but the job of policing the administrative process to see that the administrative process is properly done and specifically the kind of pattern which we suggest to you is the traditional pattern that has been used in this kind of case. For years we have had this sort of problem up in the Government.

Senator TAFT. In any case in which complete discretion is given to an administrative body, an appeal of the sort proposed is absolutely useless. I don't think this plan is practical either, but if it is, it is going to swamp any court. These cases—these contracts have gone much too far, in my opinion.

Mr. SHEA. Senator, could I call your attention to the provisions of the standard form of Government contract? In the standard form of Government contract, it is contemplated that unexpected subsurface conditions might be encountered, or as the work progresses the contracting officer may find that the plans are to be changed for one reason or another, and after those determinations are made he directs the work be done which is not specifically provided for in the contract, and as to which the price in the contract is not fixed. When he orders that to be done, what you have is work being done without a price being fixed, and the issue between the Government and the contractor is what is a reasonable return for that work which has not been bargained out at that point. The standard form of Government contract provides for an equitable adjustment and it provides (1) they will try to bargain it out, and if they reach an agreed price, that is that. If they don't, the contracting officer may make an equitable adjustment. He may make a determination of what ought to be paid for that work which was not specified in the contract, and on the basis of that——

Senator TAFT. Are you suggesting that is really anything like the renegotiation that is going on throughout the country today?

Mr. SHEA. Yes, I am.

Senator TAFT. It is so different in volume, so different in fact, that the man agrees to it voluntarily. It is different in the fact that

it is usually incidental to some larger contract in which the price is fixed. It is largely, as a rule, treated as a cost-plus proposition. I don't think it is in any way parallel.

Mr. SHEA. Well, Senator, I think it is parallel——

Senator TAFT. It involves probably $50,000,000 a year instead of $5,000,000,000 a year.

Mr. SHEA. But to the particular contractor in question it is a very important matter.

Senator TAFT. It is usually incident to some other contract; he agrees to it in advance.

Mr. SHEA. Well, of course, since April 28, 1942, any person entering into a contract with the United States knew that he was entering into it in the light of the condition that he was to be subject to renegotiation.

Senator TAFT. He had to enter into it whether he wanted to or not if he was going to be considered patriotic. There was no real parallel to a peacetime contract.

Mr. SHEA. Well, I am not expert on these matters, but there was a general here this morning who said a company has been holding up a contract for 8 months. It doesn't sound to me as if the existence of coercive action of the character which you are suggesting has reached the point where there is no bargaining at all.

Senator JOHNSON. He said that that was caused by the fact that the plant had not been constructed. They were trying to enter into an agreement to construct a plant and the plant was not constructed. That was the reason the contractor was holding him up for 8 months.

Mr. SHEA. Well, the details of actually how much compulsion they feel to enter into a contract, and so forth, I don't suppose I can speak with authority on, but I have the impression which what I have heard from those who have testified for the Army and Navy, that there was a very substantial bargaining position on the part of the contractor.

Senator TAFT. We are getting away from the point. If we are going to have a review, what kind of review are you suggesting we give?

Mr. SHEA. I am suggesting the closest analogy I can think of—. may I suggest that I complete what happens in the equitable adjustment of these contracts?

Senator TAFT. Yes.

Mr. SHEA. When a determination is made by the contracting officer there is an appeal to the head of the department, and the contractor has the right to state his case to the head of the department. The head of the department makes the final determination, and that determination stands until it is upset in the Court of Claims on the ground that the proceedings were arbitrary and capricious, or that the result was so grossly unfair as to imply bad faith, that there was not a real consideration of the issues involved.

I think that that gives, in respect to the standard contract, as satisfactory a procedure as anything I know. We have handled a lot of that kind of work. I have not heard substantial complaints, so far as I know, that contractors are not able to vindicate their fundamental rights pursuant to that procedure.

Senator TAFT. You mean if it is so grossly unfair to anybody that it is utterly confiscatory, then it can be set aside, and that is about the only ground.

Mr. SHEA. It can be set aside if it is shown the proceedings were arbitrary and capricious.

Senator TAFT. Or bad faith.

Mr. SHEA. Or that the result is so unreasonable as to imply bad faith.

Senator TAFT. I would say that was no appeal at all.

Mr. SHEA. Well, let us look at the situation, Senator.

Senator TAFT. I understand; I see the difference, but that course does not give any relief. You might as well take out this whole appeal provision.

Mr. SHEA. I don't understand what you mean, that that is no appeal. There is a hearing in court on questions as to whether the procedures have been arbitrary or capricious. I have seen a good many cases in which the courts have taken up those issues, and I assure you it is an appeal, and I assure you there is fair policing in the Court of Claims of the handling by Government contracting agencies of their contracts.

Senator LUCAS. Mr. Shea, I don't mean to anticipate your argument in any way, but in your ideas in regard to this procedural review, you have in mind making the standards any more specific, or, rather, laying down any specific standards? It seems to me that while the power of review exists, no specific standards are set up, and it does restrict very materially the scope of any such proceeding on the question of bad faith or arbitrary action, if you have no specific standards.

Mr. SHEA. In the procedures which I have spoken of in the equitable adjustment of Government contracts, there is no standard except what is an equitable adjustment. As to what standards are feasible, here again only the persons who have been actually operating the administrative processes can speak with any decent judgment about what is feasible.

Senator LUCAS. I see the difficulty in trying to set up anything. I wondered whether you had any concrete suggestions on that point.

Mr. SHEA. I wouldn't dare advance concrete suggestions, sir, unless I had real experience with the administrative procedure. But I can not agree with Senator Taft that you cannot get a policing of administrative processes by the courts. I think that is feasible.

Senator TAFT. There is fair administrative procedure, but, so far as I know, there is no great objection to the administrative procedure. All the kicks I have had did not relate to the administrative procedure. They all have had hearings. Nearly all have had three or four hearings. But, in this case, without a standard, 99 percent of the questions are questions of fact, and of those 99 percent of the questions, on your proposal they are absolutely barred from appeal. All they can deal with is the 1 percent of the little business, as to perhaps no notice being given, or he didn't have a hearing when he actually got notice you were going to hold one. It is absolutely insignificant in the questions that arise under renegotiation.

Mr. SHEA. Senator, may I respond this way? First of all, it is not suggested that there should not be an appeal. It is suggested that there should be an appeal, but it should be an administrative appeal to the head of the department.

Senator TAFT. I have just told you what I think an administrative appeal of that kind means under the renegotiation law, an appeal of 1 percent of the possible questions, and no appeal on 99 percent.

Mr. SHEA. I am afraid I did not make myself clear. The kind of thing which is proposed is that you have your original hearing before some officer or board in the agency, a determination, an attempt to arrive at an agreement, and actually the result has been agreements in all but a very minor percentage of cases. Failing agreement, that officer or board will make a unilateral determination. Now, there will be an administrative appeal, an administrative review of whether that determination is right or is not right, and that will be by the Secretary, or by someone acting for the Secretary.

Now, what we suggest in this connection is that piling two or three administrative reviews, one on top of the other, is not going to give you something better than one adequate administrative review, and what we say further is that if you want this job done, you cannot try to substitute judicial review on the basis of a trial de novo for the adequate doing of the job which ought to be done on the administrative side.

If you try to have trials de novo in the court, the result will not be to give you adequate administrative proceedings, to give you fair judgment in the administrative tribunal. If you want to police the administrative process and come out with something adequate, the way of doing it is to have the courts police the administrative processes on the kind of issues and questions which the courts can do and do with some dispatch.

Senator TAFT. I want somebody else to have final say besides the Army and Navy, I don't care who it is. It don't have to be a court or anything. I want somebody else to have final say besides the Army and Navy.

Mr. SHEA. If I may get on with the point, perhaps it will answer the question. If you think the job can be done by the courts making independent determinations in all these cases, then I don't know whether there would be much to speak of, but if you think that the brunt of the job must be done by administrative procedure, and I should think that there can be very little question that the job was not going to be done unless it can be done by fair administrative procedure, then it seems to me that the thing to aim at, so far as judicial review is concerned, is the kind of judicial review which will see to it that the administrative proceedings are fairly done, and we suggest it be limited to that, because our peculiar interest in the Department of Justice is that we don't want to be found stumbling with procedures which we know must prove inadequate to do the job, and be in the position where the courts and the Department can be criticized because it has gone on for 20 years and we have not got the job done properly.

We say to you the job cannot be done if what you are going to try to do is have any very large number of cases tossed in for trial de novo.

If a client came to me with one of these agreements and said, "The Army has determined that only so much shall be recaptured; do you think I ought to go into The Tax Court?" I think certainly my answer would be, "Certainly. It says in here that you can't get before The Tax Court the written determination of the Secretary, but it will probably come out as to what that determination was. It is very rare that it doesn't come out, and my hunch would be The Tax Court is not likely to go much lower, and in any event, if you get this suit started,

you will have a chance to try to work out a compromise, and if these cases were running against contractors, you can always drop it."

I can't believe that in these 4,000 cases which have been agreed upon, where there has been a voluntary agreement, that if they are opened up—and they can be opened up by a simple appeal to the Tax Court—that you are not going to get substantial litigation, and what we suggest is if you want to do the job which it is advisable to do, i. e., the protection of the fundamental rights by appeal to the courts, limit it to something we can do, and limit it to something the courts can do.

Senator WALSH. I think the committee has the viewpoint of the Department of Justice; thank you.

STATEMENT OF HON. JAMES V. FORRESTAL, UNDER SECRETARY OF THE NAVY

Mr. FORRESTAL. Mr. Chairman, I should like to confine my remarks today to the amendments of the renegotiation law which are contained in section 7 of H. R. 3687, omitting any discussion of the basic law itself.

The Navy Department is in complete agreement with two of these technical amendments, the one which exempts from renegotiation companies doing less than $500,000 of war business a year and the one which requires all companies not covered by this exemption to file financial statements with the Price Adjustments Boards. The $500,000 exemption will facilitate the administration of the renegotiation law. The mandatory filing of financial statements will accelerate the administration of the law and will assure its actual application to all companies which come within its scope.

There are several other technical amendments in section 7 which are acceptable to the Navy. The Navy, however, concurs in the objections which have been expressed to three of the provisions now written into section 7 of H. R. 3687.

First. Judge Patterson has outlined to you our criticisms of the type of judicial review which is proposed by the bill. His remarks require no elaboration by me. I wish only to state my own belief, and the belief of those who administer the renegotiation law, that the series of reviews contemplated by the House bill would so burden the renegotiation process that its effectiveness would be seriously impaired. The suggestions for revising the provisions of the bill on judicial review which are sponsored by the Department of Justice and Judge Patterson would, I think, grant to any contractor adequate opportunity to test in the courts the propriety of his renegotiation. I urge their adoption.

Second, the Navy also opposes the provisions of the bill which give to a contractor an absolute right to have an administrative review of his case before the War Contracts Price Adjustment Board, which is created by the bill. I see no reason for encumbering the renegotiation process with an intermediate review by such Board. We then would have one or more hearings before the sectional or departmental board, an appeal to the War Contracts Price Adjustment Board and an appeal to the courts. Inasmuch as specific provision is being made for the right of judicial review, the proposal that another administrative body pass upon the action of the duly

constituted departmental agencies seems to me wholly useless and unnecessary. It would complicate an administrative problem which already is sizeable, without any conclusive benefit to either the contractor or the Government.

Third, the retroactive provision of the bill which would reopen for judicial review all contracts heretofore negotiated and closed by the renegotiation boards is particularly objectionable. The Price Adjustment Board of the Navy Department has closed either verbally or in writing, as of November 20, 1943, 535 agreements with contractors calling for refunds or reductions in prices totaling $1,405,495,000. In addition there were 74 agreements pending calling for refunds and price reductions of $244,331,000 making a total of $1,647,826,000. All but a very few of these contracts were signed as the result of mutual agreement between the Government and the contractor. Despite the complaints which have been voiced by some individual contractors, I believe that the great majority of those companies with which we have concluded agreements sincerely believe that they have been dealt with fairly and equitably.

In the light of this record, any measure such as contained in the House bill, which would reopen all of these agreements, is illogical. This is especially self-evident as to those agreements which provide for future price reductions based on the contractor's actual experience. In the Navy, we have arranged through renegotiation for $792,000,000 of these price reductions.

Retroactive reopening of these agreements would put the contractors who have entered into them in an uncertain and perhaps embarrassing position. Officers and directors of the companies have made settlements on account of excessive profits which they consider to be in the best interests of their corporations. If these agreements are now to be thrown open to review, the board of directors of each of these companies would be faced with the problem of appealing, so as to discharge its duty to its stockholders, even though it believed that the renegotiation settlement was entirely fair and just. This provision is a mandate for mutually undesirable litigation.

I would like to emphasize the importance of expedition and finality in the renegotiation process. All contractors affected by renegotiation want the question of excessive profits to be determined and adjusted as nearly contemporaneously with the performance of the contract as possible. This end can only be accomplished, in my opinion, by the present renegotiation machinery which properly places a premium upon informality, elimination of obstructive practices, and the prompt conclusion of a definitive agreement. Any system of administration or review which impairs this present machinery will destroy the real value of renegotiation to the Government and to the contractor alike.

Senator TAFT. Mr. Secretary, on that $500,000, is there any sense to the idea that the first $500,000 ought to be exempted on all contracts for all contractors?

Mr. FORRESTAL. Is that the first $500,000 regardless of their total business?

Senator TAFT. Frankly, there was a case that came to me, a Navy contractor, and he said by speeding this thing up he could get enough stuff in here to raise him up to $550,000. He said, "I know the Navy has a large stock of this stuff on hand. I won't delay the war effort

any if I slow this thing up. What do you advise me to do?" I advised him to go ahead and ship it all in. But you have that question which shows a discrimination. Have you suggestion as to that?

Mr. FORRESTAL. You mean that otherwise he decelerates his rate?

Senator TAFT. I don't think it fair to the man who has $510,000 to renegotiate his whole contract, where a man with $490,000 is wholly exempt.

Mr. FORRESTAL. I am always reluctant, Senator Taft, to add any more qualifications of qualifications Each one, as you cite in this case, carries with it collateral disadvantages which you do not realize when they were proposed. I would like to think that suggestion over, if I might, and I would like to respond to it a little later.

Senator WALSH. Have the price reductions which you referred to been agreed to by the contractors?

Mr. FORRESTAL. Yes.

Senator WALSH. In 792 cases you have agreed with the contractors to reduce the price for products that they used in connection with their own, and in your opinion if the House bill is retained they would all be subject to appeal and review by the courts.

Mr. FORRESTAL. That is true, Mr. Chairman. The reason I raise the point here is that that deals with current business, a large part of which is for future delivery. The figure is $792,000,000, and, as I said before, it deals with products that will be delivered to us, so in a sense it is a repricing rather than renegotiation.

Senator WALSH. It is your opinion the contractor would not be bound?

Mr. FORRESTAL. Well, he would be embarrassed, because some stockholders might at some future date allege that he had not properly protected the interests of his company in not being more aggressive in trying to reopen this question.

Senator TAFT. What about the cases where the contractor is practically forced to sign under duress?

Mr. FORRESTAL. Well, that depends, of course, on the definition of duress. We have a few cases where the contractor had not expressed agreement with our conclusions and we have a right to withhold payments from him, which you might assume to be duress. On the other hand, you might also say it was duress if we gave that contractor, which we would have the right to do, outside the renegotiation law, a mandatory order which would tell him to take the business at what the Secretary fixes as a reasonable price.

Senator TAFT. You have heard something of this Warner & Swazey case. I don't know the facts, but their claim is that they had to sign a contract at $5,500,000 because they were told their plant would be shut down within 30 days if they didn't do it.

Mr. FORRESTAL. Senator, I think that is an Army case.

Senator TAFT. That is what they claim. I haven't gone into the facts enough to know.

Mr. MCINTOSH. I was present at the conference with Warner & Swazey and the Under Secretary of War, and I can say without any qualification whatsoever that there is no basis whatsoever for any such statement or any such charge, and we have repeatedly denied it publicly.

Senator TAFT. However, it is undoubtedly true that many contractors sign because they figure they have to sign.

Mr. FORRESTAL. May I speak off the record, Mr. Chairman, for a moment?

(Discussion off the record.)

Senator TAFT. Mr. Forrestal, I would like to ask one thing. Do you believe it is impossible to lay down any more definite standards in the renegotiation law than we now have? When there are no standards, you only appeal to the law and that doesn't mean anything. I remember discussing it with you long before the renegotiation bill was passed, and at that time we were trying to find some kind of a formula. I wonder, with all these cases, whether something has not developed by which we can lay down a few rules.

Mr. FORRESTAL. I am hopeful, Senator, that we will get something. I don't believe you can create any set of rules that would be applicable to this vast amount of very diverse business. I am hopeful, in the Navy, and I am sure the Army is thinking in the same direction, that out of renegotiation and our recommendations we can get such data as will enable us to do sound original pricing, and we are driving toward that end.

Senator TAFT. I think the greatest good from the whole law has been to teach the procurement officers how to make good contracts. Now, if it has served its purpose, that would seem to be a reason for ending it in January or July.

Mr. FORRESTAL. I would rather discuss with you, Senator, some date at which it is to be ended.

Senator TAFT. Rather than try to set up some standards?

Mr. FORRESTAL. That is right. I can assure you I don't enjoy having this law.

Senator TAFT. Why not discuss the possibility of ending it? I rather hate to see it get all mixed up with contract termination at the end of the war.

Mr. FORRESTAL. We cannot permit too many people to be going into their books at the same time. Otherwise the manufacturer will never get reconverted or anything.

Senator TAFT. There was, in one of the drafts of the subcommittee of the Ways and Means, a termination date of the 1st of January. Now it has been suggested that it might be extended into June 30, or even the end of 1944, but it seems to me there would be a great advantage in having a termination date, and the procurement officers would then be on notice that thereafter they would have to price correctly.

Mr. FORRESTAL. We are giving that constant study because we frankly share your feeling that to have this on the books too close to the end of the war is not desirable either for the Government or for business. I think, too, to have it there when you undertake to cancel contracts would be a very undesirable thing.

Senator MCKELLAR. I want to ask you this question, Mr. Forrestal: How many unilateral contracts has the Navy insisted upon?

Mr. FORRESTAL. I would have said a half dozen, but I am informed four or five. That is where a contractor violently objected to an agreement we felt he should have signed.

Senator MCKELLAR. And the Army understood there were only 24.

Mr. FORRESTAL. Mr. McIntosh tells me that is correct.

Senator MCKELLAR. Thank you.

Senator WALSH. Thank you, Mr. Forrestal.

(The following form was submitted by Senator Clark:)

Budget Bureau No. 49—R112
Approval expires 1 January 1944
Date: .....

CONTRACTOR'S INFORMATION FORM FOR PURPOSES OF RENEGOTIATION

As requested, the undersigned furnishes the following information and data, Section A to Section R, inclusive, for use in renegotiation pursuant to an Act of Congress, Section 403 of the Sixth Supplemental National Defense Appropriation Act of 1942, approved 28 April 1942, as amended, and certifies that the data and information are authentic, true, and correct to the best of his knowledge and belief subject to such qualifications as are set forth specifically herein.

SECTION A

The results of operations of the company for its latest closed fiscal year (ended ..... 194...) separated as to renegotiable and nonrenegotiable business as defined under the Act, were as follows (cents omitted):

	(A) *Renegotiable business*	(B) *Nonrenegotiable business*	(C) *Total business*
1. Net sales (less allowances, discounts, etc.; including sales under subcontracts as defined in the Act but excluding cost-plus-fixed-fee contracts)	$.....	$.....	$.....
2. Cost of sales (less discounts)	.....	.....	.....
3. Gross profit	.....	.....	.....
4. Selling and advertising expenses	.....	.....	.....
5. General and administrative expenses	.....	.....	.....
6. Net operating profit	.....	.....	.....
7. % Margin (ratio line 6 to line 1)	.....%	.....%	.....%
8. Other applicable expenses			
a. Interest paid	$.....	$.....	$.....
b. State taxes on income	.....	.....	.....
c. Other applicable deductions	.....	.....	.....
d. Other applicable income	.....	.....	.....
9. Basic profit on fixed price contracts (line 6 minus line 8)	.....	.....	.....
10. % Margin (ratio line 9 to line 1)	.....%	.....%	.....%
11. Other income:			
a. Net fees earned under C. P. F. F. contracts	$.....	$.....	$.....
b. Other			.....
12. Other deductions			.....
13. Net profit before provisions for Federal taxes on income and extraordinary reserves			.....
14. Provision for Federal taxes on income (gross)			.....
a. Postwar refund of excess profits tax (credit)			.....
15. Net profit before extraordinary reserves			.....
16. % of net worth at start of period			.....%
17. Provisions for extraordinary reserves			$.....
18. Net income per books			.....
20. Prime contracts and purchase orders	$.....	XXXXXXXXXX	XXXXXXXXXX
21. Subcontracts of any tier, purchase orders	.....	XXXXXXXXXX	XXXXXXXXXX
22. Total (per line 1, col. A)	$.....	XXXXXXXXXX	XXXXXXXXXX

		(A) *Renegotiable business*	(B) *Nonrenegotiable business*	(C) *Total business*
23.	Cost of Sales:			
24.	Materials	XXXXXXXXXX	XXXXXXXXXX	$
25.	Inventory—variation	XXXXXXXXXX	XXXXXXXXXX	
26.	Direct labor	XXXXXXXXXX	XXXXXXXXXX	
27.	Maintenance and repairs	XXXXXXXXXX	XXXXXXXXXX	
28.	Rents	XXXXXXXXXX	XXXXXXXXXX	
29.	Royalties	XXXXXXXXXX	XXXXXXXXXX	
30.	Other, including depreciation	XXXXXXXXXX	XXXXXXXXXX	
31.	Total (per line 2)	$	$	$
32.	Selling and advertising:			
33.	Salaries			
34.	Product advertising			
35.	Institutional advertising			
36.	Commissions paid on Government business			
37.	Commissions paid to outsiders (Commercial)			
38.	Commissions paid to salesmen (Commercial)			
39.	Branch office expenses			
40.	Other, including depreciation			
41.	Total (per line 4)	$	$	$
42.	General and administrative:*			
43.	Officers' salaries			
44.	Other office salaries			
45.				
46.				
47.				
48.				
49.	Total (per line 5)	$	$	$
50.	Other applicable deductions:*			
51.				
52.				
53.				
54.				
55.				
56.	Total (per line 8c)	$	$	$
57.	Other applicable income:*			
58.				
59.				
60.				
61.				
62.	Total (per line 8d)	$	$	$
63.	Depreciation included above:			
64.	Normal			
65.	Accelerated			
66.	On idle plant			
67.	Total depreciation	$	$	$

*List significant items. ( ) Denotes red figures.

		(A)	(B)	(C)
68.	Other charges included above:			
69.	Amortization of emergency facilities (not including estimated normal depreciation)	*Renegotiable business* $	*Nonrenegotiable business* $	*Total business* $
70.	Executive salaries' total	$	$	$
71.	Approximate cost of work subcontracted	$	$	$

SECTION B

The results of all operations for the *six* years immediately preceding the year under review are as follows (in thousands of dollars except for very small companies):

NOTE.—If the information called for on lines 23 to 71, inclusive, is difficult to obtain and does not contain any unusual items, it may be omitted for the three earliest years.

	Years ended					
	19—	19—	19—	19—	19—	19—
1. Net sales (less allowances, discounts, etc.; including sales under subcontracts as defined in the Act but excluding cost-plus-fixed-fee contracts	$	$	$	$	$	$
2. Cost of sales (less discounts)						
3. Gross profit						
4. Selling and advertising expenses						
5. General and administrative expenses						
6. Net operating profit						
7. % Margin (ratio line 6 to line 1)	%	%	%	%	%	%
8. Other applicable expenses:						
a. Interest paid	$	$	$	$	$	$
b. State taxes on income						
c. Other applicable deductions						
d. Other applicable income						
9. Basic profit on fixed price contracts						
10. % Margin (ratio line 9 to line 1)	%	%	%	%	%	%
11. Other income:						
a. Net fees earned under C. P. F. F. contracts	$	$	XXXXX	XXXXX	XXXXX	XXXXX
b. Other						
12. Other deductions						
13. Net profit before provision for Federal taxes on income and extraordinary reserves						
14. Provision for Federal taxes on income (gross)						
a. Postwar refund of excess profits tax (credit)						
15. Net profit before extraordinary reserves	$	$	$	$	$	$
16. % of net worth at start of period	%	%	%	%	%	%

		Years ended					
17.	Provisions for extraordinary reserves	19— $_____	19— $_____	19— $_____	19— $_____	19— $_____	19— $_____
18.	Net income per books	_____	_____	_____	_____	_____	_____
19.	% Government business included in line 1	___%	___%	xxxxx	xxxxx	xxxxx	xxxxx
23.	Cost of sales:						
24.	Materials	_____	_____	_____	_____	_____	_____
25.	Inventory—variation	_____	_____	_____	_____	_____	_____
26.	Direct labor	_____	_____	_____	_____	_____	_____
27.	Maintenance and repairs	_____	_____	_____	_____	_____	_____
28.	Rents	_____	_____	_____	_____	_____	_____
29.	Royalties	_____	_____	_____	_____	_____	_____
30.	Other, including depreciation	_____	_____	_____	_____	_____	_____
31.	Total (per line 2)	$_____	$_____	$_____	$_____	$_____	$_____
32.	Selling and advertising:						
33.	Salaries	_____	_____	_____	_____	_____	_____
34.	Product advertising	_____	_____	_____	_____	_____	_____
35.	Institutional advertising	_____	_____	_____	_____	_____	_____
36.	Commissions paid on Government business	_____	_____	_____	_____	_____	_____
37.	Commissions paid to outsiders**	_____	_____	_____	_____	_____	_____
38.	Commissions paid to salesmen**	_____	_____	_____	_____	_____	_____
39.	Branch office expenses	_____	_____	_____	_____	_____	_____
40.	Other, including depreciation	_____	_____	_____	_____	_____	_____
41.	Total (per line 4)	$_____	$_____	$_____	$_____	$_____	$_____
42.	General and administrative:*						
43.	Officers' salaries	_____	_____	_____	_____	_____	_____
44.	Other office salaries	_____	_____	_____	_____	_____	_____
45.	_____	_____	_____	_____	_____	_____	_____
46.	_____	_____	_____	_____	_____	_____	_____
47.	_____	_____	_____	_____	_____	_____	_____
48.	_____	_____	_____	_____	_____	_____	_____
49.	Total (per line 5)	$_____	$_____	$_____	$_____	$_____	$_____
50.	Other applicable deductions:*						
51.	_____	_____	_____	_____	_____	_____	_____
52.	_____	_____	_____	_____	_____	_____	_____
53.	_____	_____	_____	_____	_____	_____	_____
54.	_____	_____	_____	_____	_____	_____	_____
55.	_____	_____	_____	_____	_____	_____	_____
56.	Total (per line 8c)	$_____	$_____	$_____	$_____	$_____	$_____
57.	Other applicable income:*						
58.	_____	_____	_____	_____	_____	_____	_____
59.	_____	_____	_____	_____	_____	_____	_____
60.	_____	_____	_____	_____	_____	_____	_____
61.	_____	_____	_____	_____	_____	_____	_____
62.	Total (per line 8d)	$_____	$_____	$_____	$_____	$_____	$_____
63.	Depreciation included above:						
64.	Normal	_____	_____	_____	_____	_____	_____
65.	Accelerated	_____	_____	_____	_____	_____	_____
66.	On idle plant	_____	_____	_____	_____	_____	_____
67.	Total depreciation	$_____	$_____	$_____	$_____	$_____	$_____
68.	Other charges included above:						
69.	Amortization of emergency facilities (not including normal depreciation)	_____	_____	_____	_____	_____	_____
70.	Executive salaries total	_____	_____	_____	_____	_____	_____
71.	Approximate cost of work subcontracted	$_____	$_____	$_____	$_____	$_____	$_____

* List significant items. ( ) Denotes red figures. ** (Commercial.)

SECTION C

72. The method followed in segregating renegotiable business (sales) and nonrenegotiable business, as shown in Section A above, is as follows:

SECTION D

73. The method followed by the company in allocating costs, expenses, and deductions applicable to renegotiable business and to nonrenegotiable business as shown in Section A above is as follows:

SECTION E

74. There are no extraordinary reserves (other than shown on line 17) for inventory losses, post-war conversion or otherwise (of a nature not allowed as a deduction for Federal income-tax purposes) included in costs and expenses, except as follows:

SECTION F

There is attached hereto one copy each of the following customarily prepared, already available data:

75. Published annual stockholders' reports for each fiscal year beginning after 31 December 1935.
76. Long form audited reports with auditor's or comptroller's comments for each fiscal year beginning after 31 December 1935.
77. A transcript of—
    a. Schedule M of company's Federal income-tax return (Form 1120) for the two latest years filed.
    b. Lines 1–7 inclusive of page 1 of the excess-profits tax return (Form 1121) for the lastest year filed.
78. Latest interim balance sheet for current year and related statement of income and surplus as customarily prepared for the company's internal management.
79. Latest brochure, catalog, or other material setting forth company's business and products.
80. Copy of Form 10-K (or 1-MD) for latest fiscal year if such be filed with Securities and Exchange Commission.

SECTION G

81. Salaries and all other compensation (including commissions, bonuses, royalties, and other forms of extra compensation) of our ten highest paid officers or employees, or of those who received in excess of $10,000 per annum each for the year (whichever is the lesser number) were as follows:

Name, title, and duties	*Current year**	*Last closed year*	*Preceding years* 19—	19—
1	$	$	$	$
2				
3				
4				
5				
6				
7				
8				
9				
10				
Total	$	$	$	$

*Annual rate at present time.

82. A brief description of any bonus plan, pension trust, or other employee compensation plan now in effect or contemplated, with comment as to how it is applicable to personnel as listed above, is as follows:

---

83. The salaries listed above were not questioned by Federal income tax authorities except as follows:

SECTION H

84. During the year under review, the principal products which we sold, the principal services which we rendered, and the approximate dollar amount of sales of each principal type of product (or group of products) produced by us and included in renegotiable business, are as follows:

---

85. Prior to 1941, our principal peacetime products were:

---

86. At the present time our principal commercial products are:

SECTION J

87. The approximate dollar unit value of individual products of primary importance, together with any recent (1942 and later) unit price reductions are:

Item	*Present unit price*	*Previous unit prices* *Date*____	*Date*____	*Date*____
1	$_____	$_____	$_____	$_____
2	_____	_____	_____	_____
3	_____	_____	_____	_____
4	_____	_____	_____	_____
5	_____	_____	_____	_____
6	_____	_____	_____	_____
7	_____	_____	_____	_____

____ _____
Name of Company

SECTION K

88. This company has the following affiliates (i. e., companies or persons which are under our control or which are controlled by the same interests which control us):

Names and addresses	*% of stock outstanding*	*Held by*
1		
2		
3		
4		

89. The operations of the above affiliates {are / are not} included in the figures given in this form above. We {do / do not} believe that the operations of the above affiliates may properly be consolidated with those of this company for the purpose of renegotiation under the Act.

90. If affiliates are not consolidated, the basis of setting prices on intercompany transactions is outlined as follows:

SECTION L

91. Our cost-plus-fixed-fee business during the past last closed fiscal period is given below:

92.	Total incurred or accrued costs	$_____	
93.	Fees received or accrued on work done	$_____	
94.	Total of 92 and 93 above		$_____
95.	Nonreimbursable costs	$_____	
96.	Net fees or profit (93 minus 95)		$_____*
97.	% Margin of profit (ratio of 96 to 94)		___%

*To agree with line 11s of section A.

SECTION M

98. The approximate dollar value of business for the last closed fiscal year for sales made directly or indirectly to the following was:

		Total	% of total
99.	*Renegotiable:*		
	A—War Department	$	$
	1. Army Air Forces		
	2. Central Warfare Service		
	3. Corps of Engineers		
	3a. Construction Division		
	3b. Supply Division		
	4. Ordnance Department		
	5. Quartermaster Corps		
	6. Signal Corps		
	7. Surgeon General		
	8. Transportation		
	Subtotal, War Department		
	B—Navy Department	$	$
	C—Maritime Commission		
	D—Treasury Department		
	E—War Shipping Administration		
	F—Defense Plant Corporation		
	G—Defense Supplies Corporation		
	H—Metals Reserve Company		
	I—Rubber Reserve Company		
	J—Unclassified but for war purposes		
100.	Total renegotiable*	$	$
101.	*Nonrenegotiable:*		
102.	Direct sales to foreign governments		
103.	Government branches (other than those included in renegotiable business)		
104.	Miscellaneous and unclassified		
105.	Total nonrenegotiable	$	
106.	Grand total all business	$	100%

*Included in renegotiable business through this form.

SECTION N

107. The value and type of privately financed facilities for which Certificates of Necessity have been issued or for which applications have been pending as at the end of the latest closed fiscal year are detailed as follows:

SECTION P

108. The company has received the following Government assistance during or at the end of our latest closed fiscal year:

109.	Approximate value of machinery loaned	$
110.	Approximate value of plants provided	
111.	Approximate value of materials received	
112.	"V" loans (under Regulation V of Federal Reserve Board)	
113.	Approximate advances on contracts	

114. Other financial assistance (describe):

---

115. Technical assistance (describe briefly; mention patents, etc.):

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116. Significant changes of any of above during last fiscal year:

SECTION Q (OPTIONAL ON PART OF COMPANY)

117. The following are the names and addresses of some other important companies which sold or rendered the same or similar products or services in war production, and with which our war business might to a degree be comparable:

1. ----------
2. ----------
3. ----------
4. ----------
5. ----------

SECTION R

118. In a separate folio, but made a part of this Contractor's Information Form we furnish two copies of brief dictations covering each of the following items, 119 to 145:

119. Date and state of incorporation and brief history of company and its business at least since 1936.

120. The latest taxable year examined by the Bureau of Internal Revenue and any significant changes made in taxable income since 1936 as a result of examinations by the Bureau.

121. A concise statement of any changes in excess profits tax credit claimed or to be claimed under section 722 of the Internal Revenue Code.

122. If royalties in excess of $25,000 were paid or accrued during the year under review, give names of significant payees and amounts of payments. Similarly, if the company received royalties in excess of $25,000, give names of licensees and amounts paid. (If this information already has been furnished the Government, please attach a duplicate copy as sent out.)

123. A statement as to any basic changes in accounting methods since 1936 (with special reference to changes in inventory valuation and depreciation rates). Also statements as to (a) depreciation rates currently used on major classifications of plant, (b) present method of valuing inventory, (c) 20% or lower rate of amortization for facilities in operation under Certificates of Necessity, (d) any special features and details of any revaluation of assets and effect upon the data submitted herewith, and (e) full details as to latest Federal Tax return filed (final or tentative) and extent of payments thereof. (Submit copy of return if possible.)

124. Principal stockholders, either individuals or corporations, indicating percentage of ownership if over 10 percent. Set out separately the ownership by managing officers.

125. Describe any escalator clauses in company's contracts subject to renegotiation.

126. Brief description of important plants, including locations, type of construction, square feet of floor area, products manufactured, percent of output on war business. Also for the entire company give average number of employees now and in peacetime.

127. List of major customers and approximate dollar value of products purchased from company during the latest closed fiscal period.

128. List of major companies for which company is a subcontractor, and dollar value of such sales by company.

129. Dollar value and list of your principal subcontractors, method and extent of your handling them with reference to materials, supervision, inspection, and financing.

130. Approximate dollar value of 1942 renegotiable business excluded by reason of the 28 April 1942 clause concerning contracts fully completed and paid for.

131. Labor relations, union or closed shop, wage increases, number of shifts run, stated as X percent for second shift and X percent for third shift, with statement as to increased executive personnel to handle extra shifts. Piece work and bonuses for the same.

132. Significant contracts or orders received on competitive bidding basis, extent of competition, and how company's low costs and efficient operation offset territorial and freight differentials. Comparison of important high- and low-cost producers in same line.

133. Dollar value for latest fiscal period of significant raw materials and subassemblies, and from whom purchased.
134. Any other statements or representations that may be pertinent in the matter of renegotiation, with particular references to any important contribution to the war effort and to voluntary price reductions and risks involved in conversion to war production, which may include:
    135. Burden and risks thereto—reconversion.
    136. Voluntary price reduction on significant items—past and as contemplated for the future.
    137. Maintenance of production and shipping schedules—difficulty in obtaining materials.
    138. Increase in cost of materials.
    139. Economy in the use of basic, critical, and other raw materials.
    140. Degree of integration.
    141. Special efficiency in manufacturing methods and techniques.
    142. Special financial or physical risks taken by the company.
    143. Special engineering or development work of new products, and new methods of manufacture.
    144. Availability of patents and processes to the Government and to other contractors, collaboration with other contractors and with the Government.
    145. General comments on the company's over-all contribution to the war effort.

Name of company

By ---

Address of company

(Date when the form is returned by company)

INSTRUCTION SHEET FOR CONTRACTOR'S INFORMATION FORM

I. In general, the schedules in this form represent the information necessary before final determination can be made. If the preparation of the data called for would require unreasonable burden and expense, the company may supply such date as are available in regularly prepared financial and operating reports. In all such cases, however, an explanation of the reasons for substitution should be presented. All cents may be omitted. If the data for prior years requested in section B are set forth in the reports mentioned in section F, then such schedule need not be prepared. The company should so indicate if it prefers to discuss the items of segregation of sales (section C) and allocation of costs (section D), in which case a company official should complete the form in other respects and submit it. Specific comments on the various items follow:

II. *Section F.*—If annual reports to stockholders or audit reports by independent public accountants are not prepared, in lieu thereof there must be submitted financial statements for each fiscal year beginning after 31 December 1935, consisting of at least a balance sheet at the end of each such fiscal year and related statement of surplus for each such fiscal year. These statements should be in reasonable detail.

III. *Section A, Lines 8c and 8d.*—Amounts representing nonoperating income and expenses which in the light of circumstances are wholly or partially applicable to renegotiable business should be entered in these lines. However, amounts representing items of a nonoperating nature not applicable to renegotiable business should be entered in lines 11b and 12. Examples of the latter are profit or loss on disposal of fixed assets, adjustments applicable to prior years, interest and dividends received, write-off of intangibles, etc.

IV. *Section C.*—a. Sales subject to renegotiation should include the total amount of contractor's net billings on sales directly or indirectly to the War, Navy, and Treasury Departments, Maritime Commission, War Shipping Administration, Defense Plant Corporation, Metals Reserve Company, Defense

Supplies Corporation, and Rubber Reserve Company. They should include subcontracts as defined below, directly or indirectly to the above departments, as well as prime (i. e. direct) contracts and purchase orders. All sales, whether under OPA regulations, on competitive bids, or otherwise, should be included. Billings on contracts which were wholly completed and on which final payment was made before 28 April 1942, need not be included. In this connection, reference is made to the inclosed "Joint Statement" and to paragraph IX below.

b. For renegotiation purposes "subcontract" is defined as follows (section 403 (a) (5) of the Act):

> The term "subcontract" means any purchase order or agreement to perform all or any part of the work, or to make or furnish any article required for the performance of another contract or subcontract. The term "article" includes any material, part, assembly, machinery, equipment, or other personal property.

c. The definition is interpreted to include contracts not only with prime contractors but also with others who under this interpretation may be subcontractors, if such contracts are (a) for the sale or processing of an end product or of an article incorporated therein, (b) for the sale, furnishing, or installation of machinery, equipment, or materials used in the processing of an end product or of an article incorporated therein, (c) for the sale, furnishing, or installation of machinery used in the processing of other machinery to be used in the processing of an end product or of an article incorporated therein, (d) for the sale, furnishing, or installation of component parts of or subassemblies for machinery included in (c) above and machinery, equipment, and materials included in (b) above, and (e) for the performance of services directly required for the performance of contracts or subcontracts included in (a), (b), (c), and (d) above. The term "component part" as used in this section shall be deemed to include materials and ingredients.

d. In general, reference is made to the discussion of renegotiable business contained in the inclosed "Joint Statement."

V. *Sections A and D.*—In allocating costs and expenses between renegotiable and non-renegotiable business, the company's cost system should be used, if adequate. Otherwise, percentages or other formulas may have to be used, either on individual products or groups of products, or by departments, divisions, etc. Each major item of selling and general expenses should be allocated in accordance with the most equitable method in view of the particular situation.

VI. If desired, section B may be combined with section A, as the line captions are identical.

VII. *Section L.*—Cost-plus-fixed-fee contracts are considered separately for renegotiation purposes. In addition to the information called for under this section, the company should provide any further data in connection with such contracts that may be considered pertinent.

VIII. *Section K.*—Price adjustment boards approve the policy of permitting renegotiation of parent and subsidary companies on a consolidated basis where the parent and subsidiaries constituted an "affiliated group" as defined in section 141 (d) of the Internal Revenue Code. As excessive profits, if any, must be allocated among the parent and subsidiaries, a review of the unconsolidated financial statements must be made to establish such allocation. Care should be taken in the preparation of consolidated statements that intercompany eliminations are properly made.

IX. *Re 28 April 1942 business which is fully completed and fully paid for prior thereto.*—The amount of business for which final payments have been made prior to 28 April 1942 is excluded from renegotiable business in the period, unless the contractor elects otherwise with reason therefor. Billings on part or all of the contracts on which final payment of the entire principal amount called for was made prior to 28 April 1942 need not be included as renegotiable business. However, purchase orders, reorders, and part shipments representing scheduled deliveries in accordance with the monthly requirements of vendees are renegotiable if they are part of open-end contracts which are not fully completed and paid for prior to 28 April 1942. In this connection, explain your credit terms.

X. The following items are among those which generally are required to be excluded from costs pertaining to renegotiable business:

a. Provision for reserves for contingencies (if not earmarked for special purpose which the company does not wish to disclose in released statements).

b. Provision for reserve for postwar adjustments.

c. Life insurance premiums.

d. Fines and penalties.
e. Bond deposits.
f. Discount or premiums on bonds retired.
g. Profit and loss from sales of capital assets.
h. Provision for future inventory shrinkage.
i. Profit and loss from sale of investments.
j. Depreciation on appreciation of capital assets.
k. Difference between depreciation and amortization of company and allowances by United States Treasury for Federal income tax purposes. (This item to be entered on line 8c of section A.)
l. Expenditures which clearly are unwarranted in connection with war business.
m. Accelerated depreciation unless on the company's books and so claimed by the company in its income tax return.

XI. *Note for construction contractors.*—A special form is available for filing by contractors principally engaged on construction projects, including those operating under architect-engineer contracts. *Construction contractors and architect-engineers should not file this Contractor's Information Form,* but should obtain copies of the proper construction form by writing to

Departmental Price Adjustment Boards
P. O. Box 2707
Washington, D. C.

XII. In general, you are referred to the inclosed copies of section 403 of the Renegotiation Act and the "Joint Statement."

XIII. If any statements or information requested to be furnished are inapplicable in a particular item, notation to that effect should be made on the face of the form, and a rider attached explaining the reasons for omission.

Attached (unless otherwise struck out):
Copy of section 403 of the Renegotiation Act as amended to 14 July 1943
Copy of "Joint Statement" by Agencies.

STATEMENT OF JOSEPH M. DODGE, CHAIRMAN, JOINT PRICE ADJUSTMENT BOARD

Mr. DODGE. Mr. Chairman, my name is Joseph M. Dodge. I am Chairman of the War Department Price Adjustment Board, which post I assumed on September 15, and the Joint Price Adjustment Board, which was organized on October 18, and because of the urgency of your appeal and in order to save your time, and centralize the testimony, I will represent the departments included in the Joint Board.

Some of my associates are present: Mr. Rockey, chairman of the Navy Board, who is also vice chairman of the Joint Board; Mr. Rydstrom, of the Maritime Commission, who is on the Joint Board, and others, including Mr. Hershey, vice chairman of the War Department Board, and Mr. McIntosh, our counsel.

In private life I am president of a bank in Detroit which is 94 years old and has $400,000,000 of deposits and 325,000 deposit accounts; also a director of the Federal Reserve bank, Packard Motor Co., and other banks and insurance companies, and for the R. F. C.

In November 1942, at the request of General Echols, I became Chairman of the Army Air Force Price Adjustment Board for the central procurement district. I organized the price adjustment operation for that district, which includes 13 States. In doing that I established offices in Detroit, Cleveland, Cincinnati, and Chicago.

Because of the comments made here about some personnel issues, I would like to point out that in Chicago I established Mr. Philip D. Armour as our representative there. He was formerly executive vice president of Armour & Co. In Cincinnati, Mr. John J. Becker, who had just retired as vice president and chief accounting officer of the telephone company. In Cleveland, Mr. John Francis, who was a

graduate of Annapolis and had been treasurer of one manufacturing company, president of another which was sold out to a firm of which he was a director.

These are samples of the type of men enlisted in the work. My experience has been that they are all of intelligence, experience, and integrity. It is difficult to get men to do this work and stay at it, primarily because of its nature. It is very complicated and trying, and we receive little credit or appreciation for doing it.

We are not, and I want to emphasize this, engaged in furthering any new system of enterprise. We all believe we are protecting the old. No one, I know, has any desire to extend, expand, or perpetuate renegotiation beyond the necessity of the war program. There is no one interested in power or in politics. It is a job to be done that was put on the books by the Congress and we are trying to do it, and while we are doing it we hope we are working ourselves out of a job.

I want to emphasize this. Everyone I know working at this job believes in its necessity under the conditions in which the Government is the principal buyer and there is not the normal pressure of competitive operations and price, and that disbelief comes to us not by law and not by instruction, but it comes to us from what we see and what we do as we make price adjustments, and I would also like to add that the files of the price adjustment organization have plenty of evidence that the work we do has been necessary. We believe this is just as much a protection to business and the life of American enterprise as it is to Government.

I was told by my friends when I took up this work that nobody in the banking business could be in the business of taking profits away from business. I don't believe that anybody got into a great deal of trouble from doing what he thought was the right thing, and I have found from experience that I don't believe I have hurt either myself or my institution.

I have also found by experience—I opened the first cases in that district, closed the first cases, handled a substantial number of them myself—that where men get together with reasonably open minds and make an honest effort to do the job, that there is a satisfactory conclusion.

You hear criticism. I want to suggest to you that you have to consider the background of this criticism. Business began to get an extension in 1940 as a result of the defense or foreign war activity. That was rapidly accelerated in 1941, and in April 1942 after increases in volume and increases in profits, Congress passed the law which said in substance that beginning at that time "you will have to carry on your business with a reasonable profit."

You have heard complaints from a limited number of contractors who have appeared before your committee, each of whom has presented an individual opinion with regard to his particular situation, and in some cases opinions on the broader subject to renegotiation. There has been no emphasis to you on the very large number of contractors with whom the various services have easily reached an agreement on a fair price and a fair profit. The joint figures from the War, Navy, and Treasury Departments, and the Maritime Commission show that as of the end of October written or oral agreements covering 1942 fiscal year profits and prices had been reached with 13,000 war contractors. In a large majority of these cases agreements were reached with little difficulty other than the technical problems involved in the individual cases.

This in itself speaks of the understanding and cooperation of industry in general, and certainly of some acceptance of the prices through which negotiation agreements have been reached.

In the War Department as of November 27, in settling some 10,000 cases there were only 154 instances in which the settlement suggested by those originally conducting the renegotiation for the services had not been accepted by the contractor.

These contractors have had available to them an appeal for further consideration by the War Department Price Adjustment Board. Of the 154 cases, 67 were settled by agreement, 24 by determination of the Secretary. That is, only 24 have reached what is known as unilateral determination out of some 10,000 cases, of which only 154 were appealed to the War Department Price Adjustment Board.

Unfortunately, perhaps, for us, those satisfied are not as vocal as those unsatisfied. We do receive, however, occasionally testimonial letters of satisfaction.

Today the Government is the Nation's principal buyer. It is a buying monopoly supplied by the war goods producers. The purchases are paid for by taxpayers' money and Government borrowing. The goods are primarily for waste and destruction and are not addition to our wealth. There is every economic and practical reason for the price being held as low as possible, and profits, which are part of that price, being restricted. Economy of war cost must be an issue in a war which is as much an economic war as anything else.

Everyone must be on their guard against a fundamental error in thinking that war is a time of prosperity. It is not and cannot be, no matter what it may seem to be. It is a time of greatly increased activity, which is a condition usually associated with prosperity. Actually it is a time of harder work, more complications, increased responsibility, higher taxes, shortage of civilian goods and, in substance, less net usable return for effort than normal and certainly not the net return which might be expected for similar activity and effort in a time of real prosperity.

Just as rate making protects the public on the price of commonly used services, so the price adjustment boards protect the Government and the public on the price paid for material of war, because of any unreasonable profits which are part of price.

Price adjustment is directly related to war procurement. War procurement, in turn, is affected by the price and profit results of unexpected volume, shifts in production emphasis, the development of new products, and the changes and improvements in other war products. To meet this situation, there has been established for each contractor an after-actual-production experience, comparative, over-all repricing. This is renegotiation or price adjustment. If considered in these terms, its objectives, processes, and conclusions can be more easily understood.

The primary purpose of renegotiation is to accompalish sound pricing. It works retroactively through the medium of refunds and prospectively through reductions in future prices. It strives to make sure that no more than a fair price is paid for war products and that price includes no more than a reasonable profit after consideration of all the pertinent factors connected with a contractor's business.

Price is made up of costs and profit. Costs and product prices are examined and also compared with those of other producers. Excessive actual costs may result in certain specific disallowances which

serve to increase the profits that are part of the over-all price. Excessive comparative total costs and/or comparative product prices are factors in the valuation of a reasonable and just compensation in terms of profit. The profit, which is part of price, is also subject to adjustment after determination of reasonable costs, comparative total costs and product prices, the effect of volume increase, and the other pertinent factors of the contractor's business. These will be combined to indicate the necessity of an over-all price adjustment in which excessive profits, as required by the statute, are eliminated. The adjustment of price will include an adjustment of profit because of the profit element of price. When approached in this manner, the removal of excessive profit becomes part of a pricing operation, and, if all the fundamental elements of the contractor's business are properly related, the elimination of excessive profits becomes an incident of a pricing process.

You will observe that the War Department Board is a price-adjustment board and that the operation is carried on through the price-adjustment sections of the various services. From the beginning, the price-adjustment boards of all the services have been staffed with the best available business and professional men. It has been difficult to get men to do the work and stay at it because they do very complicated and trying work with little credit or appreciation for being willing to undertake it at a considerable personal sacrifice. They are men of intelligence, experience, and integrity. They are not engaged in furthering any new system of enterprise but are protecting the old. There is no intention or desire on the part of any of those responsible for renegotiation to expand, extend, or perpetuate it as a profit control measure beyond the necessities of our war procurement.

Everyone engaged in this work believes in its necessity under conditions in which the Government is the principal buyer and there are not enough producers to provide the normal pressure on prices created by competition. This belief comes to those working at the job because of what they see in what they do, and the files of every price-adjustment agency bear ample witness that what they do is necessary. This is a point too often overlooked. This service is as essential to the protection of business as it is to the protection of government.

What we want and expect our own organizations to give the contractor in the process of renegotiation briefly is this: That the contractor shall always receive courtesy and a considerate, sympathetic hearing; that he shall have an opportunity to completely develop and present his case; that the burden of information to be submitted and the number of meetings shall be reduced as much as possible; that we shall obtain the information necessary to establish the facts required, but that the contractor may present in addition to that whatever he may consider pertinent; that the factual information about the business to be included in the report should be reviewed with the contractor; that there be an agreement on all the basic facts and the case be completely developed before any attempt is made to reach a decision; and that the proposed settlement be completely discussed and, where necessary, its effect on the business of the contractor explained.

We want nothing slipshod, incomplete, haphazard, or arbitrary. Conclusions are to be carefully arrived at; should take into consideration and weigh all the facts presented, determined, and verified; and

be eminently fair under the circumstances of the case, and in relation to comparable case problems.

Our people are using their services to resolve a problem of both business and government as expressed and directed by Congress. They offer to the contractor their knowledge of renegotiation policies, procedures, and experience. Their objective is to make a settlement, consistent with their obligation to the Government and yet fair to the contractor. When a carefully considered conclusion has been arrived at, after review of the facts and consistent with our knowledge, we do not and should not bargain. Any changes should be based on new factors of sufficient importance to warrant them.

The work has had and still has many problems. It is complicated. It deals intimately with the conditions of each enterprise as components of a price and profit problem. Whatever the problems are, they are being met by people sincere in their effort to arrive at a just and reasonable answer which is within the limits of the responsibilities established by the law and the policies and procedures created to implement the law.

Opinions are given or complaints or statements made about the results of renegotiations with few of the facts upon which the renegotiation conclusion was actually based. On individual cases, we find that not many of these complaints are accurately stated or can be supported by the facts. This work is just a continuous series of individual cases. There are two sides to every story and the price adjustment organizations always have one of them.

Again, too often the issue is confused with contentions or problems which are not directly related to price adjustment. In many instances, the problems charged against renegotiation are inherent or fundamental to the contractor's business. They exist entirely apart from and prior to any price adjustment and most frequently are related to the financial management of business expansion. There is sometimes an insistence on high prices, which include high profits on Government war purchases, for the purpose of meeting some already established financial, plant, or equipment illness, or the outright cost of business expansion. No matter how real these problems are, to attempt to cure specific cases with unusual profits from war production certainly would establish broad and indefensible inequities.

Now because taxes are high and have a drastic effect on net earnings, and because there is also renegotiation, it is sometimes suggested that the latter is the problem creator. This, in spite of the fact that most settlements are substantially paid in the form of credits for taxes already paid or are offset by taxes that would have had to be paid on the unadjusted profits. An average of about 70 percent of every price adjustment is paid for in tax credits. Renegotiation settlements usually are made in 20- or 30-cent dollars, depending upon whether the tax return the business would have to pay before the adjustment is 80 or 70 percent.

Businesses subject to renegotiation have the benefit of war production, instead of perhaps being out of business or having declining volume, higher costs and lower profits or no profits, as is the case with many without the direct or indirect advantage of war production. Also, businesses renegotiated are only those which are considered to have excessive profits on war business. Renegotiated businesses in general cannot be said to be substantially harmed by the fact that profits are always left to them after renegotiation.

It seems to have escaped attention that, after a negotiated price reduction, a contractor is generally in a better position than if he had been given a mandatory order to produce the goods at a price which resulted in the adjusted dollars or margin of profit or even a lower one. A mandatory order is usually placed at the time of beginning production and applies to an individual product or contract. This authority is given to Government in time of war to insure its being able to obtain the goods it needs at a reasonable price, but in renegotiation the contractor has the advantage of a result applied to his whole business for a year and losses or low profit on one contract or group of contracts are offset against unexpectedly high profits on others. Mandatory orders were quite freely used in the last war. In this war, they have been used very infrequently. The cooperation of manufacturers and, to a certain extent, renegotiation, have served to make them unnecessary.

Criticism is inevitable in a process which, even though established by Congress, results in reducing the profits of a business after they have been entered on the books of that business. It is entirely reasonable to expect that businesses which may have had increased volume and increased profits beginning as far back as 1940, as a direct or indirect result of the war abroad, and perhaps a further substantial increase in 1941 as a result of the expanding defense program and on which the expanding volume alone contributed to higher margins of profit and on which there was a lesser impact of taxes and generally no renegotiation, cannot too readily adjust their thinking to the fact that beginning in April 1942 Congress has decreed in substance that war production business should be priced so as to include only a reasonable profit and that the impact of higher taxes would make the net return on this business after taxes substantially less.

Every businessman has a natural ambition for increased profits or increased volume of sales or production which have been the traditional yardstick of success in American enterprise. Many small businesses suddenly became large and many larger businesses multiplied their production beyond any progressive relationship to their earlier history or immediate expectations under normal peacetime competitive conditions.

It is too much to expect there would be none who would look on the necessities of war procurement as an opportunity to satisfy either their personal ambitions or desires for profit, but these are limited in number and in sharp contrast to the vast majority who realize that production of goods used in the conduct of the war should properly be on a limited-profit basis and who have done the outstanding production job which is so well known and generally recognized.

There was the additional problem of promptly creating and staffing price-adjustment sections and price-adjustment boards for all the departments and services to cover a Nation-wide problem, the work of which directly affected the business profit of war contractors all over the country. It must be expected that, when the general situation outlined above is considered, there will be some mistakes made and transactions handled in a manner not exactly as they should have been. It is astonishing that, considering the nature of the process, it has been carried on reasonably successfully over a period of a year and a half.

Entirely too little emphasis and credit has been given to the cooperation of the large number of contractors with whom the various services have easily reached an agreement on an adjusted price and a limited profit. There have been many who say frankly they do not want anything that may be considered excessive profits. Many have made voluntary refunds and price reductions as a definite business contribution to the war effort. In the War Department, as of the end of November, written or oral voluntary agreements covering 1942 fiscal year profits and prices had been reached with approximately 10,000 war contractors. In most cases, agreements were arrived at with little difficulty other than the technical problems involved. This certainly speaks of a general acceptance of the processes through which agreements are reached.

I will now refer to this Joint Board memorandum, which is divided into three principal parts.

The Joint Price Adjustment Board, comprising representatives of the several departments concerned with renegotiation of war contracts and authorized by the Secretaries of the War, Navy, and Treasury Departments; the Chairman of the Maritime Commission; the Administrator of the War Shipping Administration; and the Reconstruction Finance Corporation Price Adjustment Board to formulate and adopt statements of purposes, principles and policies and interpretations binding on the several departments, has carefully considered the provisions of H. R. 3687—Title VII—Renegotiation of War Contracts—and submits the following comments with respect thereto for the information of the Senate Finance Committee:

(1) Scope and method of judicial review: The departments concerned with renegotiation have repeatedly stated that they had no objection to the making of some statutory provision for judicial review and, in fact, have expressed the opinion that such right of review exists under the present law. There has recently been brought to the attention of the Joint Price Adjustment Board the strong objections of the Treasury Department and the Department of Justice to the proposed granting of jurisdiction over renegotiation review to the Tax Court of the United States. The strength of these arguments is recognized by the other departments concerned and in the light thereof the Joint Price Adjustment Board agrees that the jurisdiction over appeals from renegotiation determinations should be assumed by the Court of Claims in order that the Tax Court of the United States may be kept free for exclusive attention to tax matters.

With respect to the scope of review, the Joint Price Adjustment Board agrees with the position of the Department of Justice, as expressed to the Joint Board, to the effect that any determinations of the Secretaries of the departments or of the proposed War Contracts Price Adjustment Board should be final and conclusive except to the extent that the contractor can establish on the basis of the record made by the contractor in the court review proceeding that the determination was the result of a mistake of law, fraud, arbitrary or capricious action, or was so grossly erroneous as to imply bad faith. This is the traditional procedure which has been adopted in connection with court review of similar governmental determinations.

(2) Review by the War Contracts Price Adjustment Board: The proposed bill gives the contractor an absolute right to require review by the newly created Board, and the act specifically provides that the Board may not delegate "the power, function, and duty to review

orders determining excessive profits" (subsec. (d) (4), p. 118). It is respectfully submitted that in the light of contemplated provisions providing for review by a court in those cases where no agreement can be reached, it is entirely unnecessary and would constitute a very real administrative burden to provide for another review by the War Contracts Price Adjustment Board. The Joint Price Adjustment Board, created by voluntary action of the interested departments, is now functioning satisfactorily for the purpose of setting up uniform purposes, principles, policies, and interpretations, and there is no reason why a similar board should not be established by legislative action. But the requirement that such board should review all orders determining excessive profits would require the creation of a substantial administrative staff, and would impose burdens and duties upon the individual members of the board which would interfere with the performance by them of their duties in connection with current renegotiations in the various departments for which they are responsible.

(3) Review of closed agreements. The proposed bill provides for court review of past and future determinations of excessive profits (subsecs. (e) (1) and (e) (2), pp. 119 to 122). Included in this review are determinations—

made prior to the date of the enactment of the Revenue Act of 1943 with respect to a fiscal year ending before July 1, 1943, * * * whether or not such determination is embodied in an agreement with the contractor or subcontractor.

The Joint Price Adjustment Board is opposed to this provision which would render subject to court review thousands of voluntary bilateral agreements under which excessive profits refunded or to be refunded and specific price reductions on articles delivered or to be delivered will agregate (without giving consideration to the effect of taxes) upwards of $5,000,000,000. This provision would not only create a potential administrative burden, which might be literally impossible of effective accomplishment, but might be construed to invalidate the bilateral character of the agreements in such a manner as to jeopardize the right of the Government to retain the refunds which have been made and to collect the refunds which are to be made thereunder.

There might also be placed in jeopardy the provisions of the agreements providing for past and future price reductions. Many renegotiation agreements include clauses providing generally for the elimination of excessive profits likely to be realized in the future through price reductions without specifying the amount of the reductions to be made on specific articles or contracts. Total reductions and refunds under such clauses may well represent an amount equal to or greater than the recoveries and specific price reductions referred to above. The proposed review of closed agreements would render uncertain the status of such clauses and frustrate present conscientious efforts to keep procurement on a current basis and to avoid the lengthy litigation between the Government and contractors such as resulted from the last war.

The refunds and price reductions provided for under these voluntary agreements were made as a part of a repricing policy which was in fact inaugurated sometime prior to the passage of the original Renegotiation Act of April 28, 1942; and, if the act had not been available for this purpose, there is no doubt that the departments concerned would have endeavored to effect similar results through the use of

other war powers relating to the placing and cancelation of contracts and the subsequent modification thereof. In no case have the departments accepted agreements which are made conditional on the validity of the renegotiation statute or which, under their terms, could be effected by subsequent legislation or court decisions. These agreements represent accepted transactions between the departments concerned and the contractors.

It is respectfully submitted that to reopen these agreements would provide a procedure by which contractors with clearly excessive profits could delay indefinitely repricing and other corrective action. It would be wasteful administratively and clearly prejudicial to the best interests of the Government.

In addition to the foregoing matters which involve major questions of policy, there is attached hereto as exhibit A a list of certain additional suggested revisions which it is believed are consistent with the general purpose and intent of the bill but which would operate to clarify or improve, from an administrative standpoint, certain specific provisions of the bill as noted.

Then, we come to section A: Centralization of all repricing authority under the Secretaries of the departments: The provisions of the act defining the powers of the Secretaries, as distinguished from the powers of the Board, with respect to all matters affecting repricing should be modified so that the Secretaries would be given all powers relating to repricing or exemption of individual contracts and subcontracts. The proposed bill creates a clear distinction between repricing of individual contracts with respect to which authority and responsibility is centered in the Secretaries of the departments and over-all retroactive renegotiation with respect to which authority and responsibility are vested in the War Contracts Price Adjustment Board. The suggested revisions make it clear that this distinction or division of responsibility should be maintained in all of its phases and, in this connection, it is further suggested that it should be expressly provided that unless specifically exempted adjustments of prices made from time to time under the repricing power should not preclude the Board from considering profits derived from such contracts in connection with subsequent over-all renegotiations on a fiscal-year basis.

B. Raw-material exemption, subsection (b), pages 124 and 125: In order to make it clear that this exemption does not prohibit the renegotiation of management or operating contracts for Government plants to be used for processing, refining, or treatment of exempted raw materials, it is requested that the following clause should be added at the end of the raw material exemption (p. 125, line 3, after the word "use"):

except that this provision shall not be construed to eliminate from renegotiation any contract or arrangement otherwise subject to renegotiation with one of the departments (a) for services performed on a fee or cost-plus-fixed-fee basis with respect to any such products or (b) for the use or operation of a plant or facility by a department for the production, processing, treatment, manufacture, or transportation of any such products.

C. Special cost allowance in the case of integrated producers: The attention of the committee is further directed to an apparent error in connection with the provision of the bill relating to the allowance of market value as an element of cost in the case of a producer processing an exempted product "to or beyond the first form or state"

(pp. 126, lines 14 and 17) at which the exemption terminates. It is believed that the word "and" should be substituted for the word "or" in the above-quoted phraseology so that it would be clear that the allowance of market value would apply only to the producer who processes the exempted product to and beyond the exempted stage and would not only apply to a producer who purchased the product at the exempted stage at a cost which might vary materially from the market value at the time of its use.

D. Authorization of individual contract renegotiation under special circumstances: It is believed that the provisions of the act requiring over-all renegotiation on a fiscal year basis (subsec. (c), pp. 109 and 110) should be modified in order to give the Board authority to require renegotiation either on an individual contract basis or on the basis of classes or types of contracts. This provision will be necessary in the case of certain classes or types of contracts or subcontracts, such as shipbuilding or other long-term construction contracts, various types of profits-limitation contracts, or contracts which have not been completed during the fiscal year in question or with respect to which it is not practicable for accounting or other reasons to conduct renegotiation on an over-all fiscal year basis.

Senator JOHNSON. Speaking of the different types of contracts, most of the discussion has been about manufacturing contracts. There is another type of contract, construction contracts.

Mr. DODGE. That is right.

Senator JOHNSON. Which is on a competitive basis.

Mr. DODGE. That is right.

Senator JOHNSON. Of course, it makes all the difference in the world whether a person getting that contract goes out and hustles and gets the job done, or whether he lets it drag along and piles up a great expense, and yet I understand that you make no distinction whatever between a construction contract where the manager of that contract hustles, and a contract where some fellow just puts on a Palm Beach suit and goes off to Florida or California and lets the expense pile up. Is that true?

I had a letter today from a Colorado contractor, and from that letter I would be led to believe that you do not make a distinction. This was a contractor who put on overalls and got out on the job and he got no credit for that.

Mr. DODGE. The factors of what he did in connection with the contract itself are taken into consideration in the renegotiation of the contract. The question of whether or not competitive bidding would make his exempt from renegotiation is another problem entirely. The fact is today with the Government the principal buyer in buying everything, it is fair to say that no true competition exists, speaking generally. The requirements are greater than the productive capacity.

Senator CLARK. But there are many contracts now which are let under competitive bids. For instance, I have in mind a contractor clearing timber off a large tract of land. There were several bidders. The successful bidder was several hundred thousand dollars under the next lower bidder. The figures coincided almost exactly with the Department's estimates, but because he went out and exerted great energy they are coming along now and trying to wham him.

Mr. DODGE. Whatever he did that was of exceptional value in doing that job would be taken into consideration in renegotiation at the time of renegotiation, but the fact that he did get a contract because he was

low bidder is no conclusive proof it was the lowest possible price, because everybody is tied up in other work. You don't get all of the bidders who could apply their efforts to that individual problem. They may be absorbed in some other War Department work. So, speaking in general terms, you have what appears to be competitive bidding, but which actually is not competitive bidding, because the field is restricted. We have engineers tell us, for instance, that they will bid on a contract and if they don't get it, they don't care; they will bid on another one and get it at their price.

Senator JOHNSON. Well, that condition did hold forth a few months ago, or a year ago, but at the present time I am told construction contractors are a dime a dozen, that you can get right down to costs and get real competitive bidding, and that you can get good performance, too. But, of course, if you place no premium on good performance, you are more than apt to get bad.

Mr. DODGE. It is probably true that inasmuch as the construction part of the war program was early in the field, one of the first things, that is tapering off now, but this act, I believe, as drawn now, gives the Joint Board the right to exempt those where real competitive conditions can be established.

Senator JOHNSON. How do you think that will be done? Or, do you think it will be done?

Mr. DODGE. It certainly will. Our disposition is not to keep anything subject to renegotiation that we can find a reason that fully protects the Government in letting them out.

Senator CLARK. There is this very essential difference. In the unnegotiated contract there is no protection at all for the contractor if he makes a mistake in his bid, whereas in the negotiated contract they practically are guaranteed against loss. It seems to me that is an essential element that ought to be taken into consideration. A man goes out and bids against competition and gets a contract, bids a figure on which he takes a chance on suffering a loss, whereas the negotiated fellow, he gets cost plus a fixed fee, and he doesn't take any risk at all. It seems to me that is an essential element in considering whether he should be renegotiated.

Mr. DODGE. This question of individual contract renegotiation is the one referred to by Admiral Land in his longer term contracts.

In this connection attention is further directed to the fact that there should be some provision for the relaxation of the provision of the bill requiring completion of renegotiation within 1 year from the date of commencement where the nature of the contract is such that it is impossible to reach an accurate and final result on the basis of a yearly fiscal period. Long-term shipbuilding contracts are an exemple of contracts falling in this category.

E. Limitation of mandatory requirement for insertion of repricing clause in all contracts, subsection (b), page 107: The bill in its present form directs the Secretary of each Department to insert in all contracts entered into after 30 days after the enactment of this act certain terms which are specified in the legislation. It is suggested that the insertion of such terms should be made mandatory on the secretaries only in the case of contracts in excess of $100,000 as provided in the existing law, since it is manifestly impracticable to include such a clause either directly or by reference in the many thousands of small contracts and purchase orders which constitute a large proportion of the total number of contracts entered into by the departments although representing in the aggregate only a relatively small dollar volume.

It is suggested that consideration be given to the possible elimination of the provision specifying the type of renegotiation clause to be inserted in all contracts, since the bill specifically provides that the required contractual provisions shall be "binding, only if the contract or subcontract, as the case may be, is subject to subsection (c)" (p. 109, lines 1 and 2), and if subsection (c) is valid there would appear to be no necessity for a supplemental contractual commitment.

F. Retroactive application of new exemptions and related provisions: It is suggested that the exemptions of charitable contracts—subsection (i) (1) (D), page 125, line 25—and of subcontracts under exempt prime contracts—subsection (i) (1) (E), page 126, line 3—and the provision for special cost allowance at the exemption line in the case of exempted products used by integrated companies—subsection (i) (3)—should be added to the list of provisions of the act which are made effective as though they had been made a part of section 403 on the date of its enactment, April 28, 1942 (see subsection (d) effective date, p. 130, line 7).

G. Exemption of seasonal canners: Since the Committee on Ways and Means completed action on the bill, an investigation has been made of the possible effect of the provision which would exempt "any contract or subcontract for canned, bottled, or packed fruits or vegetables (or their juices) which are customarily canned, bottled, or packed in the season in which they are harvested." This investigation indicates that substantial excessive profits may have been realized in this field and that such contracts should not be included in the agricultural exemption.

We are giving you an exhibit for the record in connection with that, which indicates in substance that the 1936–39 average for these canners' profits before taxes were very low. They ran 4.2 percent; 2.1; 4.5; 2.6—around 3, 4, and 5 percent; in 1942, with sometimes substantially increased volume, these rates went up to anywhere from 12 to 20 percent.

There are more technical matters in connection with this, which are brought to your attention. I will just submit that for the record.

Senator WALSH. Very well.

(The document referred to is as follows:)

WAR DEPARTMENT,
PRICE ADJUSTMENT BOARD,
Washington, December 2, 1943.

MEMORANDUM SUPPLEMENTAL TO PARAGRAPH G OF EXHIBIT A, STATEMENT OF THE JOINT PRICE ADJUSTMENT BOARD FOR THE INFORMATION OF THE SENATE FINANCE COMMITTEE, DATED DECEMBER 2, 1943

PROPOSED EXEMPTION OF SEASONAL CANNERS

The proposed exemption of agricultural commodities embodied in H. R. 3687, subsection (i) (1) (C) (p. 125, lines 10 to 13) includes an exemption of "any contract or subcontract for canned, bottled, or packed fruits or vegetables (or their juices) which are customarily canned, bottled, or packed in the season in which they are harvested."

Subsequent to the hearings before the House Ways and Means Committee, an investigation has been made by the War Department to ascertain the effect of the proposed amendment, and the results thereof lead to the conclusion that the above-quoted portion of the proposed amendment should be deleted for the reasons hereinafter set forth.

The apparent aim of the above-described provision is to exclude from renegotiation the type of canning which is commonly described as the "seasonal pack" and to keep subject to renegotiation canning of the all-year-round type,

as in the case of soups. The view behind the proposal appears to be this: that canners whose pack is seasonal are confined in their volume by the local agricultural yield and are not likely to realize excessive profits through the great expansion in production that has been a conspicuous factor causing excessive profits in other fields.

There appears to be no distinction between this type of production and many others that will remain subject to renegotiation. The considerations which apply to seasonal packs of fruits and vegetables apply with equal force to canned fish and to canned meats. In these cases the food which is canned is also perishable. The potential expansion in volume is also sharply limited. At least in the case of fish, the canning operations are highly seasonal in character. Yet contracts for these products would not be exempt under the new measure. The effect of the bill will thus be to multiply arbitrary distinctions and to lead to discriminatory results.

Moreover, there is reason to believe that the proposed exemption would apply to companies which have made excessive profits in the accepted meaning of this term. While precise figures are not available because no financial data have in the past been prepared segregating this type of product, nevertheless from a list of 42 canning contractors selected at random and believed to be engaged to some extent if not entirely in a seasonal pack business, the following instances are offered as significant (contractors' names withheld, to be furnished upon request):

[( ) denotes loss]

Contractor	1942			1936-39 Average		
	Volume	Profit	Profit (percent)	Volume	Profit	Profit (percent)
1	$714,000	$143,000	20.0	N.A.	N.A.	N.A.
2	1,352,000	162,000	12.0	$434,000	$20,000	4.8
3	2,489,000	182,000	7.3	1,658,000	130,000	2.3
4	1,980,000	464,000	23.4	1,082,000	22,000	2.0
5	4,431,000	578,000	13.0	1,812,000	10,000	.6
6	658,000	61,000	9.3	270,000	4,000	1.5
7	1,219,000	158,000	13.0	84,000	4,000	4.7
8	538,000	104,000	19.3	330,000	18,000	5.5
9	3,445,000	422,000	12.3	1,102,000	26,000	2.6
10	10,712,000	1,321,000	12.3	4,586,000	51,000	1.1
11	1,215,000	263,000	21.7	714,000	(52,000)	(7.3)
12	1,819,000	328,000	18.1	805,000	25,000	3.1
13	5,896,000	1,029,000	17.4	2,572,000	321,000	12.5
14	11,933,000	1,503,000	12.6	6,202,000	434,000	7.0
15	4,329,000	569,000	13.2	302,000	8,000	2.7
16	3,933,000	437,000	11.0	2,371,000	(123,000)	(5.4)

NOTE.—The random selection of 42 contractors from which the above figures were culled does not include any pineapple canners among some of whom profits have been found to range between 25 and 33 percent.

These figures indicate over-all profits; and where the canner has been engaged in both seasonal and nonseasonal packing, it is of course true that the profits may have been derived in unequal proportions from these two types of business. But compensating for this possibility are the following considerations: (1) These profits are as stated by the contractor and have not been adjusted for excessive salaries, depreciation charges, or other possible inadmissible expenses charged against sales; and (2) while they represent over-all profits, the profit on Government business is likely to be greater because of the absence or limited character of selling expenses and other charges applicable to Government sales.

The foregoing objections have been addressed to the measure only insofar as it affects canners; and presumably it was originally intended to cover only canners and no others. However, the use of the word "pack" is so broad as to extend the exemption to many others. Those who pack prunes, dried apricots, pears, and other fruits in wooden or paper boxes might also come under the exemption. It would also apply to certain companies engaged in preparing and packing dehydrated fruits and vegetables. It should be noted in this connection dehydration was relatively new and contracting officers made commitments on the basis of little price experience.

The proposed exemption will make it necessary to undertake a new kind of segregation of the Government business done by the canners in order to exclude seasonal packs. It is not known how many canners deal exclusively in the kind of business proposed for exemption. But many will continue subject to renegotiation for a part of their business; and as to them, the preparation of the basic

financial data will still be required. The segregation of renegotiable from exempted business will constitute another administrative difficulty involving difficult questions of cost allocation as well as purely segregation problems.

In view of the fact that material contained in this memorandum was developed only subsequent to the action taken by the House Ways and Means Committee, copies of this memorandum are also being delivered to the members of that committee.

Respectfully submitted.

JOSEPH M. DODGE,
Chairman, War Department Price Adjustment Board.

Mr. DODGE. Section H. Definition of subcontracts: The attention of the committee is directed to the fact that the definition of "component article" embodied in subsection (5) (A) (ii)—page 104, line 21—does not clearly evidence the intention of Congress with respect to products, portions of which do not actually appear as a part of the end product ultimately acquired by the Government because of the fact that they either disappear or are reduced as the result of intermediate processing, refining, or treatment. If it is the intent of Congress that contracts for all such articles which enter into the end product or a component part thereof at any stage of the manufacturing process should be subject to renegotiation, it is suggested that the phrase "in whole or in part, directly or ultimately, or in the same or some other form" should be inserted immediately following the word "which" in the second line of the definition of component article (line 22, p. 104).

The attention of the committee is further directed to the fact that the revised definition of "subcontract" embodied in the proposed bill will result in the exclusion from renegotiation of a very large field of subcontracts for both durable products used directly for war-production purposes, such as all types of machinery and equipment and also large volumes of expendable supplies and equipment, such as grinding wheels, acetylene torches, and all types of mill supplies. It is estimated that the total recoveries of excessive profits from contracts of this character subject to renegotiation under the existing law were very substantial for fiscal periods ending on or before the proposed effective date of the new act, June 30, 1943. There is attached hereto an exhibit setting forth a number of refunds secured from companies which would be exempted under the new provisions. These examples indicate the increased cost of the war which will necessarily result from this exclusion from renegotiation of large numbers of contractors who have profited largely and directly from war business. The exemption of these contractors is also going to make it more difficult to close voluntary agreements with other contractors who will necessarily feel that there has been some discrimination based on artificial concepts of subcontract rather than on participation in the war effort.

(The following material pertaining to section H was submitted for the record by Mr. Dodge:)

UNITED STATES MARITIME COMMISSION,
Washington, D. C., December 2, 1943.

Mr. JOSEPH M. DODGE,
Chairman, Price Adjustment Board, War Department,
Washington, D. C.

DEAR MR. DODGE: You will recall I agreed to furnish you with some figures of contractors and subcontractors whose production would be partially exempted from renegotiation by the new act as drawn.

A partial survey of such contracts renegotiated by this Board shows that various contractors who furnish equipment used in connection with producing articles incorporated in ships who would be partly excluded by the new definition of subcontract show the following results:

(a) Renegotiable sales..... $95, 600, 000
(b) Percentage of profits reported before renegotiation..... 23.8 percent
(c) Amount of recovery..... $13, 800, 000
(d) Price reductions on unbilled balances..... 8.2 percent

The above does not include contractors furnishing machine tools, pipe fittings, valves, etc. Inasmuch as many contractors furnish equipment going into ship construction and also equipment used in manufacture, it will be quite difficult for certain contractors to make accurate segregation—for example, valve manufacturers who sell through distributors find it difficult to determine the end use of their own products.

Very truly yours,

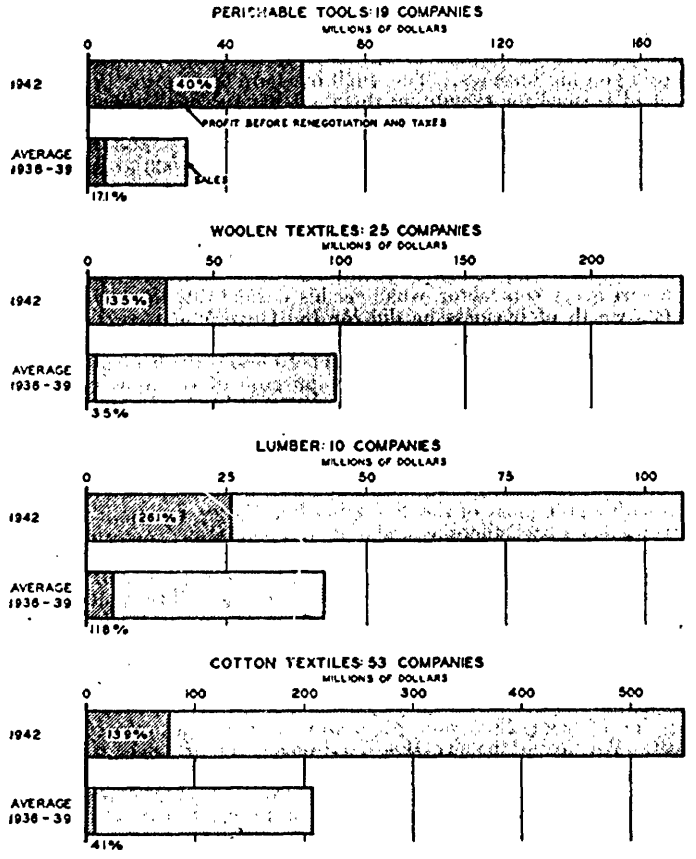
ARTHUR G. RYDSTROM,
Commander, United States Naval Reserve,
Price Adjustment Board.

Exhibit to paragraph H—Definition of subcontracts, setting forth refunds secured in connection with renegotiation of companies which would be largely or entirely excluded from renegotiation under the House bill

	Base period		1942 renegotiable [1]		
	Sales	Profit before taxes in percent of sales	Sales	Profit before taxes and renegotiation in percent of sales	Amount recovered
PERISHABLE TOOLS					
Company A	$70,000	(2)	$2,193,000	38.7	$980,000
Company B	3,234,000	9.0	10,307,000	26.4	2,130,000
Company C	2,118,000	11.1	4,989,000	20.8	535,000
Company D	16,657,000	20.6	42,477,000	32.6	11,000,000
Company E	149,000	2.7	7,454,000	34.3	1,900,000
Company F	406,000	26.1	5,213,000	44.2	1,900,000
Company G	134,000	18.0	2,446,000	54.2	1,200,000
Company H	3,047,000	20.5	13,152,000	45.3	5,000,000
MACHINE TOOLS					
Company A	1,365,000	22.6	5,922,000	23.9	959,000
Company B	3,980,000	14.3	24,267,000	25.0	3,200,000
Company C	1,503,000	11.5	9,838,000	29.2	2,000,000
Company D	2,882,000	14.5	20,846,000	37.1	5,400,000
Company E	3,756,000	16.6	12,573,000	28.7	2,033,000
Company F	288,000	23.6	3,194,000	43.4	1,088,000
Company G	7,463,000	24.9	20,157,000	38.8	5,500,000
GAGES					
Company A	159,000	6.9	3,869,000	34.0	900,000
Company B	489,000	2.7	4,437,000	18.4	545,000
MACHINERY COMPONENTS					
Company A	9,148,000	24.2	21,995,000	25.1	3,100,000
Company B	567,000	11.0	11,311,000	30.8	2,250,000
Company C	951,000	5.8	1,918,000	26.2	350,000
Company D	410,000	8.8	3,571,000	26.4	600,000
Company E	37,682,000	21.5	67,699,000	34.8	16,000,000
MACHINERY					
Company A	(3)	(3)	4,333,000	23.0	665,000
Company B	2,176,000	8.6	4,231,000	30.9	1,053,000
Company C	1,448,000	3.1	14,756,000	19.1	1,335,000
Company D	554,000	15.5	10,870,000	43.7	3,950,000
Company E	19,537,000	22.5	27,932,000	31.1	4,000,000
Company F	1,043,000	1.2	4,534,000	23.4	785,000
Company G	16,269,000	21.7	30,639,000	34.3	5,335,000
Company H	(3)	(3)	4,854,000	28.7	900,000
Company I	457,000	15.8	3,042,000	43.3	1,265,000

[1] In addition, most of these companies had substantial amounts of nonrenegotiable business.
[2] Deficit.
[3] Incorporated in 1940.

STANDARD COMMERCIAL PRODUCTS EARNINGS COMPARISON



Senator WALSH. Does the $500,000 limitation apply to prime contractors, or is that the subcontractor who has a contract under the prime contractor?

Mr. DODGE. I don't understand your question. It applies to the individual business, as to whether or not his renegotiable business with the Government is more or less than $500,000.

Senator VANDENBERG. What do you say about Senator Taft's suggestion that the $500,000 limitation should be the first $500,000 on all contracts?

Mr. DODGE. We see a great deal of these small business renegotiations. In the early part of the period, naturally everybody was working on big business. The small ones are coming in. There are a lot of reasons for exempting them. I have seen them. The fact of the matter is, in many of the small businesses, they have excessive profits under $500,000. They are mostly subcontractors. They add to the costs of the fellows above them. The $500,000 exemption is inequitable as between the man under $500,000 and over $500,000. It might have a tendency to have him restrict his business to $500,000 because in theory, if he was making 20 percent on $500,000, he could make as much money as he could at 10 percent on a million dollars. The question would be merely one of whether or not Congress wanted to assure every contractor, whatever his normal rate of profit was on $5,000 worth of business he did for the Government, regardless of what that rate might be.

Senator WALSH. The great purpose is to lessen the load.

Mr. DODGE. That is the primary purpose of recommending the elimination of small companies. If you start it, you are saying the large company should have a limitation of $500,000, too.

Senator VANDENBERG. As between these two considerations.

Mr. DODGE. The attention of the committee is directed to the requirement that the Board, at the request of the contractor, furnish him with a statement of the determination of excessive profits, of the facts used as a basis therefor, and of its reasons for such determination.

In complying with this requirement it will be necessary to set out in writing to the contractor a statement of the facts and factors, unfavorable as well as favorable, of his efficiency, ability, contribution to the war effort, risk and other elements necessary in the determination of excessive profits. This material cannot be flattering in all cases. We can anticipate a greater dispute and dissatisfaction from the detail of reducing these criteria to writing, even though they may be generally understood as between the contractor and the renegotiators in informal discussion, than over the amount of settlement itself. We do not believe this requirement, on balance, will be of sufficient benefit to contractors to outweigh the harm it may do in impairing the informal atmosphere in which these renegotiation proceedings are conducted and agreements are reached in the great majority of cases.

J. Under the present law, it is clear that patent royalty contracts and other agreements involving intangible property rights are subject to renegotiation. The House bill, in defining "subcontract" and "excessive profits" raises a substantial question as to whether contracts of this type are renegotiable. This question should be resolved by clarifying the definition of a contract "article" by adding the words "tangible or intangible" immediately following the phrase "other personal property."

Then we have a schedule of nine technical changes with reference to the bill. They refer to certain lines on pages, and these lines and pages are as reported in the bill reported out by the House. If they have been changed, the reference will have to be changed.

K. Miscellaneous technical changes: In addition to the foregoing, it is believed that the bill would be clarified and that administrative problems thereunder considerably lessened if the following changes are made:

1. Page 102, line 5, strike out the word "raw." There is no reason for confining this factor to the use of raw materials.

2. Page 102, line 8, strike out the word "and," and in line 9, after the word "earnings," insert "and comparison of war and peacetime products." A contractor now manufacturing a product substantially different from his peacetime product should have this important factor fully considered.

3. Page 103, line 15, after the word "subcontract," insert "or to such contracts or subcontracts as a group." This change would clarify the situation where the costs in question are not chargeable to any particular contract or subcontract but like items of overhead are chargeable to a broader scope of business done.

4. Page 103, line 25, after the word "agency," insert "established prior to January 1, 1942." This change would prevent the abuse of this provision by the nominal establishment of such an agency solely for the purpose of avoiding this test.

5. Page 111, line 12, after the word "them" insert "through whichever of the following methods of Secretaries or any of them so directed deem desirable." While the Board is given the power to determine the excessive profits, the Secretaries have the obligation to eliminate the excessive profits so determined. Because of the Secretary's close familiarity with the situation in the various cases it would seem best to allow him to choose the method best suited to the facts in each case.

6. Page 112, lines 18 and 19, strike out the word "determining" in line 18 and insert in lieu thereof "eliminating"; and in line 19 strike out "to be eliminated" and insert in lieu thereof "determined." This change is necessary to correct a technical error. Under the bill, the Board determines the excessive profits while the Secretary eliminates them.

7. Page 121, line 9, change "(d)" to "(c)." This change is necessary to correct an erroneous cross-reference.

8. Page 126, lines 4 and 5, strike out "exempted from the provisions of this section, or." The present language is ambiguous. The change is needed to make it clear that the subcontracts to which the provision relates are only those under prime contracts or subcontracts exempted by reason of subsection (i) (1).

9. Page 119, line 24, after the comma, insert "or after the entry of the order of the Secretary under subsection (f), as the case may be,". This clerical change is needed to clarify the time limit in which a petition to The Tax Court may be filed in a repricing case.

Senator DANAHER. Mr. Dodge, I have repeated demands from contractors that we alter the law to provide for a minimum fee or allowance on sales after taxes.

Mr. DODGE. Yes.

Senator DANAHER. Will you comment on that?

Mr. DODGE. That has had a great deal of discussion, as you probably know. Mr. Patterson made a statement on that subject to the House Ways and Means Committee on September 20.

Contentions have been made that renegotiation should apply after taxes instead of before. This is the result, I believe, of the strong impact of all the tax rates on earnings. However, it entirely overlooks two fundamental principles: First, this is a repricing job, the repricing of sales of the past fiscal year's business, and if the price had been such in the first place, the effects of volume production and other factors contributing to the unusual profit increase, could have been fully guarded against, and there would have been no price adjustment, and the profits which made the price adjustment necessary would not have existed. The tax would then have been applied to the lower price and profits basis, and there would have been no question about the net result whatever it happened to be.

Second, it is in fact only a proposal that the price the Goverment pays for its war goods shall include a loading for the taxes paid in all or in a particular case, and that the price shall be increased as the taxes are increased.

I doubt very much whether any manufacturer would use that as a yardstick in his own buying. If taxes are an over-all charge allowed by the Government against business and individuals for the expense of the Government and expenses of the war, then deliberately including them in war-production prices would be adopting a policy of varying prices to accord with the varying tax burden of varying contractors.

If anyone as an individual were to agree to pay a higher price for a suit of clothes or an automobile or any other piece of property, because that particular person from whom the purchase was made was subject to a higher tax liability than his competitors, competitive conditions would quickly take care of the price situation. Our experience shows that the present tax rates will not effectively eliminate all the war profits. The testimony before the several congressional committees which have recently considered this subject, we believe, has demonstrated the soundness of this statement beyond any reasonable doubt.

Senator CLARK. What about the fellow who pays his taxes on the basis of higher profits, and then his renegotiation comes long and wipes out the base on which he paid his taxes?

Mr. DODGE. He gets credit on the taxes. We adjust the price downward and his profit becomes less, and his taxes become less. If he has paid the taxes, he gets a credit for the differential; if he has not paid them, he gets an allowance for it, so he pays the net difference.

Senator CLARK. Suppose he has already paid his taxes?

Mr. DODGE. Then he gets credit from the Internal Revenue Department for the difference between the tax he paid or the original base and that he would pay on the finally adjusted price basis.

Senator MILLIKIN. In your opinion, when should we end this system?

Mr. DODGE. Well, sir, Mr. Patterson has made a statement on that. The question of ending renegotiations is a serious one. We have so many problems ahead of us. We don't know what they are. The War Procurement is not in the clear on its change in volumes and changes in price, particularly if the theater of war should change. It would mean, I believe, trying to say now that we think at a certain

time in the future these problems would be ended and complete competitive conditions restored. I don't think that we can do that. I believe when that time comes you will find the general disposition on the part of everybody connected with renegotiation and responsible for it, will be to recommend to you that it be eliminated.

Senator DANAHER. Mr. Dodge's answer to Senator Clark suggests one other question. What are you going to do in the case of those States where there is no provision for a refund or credit?

Mr. DODGE. That is one of the problems we have had. Mr. Patterson spoke of that in detail in connection with his statement to the Ways and Means Committee on September 20. What happens is this: If I may give you a simple illustration. First, remember that this is a repricing of sales, and a repricing downward. Let us suppose a contractor had $1,000 profit before taxes and he had a 10 percent State tax to pay, of $100. Then suppose we in readjusting his sales recovered $600 in the form of a price adjustment. That would reduce him to $400 profit, and at the 10 percent rate he should have paid $40 instead of $100. Technically, the contractor overpaid the State $60. In most cases I understand they can obtain a refund, but there are a few cases where they can not. We have to have some uniformity in our approach, and the new law says specifically that we will allow the tax charges proportionate to the adjusted sales. To do otherwise would mean that we would have to subsidize the State taxes in our pricing. That is, we would have to pay a higher price to include that tax.

Senator DANAHER. Aren't you doing it under the explanation you gave?

Mr. DODGE. No.

Mr. PAUL. In view of the fact that this question has come up, it seems to me we might hear, at the end of the last witness, Mr. O'Connell, who has made a considerable study of it.

Senator DANAHER. I am willing to defer further inquiry on it. I just wanted Mr. Dodge's view on it, because it is important.

Mr. DODGE. It is a problem I believe only in the cases where they cannot recover the adjustment from the State.

Senator WALSH. Mr. Shea, will you submit for the record the amendments you suggested?

Mr. SHEA. I will be very happy to do that.

Senator WALSH. We thank you.

STATEMENT OF RANDOLPH PAUL, GENERAL COUNSEL, TREASURY DEPARTMENT

Mr. PAUL. I will not take any of the committee's time. I will simply place in the record, if I may, a letter from the Secretary of the Treasury, addressed to the chairman of this committee. This letter is dated December 3. It refers to the statement of the Joint Price Adjustment Board which was put into the record by Mr. Dodge, and states the Treasury's concurrence in that. It also repeats the Treasury's objection to the particular item of giving the Tax Court jurisdiction of appeals from renegotiations and determinations.

The CHAIRMAN. You may do that.
(The letter referred to is as follows:)

DECEMBER 3, 1943.

Memorandum for Secretary Morgenthau.

IN RE CONSTITUTIONALITY OF TAXATION OF INCREASES IN INDIVIDUAL INCOMES

It is assumed that the tax in question is of the kind described in the Treasury's statement entitled "Taxation of Increases in Individual Incomes," which is printed (at p. 67 et seq.) in hearings before the Committee on Ways and Means, House of Representatives, Seventy-eighth Congress, first session, on revenue revision of 1943, unrevised (October 4, 1943), part 1. It is assumed further that, as indicated in the study just referred to, the tax would be limited to "wartime increases in income."

For an analysis of the constitutional questions and a clear indication of the answers to those questions, it is not necessary to go beyond the opinion of the Supreme Court in *La Belle Iron Works* v. *United States* (1921) (256 U. S. 377). That case involved the "war excess profits tax" imposed by the Revenue Act of 1917 (act of October 3, 1917) upon corporations, partnerships and individuals engaged in trade or business, with certain exceptions. There was a deduction from income measured by certain percentages of invested capital. In passing upon the construction and application of the deduction provisions and sustaining the constitutionality of the act as construed and applied, the Supreme Court states:

"The great war in Europe had been in progress since the year 1914, and the manufacture and export of war supplies and other material for the belligerent powers had stimulated many lines of trade and business in this country, resulting in large profits as compared with the period before the war, and as compared with ordinary returns upon the capital embarked. The United States had become directly involved in the conflict in the spring of 1917, necessitating heavy increases in taxation; at the same time manufactures and trade of every description were rendered even more active, and in certain lines more profitable, than before, so that *the unusual gains derived therefrom formed a natural subject for special taxation.*

* * * * * * *

"It is urged that this construction, defining invested capital according to the original cost of the property instead of its present value, has the effect of rendering the act 'glaringly unequal' and of doubtful constitutionality; the insistence being that, so construed, it operates to produce baseless and arbitrary discriminations, to the extent of rendering the tax invalid under the due process of law clause of the fifth amendment. Reference is made to cases under the equal protection clause of the fourteenth amendment; * * * but clearly they are not in point. The fifth amendment has no equal protection clause; and the only rule of uniformity prescribed with respect to duties, imposts, and excises laid by Congress is the territorial uniformity required by article I, section 8. * * * That the statute under consideration operates with territorial uniformity is obvious and not questioned.

* * * * * * *

"Nor can we regard the act—in basing 'invested capital' upon actual costs to the exclusion of higher estimated values—as productive of arbitrary discriminations raising a doubt about its constitutionality under the due process clause of the fifth amendment. The difficulty of adjusting any system of taxation so as to render it precisely equal in its bearing is proverbial, and such nicety is not even required of the States under the equal protection clause, much less of Congress under the more general requirement of due process of law in taxation. Of course, it will be understood that Congress has very ample authority to adjust its income taxes according to its discretion, within the bounds of geographical uniformity. Courts have no authority to pass upon the propriety of its measures; and we deal with the present criticism only for the purpose of refuting the contention, strongly urged, that the tax is so wholly arbitrary as to amount to confiscation." [Italics supplied.]

As is pointed out in the above quotation the only requirement of the uniformity clause ("all duties, imposts, and excises shall be uniform throughout the United States") of article 1, section 8, is territorial uniformity. In other words, intrinsic uniformity is not required but merely geographical uniformity; the tax is uniform when it operates with the same effect in every place where the subject of it is found. *Billings* v. *United States*, (1914) 232 U. S. 261, 282; *Patton* v. *Brady*,

(1902) 184 U. S. 608, 622; *Florida* v. *Mellon*, (1927) 273 U. S. 12, 17. The tax under consideration clearly would not involve any lack of geographical uniformity.

So far as the due-process clause of the fifth amendment is concerned, it is difficult to see any more arbitrariness in the tax under discussion than in the 1917 excess-profits tax involved in the *La Belle Iron Works case*. (See *Allied Agents* v. *United States*, (1939) 26 F. Supp. 98, 100). It is true that the 1917 tax was limited to incomes from trade or business whereas the tax under consideration would extend to wages and salaries, among other things. Nevertheless, the statutory method as applied to taxable persons under the 1917 act caused different results depending upon invested capital and also, in part, upon incomes over those of the pre-war period. (See A. A. Ballantine, Some Constitutional Aspects of the Excess-Profits Tax, (1920) 29 Yale L. J. 625.) Similar differences with respect to increases in salaries and wages would seem to be equally "natural." There is nothing peculiar about employment so far as constitutional limitations are concerned. In this connection the social security tax cases are helpful. *Steward Machine Company* v. *Davis*, (1937) 301 U. S. 548; *Helvering* v. *Davis* (1937) 301 U. S. 619. The *Steward Machine Company case* involved the validity of the tax imposed by title IX of the Social Security Act on employers of eight or more persons. The act was assailed on grounds which included the contentions that it was not an excise tax and that its exceptions were so many, arbitrary and discriminatory as to violate the "due process" provisions of the fifth amendment. In overruling those contentions and upholding the validity of the tax upon employers, the court stated (at pages 579–585):

"An excise, we are told, imports a tax upon a privilege; employment, it is said, is a right, not a privilege, from which it follows that employment is not subject to an excise. Neither the one appeal nor the other leads to the desired goal.

* * * * * * *

"We learn that employment for lawful gain is a 'natural' or 'inherent' or 'inalienable' right, and not a 'privilege' at all. But natural rights, so called, are as much subject to taxation as rights of less importance. An excise is not limited to vocations or activities that may be prohibited altogether. It is not limited to those that are the outcome of a franchise. It extends to vocations or activities pursued as of common right. What the individual does in the operation of a business is amenable to taxation just as much as what he owns, at all events if the classification is not tyrannical or arbitrary. 'Business is as legitimate an object of the taxing powers as property.' * * * Employment is a business relation, if not itself a business. It is a relation without which business could seldom be carried on effectively. The power to tax the activities and relations that constitute a calling considered as a unit is the power to tax any of them. The whole includes the parts. * * *

* * * * * * *

"Second. The excise is not invalid under the provisions of the fifth amendment by force of its exemptions.

"The statute does not apply, as we have seen, to employers of less than eight. It does not apply to agricultural labor, or domestic service in a private home or to some other classes of less importance. Petitioner contends that the effect of these restrictions is an arbitrary discrimination vitiating the tax.

"The fifth amendment unlike the fourteenth has no equal-protection clause. * * * But even the States, though subject to such a clause, are not confined to a formula of rigid uniformity in framing measures of taxation. * * * They may tax some kinds of property at one rate, and others at another, and exempt others altogether. * * * They may lay an excise on the operations of a particular kind of business, and exempt some other kind of business closely akin thereto. * * * If this latitude of judgment is lawful for the States, it is lawful, *a fortiori*, in legislation by the Congress, which is subject to restraints less narrow and confining. * * *

* * * * * * *

"The act of Congress is therefore valid, so far at least as its system of exemptions is concerned, and this though we assume that discrimination, if gross enough, is equivalent to confiscation and subject under the fifth amendment to challenge and annulment."

Although the question whether arbitrary discrimination exists is one of degree, I am of the opinion that a taxing statute could be drafted along the lines of the tax described in the Treasury's statement which would not violate the due-process clause of the fifth amendment. For reasons stated above, any violation of the uniformity clause of article 1, section 8 could easily be avoided.

RANDOLPH PAUL, *General Counsel.*

THE SECRETARY OF THE TREASURY,
Washington, December 3, 1943.

HON. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate.

MY DEAR MR. CHAIRMAN: There has been called to my attention the statement of the Joint Price Adjustment Board, dated December 2, 1943, with respect to the provisions of the pending revenue bill (H. R. 3687) which relate to renegotiation of war contracts.

This Department is represented on the Joint Price Adjustment Board, and through its representative took part in the preparation of the statement. One of the matters discussed in the statement, that is, the provision in the House bill giving to the Tax Court of the United States jurisdiction of appeals from renegotiation determinations, was fully considered by Mr. Randolph Paul in his testimony before your committee. This particular provision was stressed by the Department because of its serious effect on the revenue system.

As this Department is also one of the several departments concerned with renegotiation of war contracts it likewise believes that the other provisions discussed in the joint board statement are of great importance as respects renegotiation procedure and therefore fully urges the adoption of the suggestions therein continued.

Very truly yours,

H. MORGANTHAU, JR.,
Secretary of the Treasury.

Mr. PAUL. In view of the question raised by Senator Danaher, I would like to have a brief statement on that question of State taxes made by Mr. O'Connell, Assistant General Counsel of the Treasury, who has studied it at considerable length and conferred with a number of State officers.

STATEMENT OF JOSEPH J. O'CONNELL, JR., ASSISTANT GENERAL COUNSEL, TREASURY DEPARTMENT

Mr. O'CONNELL. I would like, if I might, to discuss first generally the impact of State taxes on renegotiation, and then attempt to give you something of the considerations that led to the result we have reached with respect to the treatment of that problem.

I had occasion to examine the laws of the various States in relation to the total amount of Government war business so as to see, as well as I could, how large the problem was.

To digress for a moment, it is impossible to have uniformity, if by uniformity you mean uniform application of all the State laws and at the same time have a uniform rule with respect to the treatment of the problem by the Federal Government. On the other hand, I think it is simple to have uniformity with respect to the treatment of the problem by the renegotiating agencies, and that is what I think this provision in the present bill will do.

To come back again to the general problem, there was in the neighborhood of $135,000,000,000 of war business as of June 30 of this year under contract. I broke that down by States to see just how big the problem was, and in what States it appeared to be a real problem.

Statistically, in States having some 41 percent of the total amount of war business, the States have no State taxes on corporate income. That is in some 16 States. In another 15 States, having another 31 percent of the war business, the State law affirmatively provides that State taxes will be levied on income as adjusted in renegotiation. In another 10 to 15 percent of the war business, or rather, in States having that amount of business, the law is quite clear that the result will be the same. Pennsylvania, for example, having about 8 or 9 percent

of the total war business, uses a rule that for State tax purposes Federal income will be the base, so that as renegotiation results in an adjustment of income, the result will be in Pennsylvania, if the tax has not been paid, it will be paid on a smaller basis; if it has been paid on a larger basis, the contractor will be entitled to a refund.

That leaves a residue of States, some four or five in number, the largest of which is New York, involving 10 or 15 percent of the war business, and in those States the law is not entirely clear.

The State of New York has taken the position in general that they will not allow a refund. I am frank to say I don't think that decision is compatible with the New York law. I think the New York law is, to all intents and purposes, the same as Pennsylvania and Massachusetts, in which event, where an adjustment is made in Federal income, the State authorities will adjust the tax liability downward, and in cases where they would be entitled to a refund, the State, in my judgment, would be required to grant a refund. That procedure has gone on for years in New York and in other States. It so happens that adjustments in income for Federal tax purposes over the past years have uniformly been upward rather than downward. This particular adjustment is one which is downward, and that of course causes the difficulty that some of the States are having with respect to the treatment to be given to the problem.

Senator WALSH. I have a letter from Rollin Brown, the commissioner of taxation of the State of New York, in which he states the States would be satisfied if the law would merely make the new policy effective only as to future fiscal years without saying anything at all about past years.

Mr. O'CONNELL. I am not familiar with that letter. Of course, the amendment, as I understand it, in the present law, becomes effective only with respect to the fiscal years ending after June 30, 1943, so to that extent we are not very far apart from Mr. Brown.

Senator WALSH. Mr. Brown's statement will appear at another place in the record.

Mr. O'CONNELL. Without having read the statement, I am frank to say I see no basis for going along with the suggestion. If we take the State of Connecticut, for example, I believe that under the Connecticut law if we adopt the policy and continue the policy of only allowing as cost the amount of taxes the State would collect on the adjusted income, the State of Connecticut will give effect to the renegotiation agreement and make a refund of the amount of tax the contractor would otherwise have paid.

My difficulty with going along with the suggestion urged by the commissioner from New York is we are rather in the position of having the tail wag the dog. We have 80 to 85 percent of all the business done in States in which they either have no State taxes on income, or have conceded the propriety of the position taken by the Federal Government, that in all good conscience a State which has a corporate income tax should not expect to collect taxes on excessive profits which have never been beneficially received by the companies concerned.

We have at one extreme a State like California, which has passed a statute which expressly provides that the State's corporate taxes within the State shall be based on income as adjusted in renegotiation.

If we go to the other extreme and concede the validity of the position taken by the tax commissioner of New York, I don't see how we can expect the other States, which have as a matter of principle felt that their State taxes should be so adjusted as not to impose upon the Federal Government the additional burden of State taxes on excessive profits, to continue in that attitude. I don't see how we can make that position consistent except by virtue of following the position suggested in this bill, which is that we will allow State taxes only on income as adjusted in renegotiation.

There are only three States in which machinery does not exist with respect to refunds, and they do not loom very large in the picture. The State of New York has existing machinery which will make it possible to follow out the policy we have indicated, and it seems to me that Mr. Brown's letter suggesting that we do not make it retroactive, but that it be considered all right for the future, is possibly the best proof I can think of that no change is necessary in the State of New York to put the policy we have suggested into effect.

Before the Ways and Means Committee the suggestion was made that the States were in rather dire straits and that they would need the additional revenue. I think the record is quite clearly to the contrary. We offered at that time a summary of the fiscal position of various States, some 34 or 35 in number, which had just recently been made by the Wall Street Journal, in which it appeared that while the Federal Government was spending a great deal more money than it was taking in, the position of the States was quite different; they were piling up surpluses, collecting more in taxes than they were able to spend. The State of New York is even considering making provision for a post-war reserve at the present time out of money they are getting in excess of their needs.

It has been our position that no State should expect to collect income taxes on excessive profits. We do not believe there are any serious difficulties in having the States bring their practice in line with the position that we think is a sound one.

That is all I have to say.

Senator WALSH. Very well, sir.

STATEMENT OF ROLLIN BROWN, COMMISSIONER OF TAXATION AND FINANCE, AND PRESIDENT OF STATE TAX COMMISSION, STATE OF NEW YORK

Mr. BROWN. First, I want to distinguish between what we call current renegotiation and what we call retroactive renegotiation. A current renegotiation is one which is concluded before the end of the year covered by the renegotiation. A retroactive renegotiation is one which is concluded after the end of the year. The House bill, if enacted, will inevitably cast an unfair burden on contractors whose profits are renegotiated retroactively, by allowing credit in determining excessive profits for only that portion of State taxes computed on the basis of renegotiated income, that is, on net income less excessive profits. New York and some other States might be willing to amend their tax laws or adopt an administrative interpretation of their existing laws so as to relieve the contractors, if there would be any assurance that all States would do likewise, so that there would be uniformity and equality of treatment among all States. But there

would appear to be slight chance of such uniformity being achieved by independent action of all the States which impose corporate taxes on or according to net income.

As we have pointed out, some State laws make no provision whatever for refunds based on readjustments of income after the State returns are filed. At least one State (Minnesota), by express statutory provision, treats a retroactive renegotiation as affecting the income of the later year in which the renegotiation is concluded, and not as affecting income of the renegotiated year except to the extent the recaptured excessive profits exceed the net income of the later year; and it is provided that even then no refund will be made for the renegotiated year in excess of 10 percent of the tax paid for such year. Other States, without doubt, will refuse to recognize a retroactive renegotiation as justifying any change whatever in net income. The South Carolina Governor, Tax Commission, and legislative leaders have announced that that course will be followed in that State, and that if any amendment of the State law is required it will be enacted at the next session.

It would be grossly unfair to expect some States to recognize retroactive renegotiation and make huge refunds of taxes already collected, while other States collect and retain full taxes computed without regard to retroactive renegotiation.

Moreover, it is unreasonable to expect any State to hold open the audit of returns pending renegotiation. The administrative and budgetary problems would be enormous, especially in States which currently distribute part of their corporate tax revenues, when and as collected, among their local subdivisions.

We have cases in our office here in Albany involving a total of nearly $10,000,000 of disputed franchise taxes—10 percent of our total franchise tax revenues for this year—depending on retroactive renegotiation—$10,000,000 is the amount of taxes on excessive profits recaptured after the end of the year. In those cases the corporations involved have—

1. Applied for extension after extension on the ground that they were being or expected to be renegotiated, or

2. Simply reduced their incomes as reported by arbitrary amounts which they claimed they would or might be required to repay the Government at some later time, or

3. Demanded that assessments of their taxes be postponed pending renegotiation (our tax is assessed by the Tax Commission and is not self-assessed by the taxpayer), or

4. Demanded refunds of taxes already paid on profits later determined to be excessive.

We do not believe the Federal Government ought to insist on recapturing 100 percent of every dollar of excessive profits, when to do so would involve the States in such tremendous administrative and budgetary problems. After all, State corporate taxes are imposed at very low rates and it would cost the Federal Government very little to allow the contractor in every case credit for the full amount of State taxes computed without regard to retroactive renegotiation.

Of course, the States are prepared to give full recognition to current renegotiation and to allow State tax returns to reflect any excessive profits recaptured before the end of the year, or even possibly before the statutory date prescribed for filing the State return.

As an added reason for giving full credit for State taxes without regard to retroactive renegotiation, I call your attention to the tremendous difficulty of allocating or apportioning State taxes between renegotiable income and other income, especially in the case of a corporation doing business in several States, and even more especially in cases where only renegotiable business is done in certain States and other kinds of business is done in other States. That problem will not arise in connection with New York taxes, because we take an allocation percentage factor (based on assets within the State) and apply that factor to the corporation's entire net income wherever earned. However, other States which have other methods of allocation or apportionment will present the problem, and it will affect the income earned by their taxpayers in New York as well as in other States.

If the Senate concurs in the provision inserted in the House bill (limiting the credit for State taxes to the portion thereof based on renegotiated income), the States at least hope that the effective date for the new policy will be changed so that it will apply only to fiscal years ending after December 31, 1943; and that the law will provide specifically that as to all prior years full credit will be given for State taxes computed without regard to retroactive renegotiation, and that where any past renegotiation has failed to give such full credit, the renegotiation may be reopened so that full credit may be given. If the provision is purely prospective in its operation, the States will at least have a chance to put their houses in order before the storm hits them.

The States would be satisfied if the law would merely make the new policy effective only as to future fiscal years, without saying anything at all about past years, provided the price adjustment boards will publicly and officially state that, as to such past years, full credit will be given for State taxes without regard to retroactive renegotiation.

STATEMENT OF ALBERT S. GOSS, MASTER OF THE NATIONAL GRANGE

Mr. Goss. The traditional tax policy of the National Grange is that taxes should be levied in proportion to ability to pay and benefits received. Except in time of emergency they should be levied in amounts sufficient to meet the current cost of government and make substantial inroads in any existing debt. War has created a new element of danger in the possibility of inflation.

There are two major causes of inflation. First is the fear, on the part of investors, that the Government may not be able to pay its debts in the same size dollar it borrows. The second is the pressure of surplus income upon an insufficient supply of consumer goods and services. A sound tax and savings policy combined with a practical production program are the most effective remedies that can be applied to either of these causes, provided, of course, that economy of expenditure is attained.

There are a number of considerations which must be borne in mind in developing a tax system which will result in the maximum good:

1. Ability to pay must not be sacrificed.
2. Production of usable consumer goods must not be hampered.
3. Extravagance must be discouraged.

4. Savings must be encouraged.
5. The dangerous dollars of inflated incomes must be prevented from forcing runaway prices.

These things are possible under a properly balanced tax system, the foundation of which should be an income tax and a system of excise taxes largely based on luxuries or nonnecessities.

Before discussing the five considerations just listed, let us point out roughly our present income and spending situation and its threat to our economic stability.

It is estimated that we will have a total national income during the current fiscal year of $152,000,000,000.

The total of goods and services available for purchase is estimated at $89,000,000,000 leaving a surplus spending power of $63,000,000,000. It is estimated that taxes as now levied will absorb about $21,000,000,000, leaving an inflationary gap of $42,000,000,000.

It is further estimated that we may expect possibly $20,000,000,000 in bond purchases or similar savings, leaving a net inflationary gap of over $20,000,000,000 or possibly $2,000,000 per month—a steadily accumulating source of danger. This gap must be closed or sharply reduced if danger is to be averted.

We have presented to the Banking and Currency Committees of both Houses information and data showing how futile a price ceiling-subsidy program is in coping with this grave danger, because it both reduces production and increases spending power, thus widening the gap while trying to throw up puny artificial dams against the ever-increasing volume of spending power which flows over and around the dams into black markets until the flood can no longer be held in check and the whole unsound scheme collapses. We will not burden the committee with a repetition of details, for the testimony is available for those who wish to pursue the study further. We will point out, however, that relief must come from one or more of four principal sources:

1. The supply may be increased, thus reducing the gap at one end.
2. The price may be increased, which would have a similar effect.
3. The surplus income may be drained off in taxes.
4. The surplus income may be drained off in savings.

1. Increase the supply. This, of course, is the most desirable approach. There never was inflation amid abundance. The creation of real wealth is the foundation of all prosperity and the greatest prosperity exists when a full supply is available to meet a maximum demand. Many things can be done to increase the supply, but the particular concern of your committee is to make sure that no system of taxation hampers the fullest possible production.

2. Increase the price. Unnecessary price increases—those resulting from monopolistic practices or profiteering—must be avoided. Ceilings are frequently justified to prevent such abuses. However, prices must be sufficient to meet production costs and assure maximum production. If our economy has gotten out of balance; if labor or industry have advanced their margins so as to cause increased production costs, prices must be allowed to rise to restore a reasonable equilibrium, or production will slow down and our troubles will be magnified. Your committee should avoid two danger spots at this point. First, do not attempt to keep our economy out of balance

by subsidies which will require more taxation and transfer to the future the necessary adjustments then made more difficult by the accumulations of unmet responsibilities. Second, don't load the necessities of life with taxes which add to the burdens of the poor who are the first to suffer from inflation. A balancing of price at the proper levels to meet production needs is the best means of reducing the gap from the supply end. Incidentally, if this is well done, not much change in our present price level need be made.

3. Tax surplus income. Those who think that we can adopt a tax system which will take all the income (except personal exemptions) at the top levels and keep on coming down the ladder until they have reached a point of balancing the budget make two grievous errors. First, they ignore the fact that in some cases there would be no further incentive to produce and create the usables necessary to reduce the gap at the supply end. Second, they are missing the great volume of suplus income where it actually is. Secretary Morgenthau says 80 percent of our people have incomes which have become swollen by war conditions. These are largely increased dangerous dollars which are causing the rising threat of inflation. A large portion of the remaining 20 percent of our people have substantial incomes, although they may not have been increased by the war. Our present income tax fails to reach these incomes equitably, and if levied in volume sufficient actually to reach these dangerous dollars, would hamper production and make reconversion to peacetime production impossible.

Let us illustrate.

First, we are now levying a 90 percent tax on the highest brackets. Any increase would not add much to the "take" but would destroy all incentive to risk more money in enlarging production facilities.

Second, our present income tax fails to reach the big volume of swollen income. For example, Brown is a clerk in a fairly responsible position at a salary which has remained at $4,000 for some time. He has assumed some fixed obligations, such as life insurance, rent, or payments on a home, which absorb most of his income after taxes.

Jones is a factory worker who until recently made about $1,800, but who now is also making $4,000 a year. He suddenly finds himself with an unusual amount of money to spend. A tax which would bankrupt Brown because of his commitments, could easily be paid by Jones. Because there are so many of them, it is men in the Jones class who are getting the largest part of our great increase in income. They are much more able to pay substantial taxes than those in the Brown group, chiefly because they have not been able to buy since they received such an increase in income, so their ability to pay does not seem the correct measure of taxation. Yet it is largely their surplus spending power that is responsible for our fast-increasing inflationary gap.

We should have a combined method of income tax and savings plan, under which income levies are substantially stepped up, especially in the middle and lower brackets, and a substantial portion of the tax levied is placed to the credit of the taxpayer to be repaid when the war is over, in such installments as would constitute sound Government financing with provision for drawing on such credit for certain specific purposes, such as payments on interest, life insurance, or other fixed obligations contracted before the enactment of the law. While some might say such a plan would be unfair to Jones because it would not

permit him to spend as much as Brown, we must nevertheless be realistic about it and recognize the fact that until the war is over, there will not be sufficient goods to buy, and if the pressure is allowed to continue, the answer will be inflated prices which will cost both Brown and Jones all they would have paid in increased taxes, and more too.

If we thus employed a tax system under which a substantial part would be laid aside for savings, we could levy a much heavier income and savings tax with equity for all. While it might not go further toward balancing the Budget, it could be made to go just as far as it is fiscally sound to do so, and it would effectively drain off a large volume of surplus income into savings which would not leak. Attention is called to the difference between such a savings plan and the pay-roll deduction plan. Under the latter, 10 percent may be excessive to a man with many dependents, and may be too little in the case of a single man. Under the proposed plan the exemptions for dependents determine the amount of the levy, and a man's uncontrollable circumstances control the amount required to remain in the savings fund. The combined levy could be greatly increased without injustice to anyone.

Third, there is another weakness in the income tax which should be corrected before it could be used to the maximum without injustice. Taxpayers with widely fluctuating incomes should be protected. For an extreme example, a peach grower may average one highly profitable crop in 4, with 3 years of losses. If the Government taxes most of the income in the profitable year, the grower will have no funds to carry over the unprofitable years. When the income tax was low, the injustice was not pronounced, but the higher the rates the greater the injustice. The same situation prevails to a greater or less degree among taxpayers with many types of income, and is one of the reasons why more reliance cannot be placed on the income tax for increased revenue. An income equalization plan should be provided under which any taxpayer, upon figuring his taxable income, may pay up to one-half of that taxable income into an equalization account held by the Government, and pay income taxes on the balance. He could leave the amount so paid into the equalization account for as long as he wanted, not exceeding 10 years, where it would draw such a rate of interest as would be consistent with "demand" or short-term loans. He could draw down the amount to his credit at any time, but upon drawing it down it would become part of his taxable income, and would not be available for use again for equalization deposit. Thus taxpayers with fluctuating incomes would not be put to a disadvantage as compared with taxpayers with steady incomes.

Fourth, the same principle of income tax and savings should be employed in corporation taxation where a heavier tax might be levied, but a substantial part set aside in a savings account for reconversion purposes. It would seem entirely feasible to set up rules and standards under which funds could be withdrawn from such savings account for the payment of reconversion costs made necessary because of original conversion to war production.

5. Extravagance must be discouraged. The Grange is in complete sympathy with the efforts being made to effect economies in the administration of government. This should be accomplished by a careful guarding of appropriations. Congress should revoke the blank-check procedures which have resulted in so much waste and set

up proper controls to prevent all needless extravagances. We call the committee's attention to the fact that failure to levy taxes will not solve this problem. It will only result in more borrowing and greater danger of inflation. We believe that each problem should be met separately, and that the responsibility of your committee is to place taxes on the most equitable basis, and raise as much money as can safely be done to apply on our appalling debt. Then with a proper savings plan we can reduce the swollen income side of the inflationary gap and remove this insidious danger from our economy. We believe, however, that unless something of the sort is done, we stand in grave danger of very considerable and wholly unnecessary inflation. Even though the Congress recognizes that the President's price control program will sooner or later lead to disaster, just as it has always done throughout history, we believe that Congress cannot consistently oppose it without taking the proper practical steps to meet the issue, and we believe that a sound tax program is very definitely a necessity in meeting this problem. We therefore urge that plenty of time be taken to develop a thoroughly sound program which will accomplish the purpose sought.

We are submitting extracts from the tax program of the National Grange adopted at our seventy-seventh annual session on November 17 last, which set forth the steps we have herein proposed.

REPORT OF COMMITTEE ON TAXATION

With individual incomes of the Nation totaling $152,000,000,000 for the current year and with a total value of available consumer goods and services for the year estimated at $89,000,000,000, we have in America $63,000,000,000 excess spending power, less taxes. With the total tax returns estimated at $21,000,000,000 now, we have a balance of $42,000,000,000 in the hands of consumers to exert inflationary pressure on all markets.

In the face of these facts, congressional response to the Administration's request for increased tax revenue seems pitifully inadequate.

The financial program and fiscal policy for this Nation now must not be drawn for political expediency. It must be based on sound economics because it will influence the daily living of Americans for years to come.

Such a fiscal policy should—

1. Determine the irreducible cost of the Government, including the efficient prosecution of the war to victory.

2. Ascertain the maximum amount that can be raised by current taxation without crippling the present or future capacity of the Nation to produce goods and render services—the only true source of individual or governmental revenue.

3. Put into operation without unnecessary delay a tax program designed to collect such taxes without injustice.

4. Borrow only the difference between the irreducible minimum cost of Government and the maximum amount that can be collected by taxation without strangling private enterprise and smothering incentive. Debt is deferred taxation.

A sound income tax and savings program to provide revenue as called for above would help to control inflation by preventing debt accumulation and relieving surplus purchasing pressure.

Because income in the high brackets is already taxed at a very high rate and no substantial amount of increased revenue from this source is possible, and because the big increases in income have come in middle and lower brackets, it is obvious that these brackets will have to be the source of the increased revenue. A substantially higher rate of personal income taxation can be put into effect especially in the lower brackets by combining therewith a savings plan wherein a substantial portion of the tax levied shall be placed to the credit of the taxpayer for repayment to him after the war in accord with sound Government financing with provisions for drawing on this credit for payment of fixed obligations such as insurance premiums, interest on the retirement of debt contracted before the war or other specific purposes.

In the use of a high income tax, it is necessary to recognize and protect various types of income to prevent inequities.

Persons whose income, by reason of the nature of their business, may vary widely from year to year through no fault or cause of their own, should be provided a savings plan under which a specific portion of the income for any given year may set aside under low interest rate loan to the Government, free from income-tax levy at the time, but subject to income tax when drawn down subsequently, to be added to any current year's income.

We recommend that serious study be given to the advisability of establishing the excess profits tax at 100 percent, and in turn setting aside a substantial portion in savings for reconversion or other specific purposes after the war.

To safeguard family farm operations, we recommend that Federal income-tax laws be amended to provide that losses on agricultural operations can be deducted only from incomes derived from agricultural operations, in the determination of income-tax payments.

Dividends from cooperative agencies operating under cooperative laws, not for profit but for savings to patrons thereof, are not earnings but are a deferred completion of each individual's transactions and are in no sense a profit, therefore are not taxable as income.

In levying excise taxes we would recommend that no burdensome or discriminatory tax be placed on commodities listed in determination of cost of living index, solely because it seems to lend itself to an easy way of acquiring funds.

The above program of increased income-tax revenue and savings would eliminate any need for a general sales tax. We further believe that inequities and injustices are far more difficult to eliminate from a sales tax than from the above program.

Whereas, a very important part of any tax program is utmost economy and efficiency; therefore, be it

Resolved, That further reduction in expenses and greater efficiency of Government be sought by decentralization, and the elimination of unnecessary functions and duplicating agencies.

Mr. DODGE. I have a statement on standard commercial products, prepared by the War Production Board, which I would like to present for the record.

Senator WALSH. That may be done.

(The statement referred to is as follows:)

STANDARD COMMERCIAL PRODUCTS

WAR DEPARTMENT PRICE ADJUSTMENT BOARD

The contention is made that these businesses operate under Office of Price Administration price ceilings. Therefore, they should be exempt from renegotiation. The standard product, however, may be an integral part of some volume-produced war product or it may be used as such in volume for war purposes. I understand the Office of Price Administration price ceilings usually are set at a level to permit the marginal producer to cover costs and make a fair profit—that is, the man who has no great volume and not particularly low costs. The question as to whether more efficient and greater volume producers or dealers can make excessive profits under these ceilings has not been considered in fixing Office of Price Administration ceilings. When this situation is translated into the terms of the producer with multiplied volume and normally low costs because of better equipment, processes, and management, the profit results are startling.

The renegotiation law applies only in cases where excessive profits are being realized. No contractor has been renegotiated except where substantial profits are evident. With regard to the elimination of so-called standard commercial articles, experience with the administration of the renegotiation law clearly demonstrates that in this field excessive profits have appeared consistently.

From the procurement angle the chief difficulty is that while the procurement officers can and are securing reasonable prices in the case of prime contractors, the lower tiers of subcontractors simply cannot be handled by the procurement agencies. The excessive profit, if allowed, in the lower tiers of subcontractors, pyramids as it comes upward through the various tiers of contractors, cumulatively creating inflated costs, prices, and profits as it goes. The following

figures show the excessive profits which have been realized in certain standard goods industries. These companies, it should be noted, are engaged principally in subcontracting and are substantially all of those in these classifications which have been renegotiated by the War Department. These cases represent what has happened in standard product businesses as a result of the war and are examples of the profit results of volume increases before taxes.

[000 omitted]

	1942	Average 1936-39	Increase	Percent increase
Perishable tools, 19 companies:				
Sales	$172,011	$29,418	$142,593	485
Profit before renegotiation and taxes	$62,010	$5,025	$59,985	1,134
Percent profit	40.0	17.1	22.9	128
Woolen textiles, 25 companies:				
Sales	$237,782	$98,030	$139,752	143
Profit before renegotiation and taxes	$31,965	$3,245	$28,740	885
Percent profit	13.5	3.5	10.2	309
Lumber, 10 companies:				
Sales	$106,677	$42,228	$64,449	153
Profit before renegotiation and taxes	$25,908	$4,991	$20,917	419
Percent profit	26.1	11.8	14.3	121
Cotton textiles, 53 companies:				
Sales	$548,633	$207,185	$341,448	165
Profit before renegotiation and taxes	$76,209	$8,467	$67,742	800
Percent profit	13.9	4.1	9.8	239

Thus, it seems obvious to exempt producers of standard goods from renegotiation would be to increase tremendously and unnecessarily the cost of the war. Moreover, it is extremely difficult to define "standard commercial articles." Any general language in the statute which would exempt, say, tooth brushes from renegotiation would in all likelihood also exempt a great many motors, sheets, shapes, steel products of all kinds, aluminum, ingots, castings and forms and many other basic parts of the machinery of the war. For example, exempting a motor in a jeep may very well be a standard commercial product to the same extent as the tooth brush is a standard commercial product. It is difficult to understand how these products can be limited by any definition so far observed in such a way as to remove the possibility of exorbitant profits being realized, in many cases directly as a result of war business.

As a specific example, one company, and not by any means the most unusual, did an average volume of business from 1936 to 1939 of $16,500,000. He earned an average dollar profit, before income taxes, of $1,220,000, at the rate of 7.4 percent on sales. In 1942, his sales were nearly $50,000,000, his profit before tax $12,500,000, and his earning rate 25 percent on sales. It would be difficult to conclude that this manufacturer of a standard product under Office of Price Administration price ceilings was not benefiting from the war to an unreasonable degree.

DECEMBER 4, 1943.

Senator WALSH. I am submitting herewith for the record statements on behalf of various people covering the bill under consideration. (The statements referred to are as follows:)

STATEMENT OF THE WINE INDUSTRY TO THE MEMBERS OF THE SENATE FINANCE COMMITTEE

This statement with respect to H. R. 3687 is submitted on behalf of the American wine producers and the 150,000 growers in 28 wine producing States.

The proposed war tax on wine is a minimum increase over present rates of 50 percent on some types of wine and 100 percent on others. Since the bill provides for the termination of this war tax upon the cessation of hostilities, the wine growers of America, desiring to contribute their full measure of support to the war effort, are entering no protest to the adoption of these rates.

We are, however, for the reasons given below, unalterably opposed to any increases in excess of those set forth in H. R. 3687, whether they be for the duration or not.

1. Wine excise taxes, including war tax rates in H. R. 3687, have increased on an over-all average of 355 percent since 1939—a far greater rate of increase than, and entirely disproportionate to, those levied on any other item or service.

2. Grape and wine growing constitutes a vitally important agricultural industry, and, unlike other alcoholic beverages or other agricultural products, requires an average investment of $300 and 4 years of labor in each acre of vineyards before the first yield. Manifestly, if this wholesome beverage of moderation is to develop a normal, stable market in this country, wine must have more favorable recognition from State and Federal taxing authorities.

3. Despite growing acceptance of wine in the United States, our industry is still in its infancy. We produce less than a tenth as much wine as Italy or France and even less than a small country like Greece. Since our entry in the war, American wine production has materially decreased due to manpower and container material shortage, and conversion of a portion of the industry to production of food items and war materials.

Respectfully submitted.

WINE INSTITUTE,
By H. A. CADDOW,
Secretary-Manager.

MEMORANDUM ON FLOOR STOCK TAXES

(Submitted by Wine Institute)

Since H. R. 3687 levies floor-stock tax and provides for the termination of all war-tax levies upon the cessation of hostilities, it is only just and equitable that upon the termination of the increased tax, there should also be a remission of tax on all items then held in storage or inventory.

The failure to do so will be tantamount to continuing the war tax after the termination date until all stocks on hand at that time may have passed on to the consumer.

SUGGESTIONS OF COMMITTEE ON FEDERAL TAXATION OF THE ILLINOIS MANUFACTURERS' ASSOCIATION FOR SUBMISSION TO THE SENATE FINANCE COMMITTEE

The Illinois Manufacturers' Association, comprising 3,300 firms—large, small, and middle-sized—and engaged in a variety of manufacturing activities, submits the following suggestions to the members of the Senate Finance Committee for consideration in connection with pending tax legislation.

The committee recommends:

(1) That the Federal revenue laws be amended to provide for the adoption of a provision for the creation of cash reserves, the use of which would be limited to paying for the cost of reconversion to a post-war production basis. Such reserve funds should be set aside out of earnings and be deductible for tax purposes at a rate of from 10 to 25 percent of net earnings.

During the last few years it has been necessary for most manufacturing corporations to tremendously expand their production facilities to meet the demand for war production. Many corporations have invested their entire cash surplus in additional factory space, machinery and equipment, and are often encumbered with bank and government loans. Present high taxes will not permit a corporation to set up cash reserves to meet reconversion costs. Upon the termination of the war, many manufacturing corporations will find their entire assets tied up in plant facilities, machinery, and equipment, and will not be in a position to provide employment for production of products temporarily suspended during the war.

(2) That proposals for an increase in the Federal income-tax rates be opposed. An extensive study of all types and sizes of companies throughout the country indicates that the rates of tax on individual and corporate income are now excessive.

(3) That the Federal capital-stock tax and declared-value excess-profits tax be repealed. These taxes are of little value as revenue measures and only serve to add confusion to the present system of taxation.

(4) That the present complicated tax laws on corporations, as well as upon individuals, be simplified in every feasible manner. The unduly complex character of our present laws imposes severe and unnecessary hardships on all taxpayers.

(5) That Congress assume the initiative in making a thorough inquiry into the expenditures of the Federal Government with the purpose of eliminating waste and extravagance and effecting real economy in the conduct of governmental activities. It is a matter of common knowledge that many billions of dollars can be made available to the Federal Treasury through the adoption of a strict program of governmental economy, the elimination of unnecessary employees, and a business-like conduct of the various governmental agencies.

(6) That the 2-year loss carry-forward or carry-back which allows companies to offset the losses of the two immediately preceding and succeeding years against the taxable profits of the current year be extended to a 3-year carry-forward or carry-back in order to give more adequate protection to these companies.

(7) That the present relief provisions, as provided by section 722 of the Internal Revenue Code, be extended to give adequate and necessary relief to all companies unfairly penalized by the excess-profits tax and to clarify the language of the existing tax law.

(8) That if after a thorough inquiry has been made regarding ways and means by which waste and extravagance in governmental expenditures and economy in the operation of the various governmental activities has been completed, it is necessary to impose additional taxes, a Federal tax on the sale of all tangible property through retail and other channels, except sales for resale, at a flat rate up to 10 percent, without exemptions, be adopted and the variety of excise taxes now imposed on miscellaneous industries be eliminated.

(9) That the 1942 law be clarified to specifically include, for the purpose of loss deductions, real property which may have been used in the past or bought for the purpose of use. The law provides that real property used in the business may be sold at a loss and the loss deducted as an ordinary loss. The Commissioner has construed this to mean property actually in use on the date of sale. Only property bought for investment purposes should be excluded.

(10) That section 102 which relates to the unreasonable accumulation of surplus beyond the reasonable needs of business, be reconsidered in the light of existing conditions as well as those likely to arise by reason of post-war adjustment.

At the present time, internal revenue agents are directed to make specific recommendations as to whether or not a corporation may be considered as having an unreasonable accumulated surplus. Corporation taxpayers are under the uncertainty, until all returns are examined and accepted, as to whether or not they may be compelled to pay a substantial penalty by reason of being held in violation of this section of the code. In the light of present problems, particularly with respect to proper refunds as a result of renegotiation provisions, for reserves necessary to adjust to post-war operation, for reserves as a result of loss in value of inventories, and for reserves incidental to termination and cancelation of Government contracts at the will of the Government without notice, it is virtually impossible for any corporation to make a determination as to what its reasonable needs are.

(11) That the present provisions of the statute with respect to the collection of interest at the rate of 6 percent on any deficiencies of taxes be modified so as to provide that the interest rate shall be reduced to 3 percent for the first year following the due date of the return, 2 percent for the second year, and 1 percent for the third year.

The purpose of this modification is to encourage the prompt examination of returns and not unduly penalize taxpayers by reason of examination of returns being delayed unnecessarily.

RECOMMENDATIONS REGARDING CHANGES IN THE RENEGOTIATION OF GOVERNMENT CONTRACTS LAW (PUBLIC LAW NO. 528)

The Illinois Manufacturers' Association has frequently represented to Congress that the only proper way to recover so-called excessive profits is through our Federal revenue laws. The energies and the time of our war-production agencies should be devoted exclusively to the war effort. These agencies should not be used as the tax collectors. This responsibility should be lodged exclusively in the Federal Revenue Department. If the revenue laws are not now adequate to accomplish the return to the Government of excessive profits, they should be amended.

The Illinois Manufacturers' Association, therefore, reiterates its recommendations that the renegotiation of Government contracts law be repealed and excessive profits recouped exclusively through our Federal tax laws. In event, however, the repeal of this law cannot be accomplished at this time the following recommendations for changes in said law are respectfully submitted:

Section 403, subsection (a) (3) states: "The terms 'renegotiate' and 'renegotiation' include the refixing by the Secretary of the Department of the contract price."

Section 403, subsection (a) (3) should be eliminated. The Secretary should not have the arbitrary right to refix prices which might be exercised so as to work great hardship on the contractor. If any such right is to be given to the Secretary, the contractor should be protected by permitting him to terminate the contract upon some reasonable basis if the refixed price was not acceptable.

Section 403, subsection (b) (2) states: "A provision for the retention by the United States from amounts otherwise due the contractor, or for the repayment by him to the United States, if paid to him, of any excessive profits not eliminated through reductions in the contract price, or otherwise, as the Secretary may direct;".

Section 403, subsection (b) (2) should be amended to eliminate the right of the Secretary to recover "excessive profits" by their retention "from amounts otherwise due the contractor." Such a procedure might very easily force many contractors into bankruptcy, particularly where they had not fully realized the possible effect of renegotiation on their financial position and had not set up adequate reserves to take care of the situation.

Section 403, subsection (b) (3) (ii) reads; "a provision for the retention by the contractor for the United States of the amount of any reduction in the contract price of any subcontract pursuant to its renegotiation hereunder, or for the repayment by the subcontractor to the United States of any excessive profits from such subcontracts paid to him and not eliminated through reductions in the contract price or otherwise, as the Secretary may direct,".

Section 403, subsection (b) (3) (ii) should be amended so that the contractor is not obligated to insert in subcontracts a provision for the "retention by the contractor for the United States of the amount of any reduction in the contract price of any subcontract pursuant to its renegotiation hereunder." Notwithstanding the inclusion of a clause which relieves the contractor of liability to the subcontractor, the subcontractor might still have the basis for a suit against the contractor, and in any event such a procedure might very well cause a breakdown of the normal, friendly relationship between buyer and seller.

Section 403, subsection (b) (4) the first sentence reads: "A provision for the retention by the United States from amounts otherwise due the contractor, or for repayment by him to the United States, as the Secretary may direct, of the amount of any reduction in the contract price of any subcontract under such contract, which the contractor is directed, pursuant to clause (3) of this subsection, to withhold from payments otherwise due the subcontractor and actually unpaid at the time the contractor receives such direction."

Section 403, subsection (b) (4), should be amended by striking out the first sentence in its entirety. The matter of recovery of any excessive profits from subcontracts should be one to be settled between the Secretary and the subcontractor, and the contractor should be required to assume no responsibility in this connection.

Section 403, subsection (c) (1), reads: "Whenever, in the opinion of the Secretary of a Department, the profits realized or likely to be realized from any contract with such Department, or from any subcontract thereunder whether or not made by the contractor, may be excessive, the Secretary is authorized and directed to require the contractor or subcontractor to renegotiate the contract price. When the contractor or subcontractor holds two or more contracts, or subcontracts, the Secretary, in his discretion, may renegotiate to eliminate excessive profits on some or all of such contracts and subcontracts as a group without separately renegotiating the contract price of each contract or subcontract."

Section 403, subsection (c) (1), should be amended to require that the Secretary renegotiate on an over-all basis instead of permitting him to exercise discretion as to whether it is to be done on an over-all basis or by individual contracts. If the latter method should be adopted, it will result in increased administrative difficulties, will require a vastly increased amount of work on the part of many contractors, and may result in increased hardship since the contractor may not be given the advantage of offsetting high profits on some contracts with losses on others.

Section 403, subsection (c) (2) reads in part as follows: "Upon renegotiation, the Secretary is authorized and directed to eliminate any excessive profits under such contract or subcontract (i) by reductions in the contract price of the contract or subcontract or by other revision in its terms; or (ii) by withholding, from amounts otherwise due to the contractor or subcontractor, any amount of such excessive profits; or (iii) by directing a contractor to withhold for the account of

the United States, from amounts otherwise due to the subcontractor, any amount of such excessive profits under the subcontract; * * *."

Section 403, subsection (c) (2), should be amended to eliminate the right of the Secretary to recover excessive profits by arbitrary reductions in price, by withholding sums otherwise due the contractor or subcontractor, and by having the contractor withhold sums due the subcontractor.

Section 403, subsection (c) (3), reads as follows: "In determining the excessiveness of profits realized or likely to be realized from any contract or subcontract, the Secretary shall recognize the properly applicable exclusions and deductions of the character which the contractor or subcontractor is allowed under chapter 1 and chapter 2E of the Internal Revenue Code. In determining the amount of any excessive profits to be eliminated hereunder the Secretary shall allow the contractor or subcontractor credit for Federal income and excess profits taxes as provided in section 3806 of the Internal Revenue Code."

Section 403, subsection (c) (3) should be amended so that the Secretary is required to allow at least all applicable exclusions and deductions which are allowed under chapters I and 2E of the Internal Revenue Code. It is believed that this is what Congress intended but the Price Adjustment Boards have interpreted the language to mean that they are not "required to compute and allow the actual dollar amount of exclusions and deductions which the Bureau of Internal Revenue would allow."

Section 403, subsection (c) (4) authorizes the Secretary to make such final or other agreements in renegotiation * * * as the Secretary deems desirable. * * *

Section 403, subsection (c) (4) should be amended so that the terms and conditions of the final agreement are specific and not discretionary with the Secretary. They should be confined to a statement of the net amount of the refund, the terms of payment and a final and conclusive release. It should be clear that any such agreement shall not be reopened under any circumstances except upon showing of fraud or malfeasance or a willful misrepresentation of a material fact. This latter requirement is of considerable importance because although section 403 now appears to make this provision, it is understood that such final agreements are now being reopened by the Government because of the recent inclusion of contracts with Defense Plant Corporation within the meaning of the statute.

Section 403, subsection (c) (5) provides for the filing of financial statements by the contractor and gives the Secretary of a department 1 year or less to notify the contractor of intended renegotiation.

Section 403, subsection (c) (5) should be amended so that the Secretary is required to give notice of the intention to renegotiate within 90 days rather than 1 year after the filing of financial statements by the contractor or subcontractor. The Secretary, however, should not be bound by this condition if the financial statements filed with him were later found to be fraudulent.

Section 403, subsection (c) (6) excludes from renegotiation contracts or subcontracts on which final payment was made prior to April 28, 1942.

Section 403, subsection (c) (6) should be amended so that contracts entered into prior to April 28, 1942, are not included, whether or not final payment on such contracts had been made prior to that date.

Section 403, subsection (d) refers to allowances which the secretaries may make for salaries, bonuses, reserves, costs, etc.

Section 403, subsection (d) should be eliminated in its entirety and the following inserted in its place:

"(d) In renegotiating a contract price or determining excessive profits for the purpose of this section, the Secretaries of the respective Departments are directed to allow as an element of cost reasonable reserves for deferred war costs and reconversion. Such reserves shall be allowable in an amount which (after taxes) will, when added to the post-war tax credit of the contractor or subcontractor for the fiscal year which is being renegotiated, be not less than the reserve which would have been provided through the operation of the post-war tax credit if no renegotiation had taken place. A similar credit should be extended to proprietorships and partnerships on renegotiable business."

Section 403, subsection (h) reads: "This section shall remain in force during the continuance of the present war and for 3 years after the termination of the war but no court proceedings brought under this section shall abate by reason of the termination of the provisions of this section."

Section 403, subsection (h) should be amended to provide that the section 403 shall not be applicable to any contracts entered into after December 31, 1943, and shall not remain in force later than December 31, 1945, but that court proceedings brought under the section shall not abate by reason of its termination.

Section 403 should be amended by an additional subsection to provide that, upon determination by the Secretary of the amount of excessive profits, he should be required to immediately supply the contractor or subcontractor with a written statement setting forth the amount of the excessive profits, and the facts upon which the determination was based. The Government should thereafter in any proceedings be confined to this showing of facts. In the event that the contractor or subcontractor feels that the determination by the Secretary is inequitable, he should be given the right of appeal to the Board of Tax Appeals.

PEAT, MARWICK, MITCHELL & CO.,
New York, December 3, 1943.

In re section 203, pending Revenue Act of 1943, relating to fiscal years ending after June 30, 1942.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR: This communication is submitted to bring to the attention of your committee an inequity with respect to the taxation of corporations having fiscal years beginning in 1941 and ending after June 30, 1942, which is not intended by those responsible for the legislation included in the 1942 Revenue Act or the pending 1943 Revenue Act. If the law is amended as now proposed, some such fiscal-year corporations will pay more tax (after post-war refund) than if they were wholly taxable at 1942 rates.

The ultimate results in the case of three corporations, designated respectively as A, B, and C, are set forth in the following tabulation, which shows the next tax liability, after allowing for the post-war refund, under existing law, the pending amendment and a further amendment herein suggested:

	Company A (of Michigan), year ended Nov. 30, 1942	Company B (of Pennsylvania), year ended Nov. 30, 1942	Company C (of Ohio), year ended Oct. 31, 1942
(1) Tax computed under proposed sec. 203 of Revenue Act of 1943	$15,808,699	$3,963,558	$1,266,219
(2) Tax computed entirely at 1942 rates	14,998,480	3,961,490	1,324,259
(3) Tax computed in accordance with the existing law	14,629,020	3,787,562	1,210,753
(4) Tax computed entirely at 1941 rates	14,671,902	3,750,362	1,190,607
(5) Tax computed under amendment of Revenue Act of 1943 herein suggested	14,808,795	3,838,862	1,235,646

For record purposes, the exact computations are illustrated by schedule No. 2, which contains the details of the computations with respect to company A. The names of the taxpayers and others similarly affected have been excluded but will be supplied if desired. All the figures are exact and correct and in accordance with the returns in each particular case except that the cents have been omitted.

It is conceded that the proposed 1943 amendments place the tax computation, before post-war refund, on a logical and equitable basis to produce a gross tax that is more than under the 1941 rates but less than under the 1942 rates—but such result does not obtain after the post-war refund.

The proposed amendments should be corrected or amplified so that the net tax rate payable with respect to the period after June 30 would be the 90 percent provided by statute (or the 80 percent over-all limitation), less the appropriate post-war refund or credit figured at 10 percent of the tax imposed at 1942 rates. The original statute (sec. 780) did not provide for that method of computation, and limits the post-war refund to 10 percent of the difference between the tax actually payable and what would have been payable under 1941 rates. If the equitable approach is to assess a part of the tax under the 1942 rate schedule and method, then it would be equally proper to compute the net tax payable at 1942 rates by determining the portion of the tax payable at 1942 rates and allowing post-war refund for 10 percent of the excess-profits tax part of it.

The inequity of the result that will be attained under the pending bill is clearly evidenced by the results in the three cases cited, or at least in two of them, to the extent that the tax retroactively payable, after allowing for the post-war refund

in the case of the two fiscal-year November 30 companies, exceeds the tax that would have been payable if the entire tax had been computed at 1942 rates. In one case cited, the tax is over $300,000 in excess of what would have been payable if the 1942 rates had applied to the entire fiscal year. Congress certainly intends that such a fiscal-year company should pay something between what would have been payable at 1941 rates and what would have been payable at 1942 rates, and any statute or regulation that requires such a taxpayer to pay more tax than the amount computed at 1942 rates clearly does not carry out the intention of Congress.

It is suggested, therefore, that the Revenue Act of 1943 should further clarify the existing Internal Revenue Code, to provide that the post-war credit should be 10 percent of that portion of the excess-profits tax which is imposed at the 1942 rates. For purposes of comparison, the tabulation previously set forth herein shows, for the three illustrative cases, the taxes that would be payable under the method herein suggested and what would have been payable at either the 1941 or 1942 rates if they had been applied for the entire fiscal year. It will be observed that, in all cases, the tax payable under the procedure now suggested will fall between the 1941 and 1942 rate computations.

The tabulation below further demonstrates that the amendment herein suggested will produce a net tax result that is exactly what Congress clearly intended, as evidenced by the statements in the committee reports relating to the pending Revenue Act of 1943:

	Company A	Company B	Company C
(1) Tax computed at 1942 rates	$14,998,490	$3,961,490	$1,324,259
(2) Less tax computed at 1941 rates	14,671,902	3,750,362	1,190,607
(3) Difference	326,578	211,128	133,652
(4) Portion of difference applicable to period after June 30, 1942, being amount of difference divided by 12 and multiplied by number of months after June 30, 1942	136,074	87,970	44,551
(5) [1] Total of tax at 1941 rates and above portion of difference between 1941 and 1942 tax rate computations	14,807,976	3,838,332	1,235,158
(6) [1] Tax computed under amendment herein suggested	14,808,795	3,838,862	1,235,646

[1] These results would be the same if all prorations were made on a daily basis.

To explain the above by reference to company A, it will be noted that the 1942 rates produce a tax that is $326,578 more than the 1941 rate computation. As 5 months, or five-twelfths, of the fiscal year came after June 30, 1942, and is intended by Congress to be taxed on the 1942 rate basis, the addition of five-twelfths of that difference to the 1941 rate computation results in a tax that is the same as would be determined under the further amendment now suggested. I have submitted herein the figures of three taxpayers representing the three possible situations, namely, where the tax under the pending amendment is—

(1) more than if computed at the 1942 rates (company A);
(2) is about the same (company B); and
(3) is somewhat less (company C).

But in each case my suggested amendment produces the correct result. I might add that I know of a number of other similar situations.

For the assistance of your committee's legislative draftsmen, I attach hereto in schedule No. 1 a possible wording of amendments that will effectuate the method herein suggested. I have already brought this matter to the attention of Mr. Colin F. Stam and Mr. Stanley S. Surrey, and they are fully conversant with the problem involved.

I am sending a copy of this communication to the clerk of your committee, with a request that it be inserted in the record of the hearings now in progress, as it seems unnecessary to consume valuable time of your committee through a personal appearance. I would appreciate your authorizing such insertion in the record.

Respectfully yours,

WALTER A. COOPER.

SCHEDULE 1

RE 1941 AND 1942 FISCAL YEARS

SUGGESTED AMENDMENT OF SECTION 780

Eliminate from last sentence of section 780 (a) the words: "* * * excess of the tax imposed by such section 710 (a) (3) over the tax that would be imposed if such section 710 (a) (3) were not applicable" and insert: "tax imposed by section 710 (a) (3) (B)," so as to make the last sentence read as follows: "For the purposes of this part, in the case of a taxpayer whose tax is determined under section 710 (a) (3), the term 'tax imposed under this subchapter' means the tax imposed by section 710 (a) (3) (B)."

Also amend section 781 (d) to add (2):

"(2) SPECIAL RULE IN CASE OF CERTAIN FISCAL YEARS BEGINNING IN 1941.—In the case of a taxable year beginning in 1941 and ending after June 30, 1942, paragraph (1) shall not apply, and the credit under section 780 (a) for such taxable year shall not be greater than the excess of the tax paid under this subchapter to the United States for such taxable year (and not credited or refunded under the internal revenue laws) over the amount which would be payable to the United States if in the computation under section 710 (a) (3) (B) the excess profits tax rate were 81 per centum, or in case the limitation of section 710 (a) (1) (B) is applicable in such computation, if the amount determined under such section 710 (a) (1) (B) were reduced by 10 per centum."

Also change number of proposed subsection 781 (d) (2) to 781 (d) (3).

SCHEDULE 2

"A" corporation—Computation of Federal income and excess-profits taxes for the year ended Nov. 30, 1942

	(1) Under sec. 203 pending revenue act of 1943		(2)	(3) In existing statute		(4)	(5)
	1941 rates	1942 rates	Tax computed entirely at 1942 rates	1941 rates	1942 rates	Tax computed entirely at 1941 rates	Tax computed under amendment herein suggested
Excess-profits tax:							
Normal-tax net income, before deduction of excess-profits tax	$20,785,000	$20,785,000	$20,785,000	$20,785,000	$20,785,000	$20,785,000	$20,785,000
Deduct:							
Gain on sale of depreciable assets	25,000	25,000	25,000	25,000	25,000	25,000	25,000
Credit and exemption	807,000	807,000	807,000	807,000	807,000	807,000	807,000
	832,000	832,000	832,000	832,000	832,000	832,000	832,000
Adjusted excess-profits net income	19,953,000	19,953,000	19,953,000	19,953,000	19,953,000	19,953,000	19,953,000
Tax:							
$500,000	254,000			254,000		254,000	
$19,453,000, at 60 percent	11,671,800			11,671,800		11,671,800	(1)
$19,953,000	11,925,800			11,925,800		11,925,800	
90 percent of $19,953,000		17,957,700	17,957,700		7,957,700		
80 percent of $20,785,000		16,628,000	16,628,000		16,628,000		
Less normal tax and surtax		332,800	332,800		1,492,225		
Tentative excess-profits tax		16,295,200	16,295,200		15,135,775		
Portion taken into account	11,925,800	16,295,200	16,295,200	11,925,800	15,135,775		
	212,365	153,365		212,365	153,365		
	6,926,766	6,832,500		6,926,766	6,344,584		
Excess-profits tax		13,757,356	16,295,200		[2] 13,271,350	11,925,800	[3] 13,757,356
Post-war refunds:							
Basis		1,831,556	16,295,200		1,345,550		6,830,500
10 percent		183,155	1,629,520		134,555		683,050
Normal tax and surtax:							
Net income (after deduction of $27,000 declared value excess-profits tax	20,785,000	20,785,000	20,785,000	20,785,000	20,785,000	20,785,000	
Deduct:							
Excess-profits tax	11,925,800			13,271,350		11,925,800	
Income subject to excess-profits tax		19,953,000	19,953,000		19,953,000		
Normal tax net income, carried forward	8,859,200	832,000	832,000	7,513,650	832,000	8,859,200	(1)

Normal tax:							
$8,859,200, at 24 percent	2,126,208					2,126,208	
7,513,650, at 24 percent				1,803,276			
832,000, at 24 percent		199,680	199,680		199,680		
Surtax:							
$25,000, at 6 percent	1,500			1,500		1,500	
8,834,200, at 7 percent	618,394					618,394	
7,488,650, at 7 percent				524,205			
832,000, at 16 percent		133,120	133,120		133,120		
Tentative normal tax and surtax	2,746,102	332,800	332,800	2,328,981	332,800	2,746,102	
Portion taken into account	212/365	153/365		212/365	153/365		
	1,594,996	139,502		1,352,723	139,502		
Normal tax and surtax		1,734,498	332,800		[1] 1,492,225	2,746,102	1,734,498
SUMMARY OF TAXES							
Normal tax and surtax		1,734,498	332,800		1,492,225	2,746,102	1,734,498
Excess-profits tax		13,757,356	16,295,200		13,271,350	11,925,800	13,757,356
Total taxes		15,491,854	16,628,000		14,763,575	14,671,902	15,491,854
Less post-war refund		183,155	1,629,520		134,555	None	683,059
Net tax		15,308,699	14,998,480		14,629,020	14,671,902	14,808,795

[1] See No. 1.
*See attached computations.

STATEMENT OF SENATOR J. G. SCRUGHAM, UNITED STATES SENATOR FROM THE STATE OF NEVADA

DEFERRED DEVELOPMENT EXPENSE NOT TO BE REGARDED AS PROFIT

As a result of manpower shortage in the mines, plus an accelerated rate of output, a situation has arisen that creates a definite tax injustice to many mining companies, and which should be corrected. The problem involved deferred development expense, necessarily postponed by lack of manpower and pressure for production.

As is well understood within the mining industry, nearly all mines, if they are to remain in production, must maintain development ahead of mining operations for the purpose of finding new ore and making it available for extraction. In typical cases this is a considerable source of expense and ties up a substantial number of employees. Naturally, when this work is deferred because of the need for continued production in the face of serious manpower shortage, considerable sums accumulate that look like profits. However, they are not true profits, and should not be regarded as such because, in order to keep the mines in operation, they must eventually be spent for development. If they are considered as profits and taxed as such, an unjust burden is placed on mining companies, particularly in view of the high rates at which profits are now taxed.

Under separate cover I will send the mining companies' statement asking for a rectification of the situation to permit deductions from income to provide for deferred development expense.

STATEMENT BY R. J. WILKINSON, EXECUTIVE MANAGER OF THE MASTER PHOTO FINISHERS OF AMERICA

To: United States Senate Finance Committee, Hon. Walter F. George, chairman, Senate Office Building, Washington, D. C.

GENTLEMEN: The proposals to increase postal rates generally, and specifically the doubling of the rate for third-class mail matter and the increasing of postal money order rates as included in proposed tax raising legislation now before your committee, is little short of a disaster to the hundreds of small business firms engaged in the photo finishing and amateur photographic business. If such proposals are enacted into law in their present form as presented by the House bill H. R. 3687 (Report 871) they will literally put many of these firms out of business, to say nothing of putting most of the remainder on or near a no-profit basis. The severity of effect on these firms will be directly in proportion to that amount of their business that is transacted via the United States mails. Some are wholly dependent upon mail-order business with transactions covering the entire country—others are doing various proportions of mail order business, and practically all photographic establishments handle individual films and the resulting orders of snapshots through the mails—almost all of it being rated as third class. The proposal to double the rate on this third-class mail works a severe and peculiar hardship on the people engaged in this business.

AN ACTUAL INDIVIDUAL STATEMENT SHOWS THE TRUTH

Believing that your committee desires not only general statements of the effect of the these proposed increases in postal rates, but will in addition be interested in the detail of an actual illustration of the effect of this proposed increase, I am submitting herewith as a part of this statement, a sworn statement from one of our typical or representative firms engaged in the photo-finishing business.

I present this statement because it so accurately portrays the impossible situation that faces all such photo firms if this tax legislation is passed by the Senate in its present form. (See attached sworn statements of Rockford Photo Service, of Rockford, Ill. and Geppert Studios, of Des Moines, Iowa.)

One of the above firm's statements shows that their present postage bill for returning their packages of photo finishing to their customers amounts to 9.1 percent of their total income. This is not unusual for this business. If the rate for third-class mailing is raised to double the present rate—it simply means "curtains" for all such firms where their business is principally through the mails. If this situation is true in the photographic establishments of this business it must likewise be true in thousands of other small business enterprises of a similar nature.

INCREASE CANNOT BE RECOVERED FROM THE PUBLIC

It might be argued that this postal increase can and should be passed on to the public, but in this business this is impossible in most cases. First, under Office of Price Administration regulations this additional postage expense cannot be recovered legally by raising the price. It is not classed as a tax—therefore cannot be added to the ceiling prices with which this service industry is frozen.

Second. Most of this business is done at a very low price per unit of sale and so narrow a margin of profit per roll of films finished, that it is the usual practice not to even attempt to keep addressograph or other addressed lists of mail-order customers—hence there is no way for these firms to make a general announcement to their customers, that an increase in price has been added or that hereafter they will have to send postage stamps in addition to the usual charge. These thousands of customers who have been doing business through the mails do not have occasion to read the advertisements of these firms after the initial start has been made. If and when the films arrive without the increase having been included by the customer, it will cost a 3-cent stamp and the writing of a letter that at a very minimum will cost 4 cents more to prepare to notify the customer that his pictures are being held for the balance due.

Many customers sending in a single roll of films, include the usual silver 25-cent piece, but all customers who order pictures in quantities greater than the initial 25-cent unit are in the habit of using a postal money order to remit the money. The proposal to increase money order rates by 66⅔ percent will simply build a wall of sales resistance for these customers and will without question, not only diminish the volume of business upon which these firms depend but in addition, will not result in increased revenue to the post office receipts because it will, in proportion to the increased rate, diminish or disappear.

THIS TAX MEASURE WILL DIMINISH INCOME TAXES

This proposal to increase tax income by using the Post Office Department as a tax raising agency, has a natural boomerang built in, which must be as obvious to you gentlemen as it is to all of our business people. If it puts firms like the Rockford Photo Service out of business by the hundreds—they will not only not produce the present income for the postal service, but it will in addition prevent them from being accountable for their usual income taxes. Correspondingly as this measure affects all the other firms proportionately, it will reduce their income taxes too. Thus there will result no total gain in revenue for the Treasury Department.

THIS PROPOSAL HITS "SMALL BUSINESS" WITH PECULIAR FORCE

It is our considered opinion, that directly in proportion as you raise postal rates that affect business transacted via the United States mails, you will reduce the total volume of mail in the affected classes. If this factor is to be ignored in computing the tax raising possibilities of this new tax bill, then at least the damaging effect on small business throughout the Nation, should be noted by your committee. The Senate has set up a Small Business Committee for the study of and aid to the small businessman and that committee, in our opinion has done an admirable job that was and is most important to the Nation's welfare. What is the sense of aiding the small businessman with one hand and then turning around and hitting him over the head with your doubled fist. That is exactly what will occur if these postal rates are so drastically increased in the brackets which affect his business transactions and profits. Big business will be affected too, they will also suffer reductions of mail-order sales just as the small operator will. They can, however, do a better job of surviving than can the small businessman. They are more successful at the game of recovery of their additional or increasing costs. You gentlemen have pointed out repeatedly in various statements at various times and places that the bulk of American business firms are small business. You know that they have been hurt already to the danger point. I need only remind you that they cannot stand much more of these taxing attacks and survive. Our home front economy made up of small business firms has been shaken to it's very foundations by war time measures that apparently were necessary. Every possible measure should now be taken to avoid further damage.

THE POSTAL SERVICE SHOULD NOT BE USED AS A TAXING MEDIUM

It was the unanimous opinion of our Cleveland War-Time Photo Industry Conference held November 2, 3, 4, 5 at Cleveland, Ohio, that the Post Office Department should not now or at any other time become a part of our taxation system, but should remain on a business basis. It should not be used for raising taxes. Today over $100,000,000 of franked mail is being dumped into post offices by the new mushrooming governmental agencies that have been created. This should be stopped, instead of dumping an alleged deficit upon the small businessman—or the general taxpaying public, for that matter. Make these agencies draw from their own budgets for postal charges and you will stop at its source tons of unimportant, unwanted material from ever being created in the first place. This will not only have the effect of improving the income position of the Postal Service but will result in manpower and paper savings—both of which we are told are now a national problem and are important.

PREVIOUS EXPERIENCE SHOULD NOT BE IGNORED

You gentlemen have the problem before you of raising the total income needed for taxes, in such a manner as will do the least damage to business and the people who are taxed. In the pressure of enacting a tax bill, it does not seem logical to ignore or overlook the previously recorded experiences of what happens when postal rates are increased. Such experience is available in the records for your study. It indicates that comparatively little actual increase of total revenue will be received through substantial increases in the postage rates for business mail. If the loss that will be taken in reduced income-tax rates and amounts paid by business firms is considered, we feel that the proposals of this portion of the newly proposed tax bill will inevitably defeat the objective they are aimed at and at the same time do an unrepairable damage to thousands of small business enterprises that are already floundering under price ceilings, increased labor costs, and taxes that have multiplied in number and amount till they have almost become confiscatory. This ultimate fact seems self-evident: "If postal rates on business mail are increased excessively, they will reduce the volume of mail proportionately, with no accomplishment of the objective intended." We, therefore, conclude our plea for careful consideration of the effect on our hundreds of small businesses, which these postal increases will have, by summarizing that:

1. The Postal Service should not be used to raise taxes.
2. Small business will especially be hurt if postal increases are made that affect business mail, and our business—the photo establishments—will suffer severely with many of them being forced out of business.
3. That if there is the determination to use the postal rates increase as a medium of taxation, then we urge modification of the proposals submitted in report No. 871 to:

(a) Reduce the amount of the increase on third-class matter so that it will not exceed a 25-percent increase. We suggest that not more than 2 cents for 2 ounces, with a minimum of 2 cents be set.

(b) Elimination of the increases proposed on postal money orders or at least substantially reduce the amount of the proposed increase.

Respectfully submitted.

MASTER PHOTO FINISHERS OF AMERICA,
R. J. WILKINSON, *Executive Manager.*

ROCKFORD PHOTO SERVICE,
Rockford, Ill., December 2, 1943.

Reference: Doubling third-class postage rate, proposed new tax bill.

To the Senate Finance Committee, United States Senate, Washington, D. C.

GENTLEMEN: From figures given you below, you will note that proposed doubling of third-class postage rate would work an extreme hardship on thousands of mail-order photo finishers, three-fourths of whose product (personal snapshots) are now going to men in armed forces. You will note that the amount of my firm's gross income paid out as postage on return of mail orders to customers is over 9 percent. Doubling third-class postage would in effect impose a 9-percent tax on gross business, leaving little or no net profit in the business. Our average order is 25 cents, with so little net profit left these days from higher costs that none of the thousands of operators I know can afford or have built a current customer's address file. Even if Office of Price Administration should allow a higher retail to cover additional postage cost, none of us could advise our millions of customers Nation-wide; neither is it practical to dun them with first-class letter at 3 cents, trying to collect 1½ cents extra for postage tax. This situation must be

current in hundreds of other mail-order lines who use the mails, not for promotional advertising alone, but for transportation of goods and services Nation-wide. We feel that if Congressmen have the facts they will not approve a 9-percent tax on thousands of little businesses in the form of a postal increase, a tax which most cannot possibly pass on to the customer. To pass this law will put thousands of firms of our kind (we employ 85 skilled operators) out of business starting with the application of the tax. There is no other answer for us. And in general—why use our Postal Service as a tax collection agency?

Yours very truly,

ROCKFORD PHOTO SERVICE,
GUY A. BINGHAM, *General Manager.*

Percent cost of postage, 1942, of mail-order photo finishing gross income

Total gross income	$84, 842. 21
Postage return orders (third class)	$7, 799. 45
Postage percent income	9. 1

This is to certify that the above statement is a true and correct transcript of cost figures on file in company office.

GUY A. BINGHAM.

Subscribed and sworn to before me this 2nd day of December 1943.

[SEAL] REBA M. THILL, *Notary Public.*

GEPPERT STUDIOS,
Des Moines, Iowa, December 3, 1943.

To Whom It May Concern:

The following figures, tabulated by months, beginning with October 1942 and including September 1943, are copied from our bank checks made payable to postmaster, Des Moines, Iowa, in payment for stamps used exclusively on third-class matter, which includes circular matter and parcels of pictures mailed to our customers all over the continental United States and overseas:

Month	*Stamps for third class matter*	*Month*	*Stamps for third class matter*
October 1942	$2, 276. 06	May 1943	$1, 002. 65
November 1942	2, 043. 02	June 1943	1, 650. 26
December 1942	2, 185. 85	July 1943	1, 795. 62
January 1943	1, 817. 82	August 1943	1, 539. 96
February 1943	1, 321. 12	September 1943	1, 605. 23
March 1943	1, 439. 40		
April 1943	912. 37		19, 589. 36

The effect of increase in third-class rates would wipe out our net profit in proportion to the amount of increased expenditure for third-class postage, but doubling the rate is positively preclusive and fatal to our business. Our yearly net profits never have been more than a fraction of 1 percent of the volume of business and much less since the War Production Board curtailed film production of the Eastman Kodak Co. and the Agfa Ansco Corporation for civilian use.

During the month of August 1942 we finished approximately 20,000 rolls of film sent to us for that purpose from all over the United States, but during the month of August 1943, we received only approximately 4,000 rolls of film for finishing and these figures represent mail orders exclusive of local business. The decrease is attributable to curtailment of film production for civilian use by the kodak companies mentioned herein. In this connection we receive almost daily letters from our customers imploring us to send them new and unused rolls of film which we cannot do because we cannot get enough new rolls from factories to supply even our local trade, and all other dealers are in the same condition.

WARD S. HILL, *President.*

STATE OF IOWA,
Polk County, ss:

Be it remembered that on this 3d day of December 1943, before me, DeWitt C. Hill, a notary public in and for Polk County, Iowa, personally appeared Ward S. Hill, to me personally known to be the president of Geppert Studios, and stated under oath that to his best knowledge and belief all of the statements of fact and figures made and contained in the foregoing instrument are true and correct.

[SEAL] DEWITT C. HILL, *Notary Public.*

GEPPERT STUDIOS,
Des Moines, Iowa, December 3, 1943.

R. J. WILKINSON,
Washington, D. C.

DEAR SIR: I have your wire of December 3 and attached hereto is a sworn statement of statistical figures taken from our records for the period October 1, 1942 to September 30, 1943.

You will note that if H. R. 3687 passes the United States Senate and becomes law, the drastic increase in postal rates on third-class matter and c. o. d. fees will not only put us out of business, but the effect will be the same to hundreds of other large concerns doing photo finishing by mail, but will work a drastic hardship on all other sorts of business that uses circular matter extensively. While we are one of the largest photo finishers in our Nation, yet there are hundreds (perhaps thousands) of firms who use the mails extensively as third class and c. o. d. matter in other lines of business and it is our firm opinion that such action as contemplated by H. R. 3687 will raise a storm of protest that will echo and reecho throughout our Nation.

We employ some 80 to 150 persons--the number depending on the season of year, in addition to the amount we spend as postage on third-class matter and other overhead expense. Our employment expense for from 80 to 150 employees is a very considerable sum, as you may well surmise, but it is impossible to give figures because of the ever varying number of people employed.

Furthermore, the Office of Price Administration forced us as well as all others in this business to list all of our prices as of March 1942 and the Office of Price Administration set a ceiling thereon for conformity during this war or until further notice.

The Office of Price Administration set a ceiling also on wages paid to employees as of March 1942.

Our net profits have always been small in comparison to the amount of capital invested and the overhead expense, but if the rate of postage on third-class matter is increased it means that not only we, but also many concerns all over the Nation will be compelled to fold up and go out of business.

Such a state of affairs would cause many people to be thrown out of employment, to say notning of the indirect hardship to millions of people who desire pictures of absentees gone from home, perhaps never to return. In this connection, we alone receive thousands of such orders daily and some of the letters are pathetic in nature with reference to the pictures of soldiers, sailors, and marines. Many of them (yes, many thousands) want a life-like enlargement tinted in service colors from kodak pictures of fathers, sons, and brothers now serving in the continental United States and overseas.

Furthermore, it has been demonstrated heretofore that any drastic increase in postal rates serves to decrease revenues of the Postal Department instead of showing an increase in revenue.

It is much wiser to prevent a mistake than to attempt to correct a blunder after the harm has been done.

Sincerely yours,

WARD S. HILL, *President.*

Senator WALSH. I am inserting a column of figures with reference to the Timken-Detroit Axle Co. which refers to business of this company that is renegotiable, and shows profits of 31 percent on contracts that were not negotiable and which could only be reached by the tax law.

Mr. DODGE. That is correct, sir.

Senator WALSH. And they made as much if not more on their nonnegotiable as on their renegotiable. I think, if this is going out all over the country, the people will get an awful shock.

(The document referred to is as follows:)

The Timken-Detroit Axle Co.

	Net sales	Basic profit before Federal income taxes	Percent	Net profit (including excess-profits tax credit) after taxes	Percent net worth
Fiscal year ending June 30—					
1943:					
Renegotiable:					
Price fixed before adjustment	$49,557,000	$16,572,000	33.4		
Amount recovered	12,500,000	12,500,000			
Fixed price after adjustment	37,057,000	4,072,000	11.0		
Nonrenegotiable	78,243,000	23,267,000	29.6		
Total before adjustment	127,800,000	39,839,000	31.2	$8,237,000	52.6
Total after adjustment	115,300,000	27,339,000	23.7	5,070,000	32.4
1941	63,667,000	15,921,000	25.0	4,595,000	33.2
1940 (6 months)	17,596,000	3,715,000	21.1	2,021,000	15.4
Fiscal year ending Dec. 31—					
1939	21,752,000	2,964,000	13.6	2,658,000	17.8
1938	14,427,000	766,000	5.3	536,000	5.6
1937	23,466,000	2,146,000	9.2	1,810,000	12.4
1936	21,197,000	2,585,000	12.2	2,311,000	
1936-39 average	20,210,000	2,116,000	10.5		

Senator WALSH. I have also a communication from Mr. Paul with reference to the constitutional phase of the tax increase on individual incomes, which I would like to submit for the record.

Mr. PAUL. If I suggest, before that goes in the record, I would like to put in the record a short statement made before the Ways and Means Committee on the part raised by Senator Danaher on the advisability of renegotiation after taxes.

Senator WALSH. You may insert that later.

I have a letter from the Secretary of Commerce and one from Mr. Murdock, presiding judge of the Tax Court, which I will insert in the record at this point.

(The letters referred to are as follows:)

THE SECRETARY OF COMMERCE,
Washington, December 6, 1943.

Hon. DAVID I. WALSH,
Acting Chairman, Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR WALSH: I listened with considerable interest to the testimony before your committee this morning of the Honorable Robert P. Patterson, Under Secretary of War, and Maj. Gen. Lucius D. Clay, Director of Materiel, Army Service Forces, regarding the proposed amendments to the renegotiation law.

I regret exceedingly that I cannot be present at this afternoon's hearing, at which time I understood I was to be given an opportunity to express my views. At this afternoon's session I understand a carefully prepared statement is to be submitted on behalf of the Joint Price Adjustment Board, setting forth the recommendations of that Board regarding certain changes that should be made in the bill. The Reconstruction Finance Corporation agencies are represented on the Board. I have read the statement and I am in full accord with those recommendations, as well as the views expressed by Judge Patterson and General Clay.

There are two matters, however, that I wish to mention specifically. The first is that of the proposed amendment to the so-called raw materials exemption. This amendment would make it clear that we could determine whether there

have been excessive profits in connection with the operation of Government-owned plants and facilities and that we might recover any excessive profits, even though those plants and facilities are used in the manufacture, production, treatment, or transportation of a product, the procurement of which itself would be exempted from renegotiation by the raw materials exemption. We are accomplishing this now by administrative agreement, but the law is somewhat ambiguous and I believe that Congress should clarify the matter by including in the bill the proposed amendment.

The second point, that of judicial review, particularly insofar as it applies to closed cases, is so objectionable that I do not think it can be opposed too strongly. Renegotiation, it seems to me, is a business problem and should be handled as in the past by people carefully selected because of their business experience. Further, the determination of excessive profits requires a flexibility of treatment which is not possible under any form of traditional judicial review.

It must be admitted that American industry has done a remarkable job in producing the things necessary to the war effort, but the Government has taken most of the financial risks, as it properly should have done.

While there have been complaints from contractors as to individual settlements, I believe that on the whole an eminently satisfactory job has been done and clearly that no provision should be made for the reopening of the thousands of cases settled. To do so would really mean a repudiation of all the work done by the various price adjustment boards since April 1942. I know of no instance where Government contractors have been imposed upon by Government, either in the original contract or after renegotiation.

Sincerely yours,

JESSE H. JONES,
Secretary of Commerce.

THE TAX COURT OF THE UNITED STATES,
Washington, December 6, 1943.

Hon. DAVID I. WALSH,
Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR WALSH: I am informed that you are presiding over the hearings before the Senate Finance Committee in regard to the new revenue bill, and I would like to tell the committee, through you, briefly of the attitude of the Tax Court in regard to the provisions in the bill conferring jurisdiction upon it in renegotiation of contracts cases.

We have very little information on the subject of renegotiation of contracts and, therefore, it would be foolish for me to speak to you on the over-all question of the need for the legislation or the advisability of conferring the jurisdiction here as compared with some other tribunal as, for example, the Court of Claims. Those matters, we feel, must be left entirely to the wisdom of Congress. This court did not seek and does not now seek this jurisdiction. We hope there may be some other solution but, realising that an effort is being made to take care of an emergency measure, we are ready to do what we can.

However, we feel that the consequences of conferring this additional jurisdiction here may be serious and we want to call that matter to your attention, as we did to the attention of the House subcommittee. If appeals in these cases develop in any volume, they will greatly interfere with the disposition of our regular tax cases. There was a time when the number of pending cases before this court was staggering. Valiant efforts on the part of all concerned have corrected that condition. The court is now functioning smoothly with no more than a sufficient number of pending cases to permit efficient operation. However, there is a strong probability that a great many cases will come here under the relief provisions of section 722. Broadening of the tax base may be expected to bring more. We also have a few processing-tax cases still to be disposed of. If, in addition, many cases come in under the renegotiation provisions, a serious tie-up of litigation may develop before this court.

I have discussed these matters before members of the House subcommittee and also in letters dated September 18 and October 15, 1943, addressed to Colin F. Stam, Esq., Chief of Staff of the Joint Committee on Taxation. No doubt those letters are available to you. If you desire to ask me any questions, I will do my best to answer them.

Respectfully yo s.

J. E. MURDOCK, *Presiding Judge.*

Senator WALSH. This closes the testimony on the renegotiation provisions of this law.

Senator MCKELLAR. Before you close, may I ask Mr. Paul to put in the record the total amount of the excess-profits taxes collected by the Government for the last fiscal year?

Mr. PAUL. That is the fiscal year 1943?

Senator MCKELLAR. Yes.

Mr. PAUL. I will put it in for all the years.

(The above-requested information is as follows:)

Excess-profits-tax collections under ch. 2, subch. E, of the Internal Revenue Code

Fiscal year—	
1941	$164,309,000
1942	1,618,189,000
1943	5,063,864,000
1944 (July to October, inclusive)	1,912,356,000

SOURCE: Treasury Department, Division of Research and Statistics, Dec. 6, 1943.

Senator WALSH. The next witness is Mr. J. W. Oliver, who wants to discuss the general phases of this bill.

STATEMENT OF J. W. OLIVER, REPRESENTING THE COMMERCE AND INDUSTRY ASSOCIATION OF NEW YORK

Mr. OLIVER. Mr. Chairman and members of the committee, I appear as acting chairman of the committee on taxation and public revenue of the Commerce and Industry Association of New York, Inc., formerly the Merchants' Association of New York, the largest chamber of commerce in the city of New York, to lay before you the views of that association adopted by its board of directors and executive committee, upon a report made after careful consideration of the provisions of the pending revenue bill of 1943.

The merits of the proposed bill have been obscured by centering public discussions on the difference between the amount to be raised by the bill and the amount of additional revenue asked by Secretary of the Treasury Morgenthau. The Secretary of the Treasury has, on several occasions during the past few years, changed his requests and estimates. In 1941 he favored financing the war effort two-thirds by taxation and one-third by borrowing, but this was soon found to be impossible.

In testifying before the Ways and Means Committee on March 3, 1942, he asked Congress for a tax bill that would raise 8.61 billion dollars additional revenue, which, after allowance for interrelated effects, he estimated would yield 7.61 billions net. The House of Representatives passed a bill that was estimated to produce 6.271 billion dollars. The Senate, among other things, added a provision for a 5-percent Victory tax which was virtually a gross tax with a $624 exemption.

In presenting his program of taxation this year the Secretary of the Treasury, testifying before the Ways and Means Committee on October 4, 1943, stated that the Treasury's goal as the amount that should be raised by new taxation was $12,000,000,000. He said:

> We knew that $12,000,000,000 when translated into individual cases was a great deal of money; and as we progressed in our investigation we became more and more aware of the problems we would have in levying so large an additional tax on anything like an equitable basis.

The Secretary of the Treasury submitted proposals calling for additional taxes to the extent of 10.5 billions, the sources of which follow:

Individual income taxes	$6, 500, 000, 000
Corporation taxes	1, 100, 000, 000
Estate and gift taxes	400, 000, 000
Excise taxes	2, 500, 000, 000
Total	10, 500, 000, 000

In view of the country-wide agitation and demand for tax relief during the early part of this year, brought about by the effect of the taxes imposed by the 1942 tax bill, it is difficult to understand how anyone could expect to levy the $10,500,000,000 in additional taxes which the Treasury proposes without seriously affecting the standard of living and the morale of the people.

In presenting his tax plan to the Ways and Means Committee on October 4, the Secretary pointed out that "at the present time 27,000,000 persons are deducting a total of $420,000,000 a month" from their salaries and wages under the pay roll savings plan for the regular and systematic sale of United States Savings bonds. This deduction amounts to more than $5,000,000,000 annually, and indicates that additional taxation might easily result in a substantial reduction in the pay roll savings plan.

The Secretary of the Treasury, in discussing his plan for additional taxation, also stated:

> It would enable us to finance a considerably larger part of our huge war costs through taxation; and by so doing would relieve us and our children of a burden which could materially retard post-war progress.

Our association believes that the amount of tax to be raised for the prosecution of the war cannot be limited by any arbitrary amount. Taxation must be increased to the utmost amount that it is practicable to raise. Our association is in favor of financing the war through taxation to the greatest possible extent without impairing the war effort or drying up the source of revenue.

Excessive taxation, failure to allow for the ordinary contingencies of life, the need for provision for the rainy day, the failure to permit corporations and individual business enterprises to provide for excessive wear, accelerated depreciation or deferred maintenance, would unquestionably have serious, if not disastrous, results in the post-war period if the existing generation were forced to pay too great a part of the enormous cost of this war.

We believe that the Ways and Means Committee of the House was mindful of the burden of taxation now imposed upon individuals and business, and limited the proposed bill to the amount which it felt could be safely imposed in addition to the existing taxes.

The association has limited its consideration to what it believes to be the most important features of the bill. In expressing its disapproval of, or its concurrence with particular provisions it does not wish to be recorded as either approving or disapproving other provisions which are not discussed in this memorandum.

1. Individual income taxes: We are opposed to any increase in the normal tax or surtax rates on individual income taxes. Existing taxes bear heavily upon all classes of individuals and especially upon the white-collar classes who have had little, if any, increase in income as

the result of the war activity. Individual income taxes have been increased enormously since 1940.

We believe that the new bill should integrate the rates and exemptions of the Victory tax, the normal tax, and the first bracket of surtax, and that the entire return should be simplified.

The second antiwindfall provision of the present Federal Revenue Act is unfair and inequitable in its application and should, in the interest of fairness if for no other reason, be modified.

We are opposed to the repeal of the provision of the existing law providing for earned-income credit. If this credit is repealed it will result in greater taxes upon individuals because of the application of surtax rates.

An incentive for savings by individuals should be adopted under which credit against taxable income would be allowed in a limited amount; the details as to the amount and method of deduction to be worked out.

We are opposed to any plan of forced savings at this time.

2. Corporate taxes: The existing rates of corporation income and excess-profits taxes are extremely high, and we believe are at the maximum which should be imposed if the post-war requirements of the business and employment possibilities of industry are given careful and proper consideration. Further increases in these taxes, except perhaps in isolated cases, cannot be made without endangering production, the national economy, the possibility of full and liberal employment of labor, and the revenues which the Government may rely upon for the prosecution of the war.

We urge the amendment of the existing tax law so that appropriate allowances might be made to corporations to provide for deferred maintenance and for accelerated depreciation.

Such allowances should also be made, where proper and desirable, to business incomes of partnerships and individual proprietors.

The excess-profits-tax provisions should be amended so that they will expire at the end of the year in which hostilities cease without taking away the right to carry back unused excess-profits credits.

We favor the repeal of the existing penalty tax on the filing of consolidated returns, and we also favor the repeal of the tax on intercorporate dividends.

We favor the repeal of the existing capital-stock tax and the accompanying declared-value excess-profits tax.

We favor the adoption of an incentive savings plan for corporations similar to the savings plan proposed for individual income taxes; such savings plan to permit of a credit up to 20 percent of the taxable income for earnings invested in special Government securities, noninterest bearing and nonnegotiable during the war, but becoming negotiable and interest bearing upon the cessation of hostilities. The adoption of such a plan would give corporations an opportunity to provide reserves for the post-war period, and would also make available for immediate Government use a substantial sum in excess of tax revenues from corporations under existing law.

Such investments should be allowable as a credit under section 102 of the revenue act.

3. Renegotiation of war contracts: The association is on record as opposing the renegotiation law as a means of recapturing excessive profits already earned, and on October 16, 1942, sent to each Member

of the House of Representatives and the Senate a memorandum giving the reasons why this law, known as Public Law 528 (77th Cong.) should be repealed, and we append hereto a copy of our original memorandum. This is still the attitude of the association.

However, it is recognized that several of the amendments contained in H. R. 3687 are intended to remove some of the most obvious bad features in the current law, and in order to insure the remedial effect which the House report states is intended, we desire to point out the following changes that should be made in the House bill:

1. With respect to the definition of "standard commercial article," which the bill is designed to exempt from renegotiation, the definition should be so changed as to provide that articles made to specification are not to be considered as having been removed from the category of standard commercial articles unless they are made to peculiar specifications designed especially for the requirements of the war effort. Articles sold to the Government under normal specifications, even though the specifications be included in the contract, should not be, by reason of that fact alone, considered as nonstandard. With respect to the provisions in the House bill the terms relating to normal competitive conditions affecting the sale of the article should not be left to the opinion of the board, but the definition should define normal competitive conditions as embracing goods sold by more than one manufacturer to a regular commercial trade when normally sold to the Government on the basis of competitive bids.

2. The provision for appeal to The Tax Court should carry with it two express provisions——

Senator MILLIKIN. Coming back to standard articles, what is the reason for wanting to classify standard articles with those articles made to specification?

Mr. OLIVER. The House bill specifies they shall not be considered standard if according to specifications. Now, in the textile industry we do not sell a pound of thread or a pound of twine to the Government unless the contract calls for a specification. That specification does not make it nonstandard, but it is in the contract, and we were fearful if that were left in the law that way, that would mean that practically all the textile business could be excluded from the law as being standard articles, because it was made to specification. So we wanted it changed so that only peculiar specifications, uncommon to the trade, would be the cause for throwing it out as a standard commercial article. [Continuing his statement:]

(*a*) Provision for refund in the event that The Tax Court finds the amount recovered to be more than justified by the review.

(*b*) Provision whereby the renegotiation boards would be required to submit detailed computations of the excessive profits somewhat similar to the procedure followed in connection with normal corporate tax deficiencies, and that this information be accepted in evidence by the reviewing court.

3. If the contractor or subcontractor appeals to The Tax Court of the United States for a determination of excessive profits there should be suspension of the power of the governmental department or agency to withhold payments upon the contract or subcontract prior to final determination of that court.

4. Contracts and subcontracts be exempted from renegotiation if made prior to April 28, 1942 (the date of the original renegotiation

law), or if made with subsidiaries of the Reconstruction Finance Corporation prior to their recent inclusion as agencies of renegotiation.

5. In the event that a calculation of the net profits after taxes shows that the retainable net profit, before consideration of renegotiation, is no greater than the amount of the earnings credit or the invested capital credit (whichever is used) there should be no further recapture of alleged excessive profits.

6. Section 3806 (technical amendment) should be amended to provide that in determining the tax credit to be deducted from the gross amount refundable under renegotiations, so that the credit in the case of a fiscal year corporation shall be determined in accordance with the tax applicable to the dates when the excessive profits were earned rather than to be assumed to have been earned ratably over the whole fiscal year.

At that point, Mr. Chairman, if I can take one moment to explain precisely what I mean, and I will refer to my own company, the Linen Thread Co. We are a fiscal year corporation and practically all of our profits or recovery by the contract we have just settled were earned, as a matter of fact, and established by the war board as having been earned during the period when the 90-percent tax was in effect, but the law which grants the credit for refund is based on all profits as having been earned over the entire fiscal year. Consequently, we only received one-quarter of the credit for the amount of tax at the higher rate we had actually paid, on that so-called excessive income, and that example relates to the provision I have in mind here.

As to fiscal year of corporations operating on a basis of 13 four-weekly accounting periods:

On October 27, 1942, the Circuit Court of Appeals, Fifth District, in the case of *Parks-Chambers, Inc.* v. *Commissioner*, upheld the Board's findings, Docket No. 101,802. The board's findings in this case were to the effect that the taxpayer, having closed his books for tax purposes on the last Saturday of the month which it regarded as its fiscal year, had, by reason of closing the nearest Saturday to the last calendar day of the month rather than actually closing on the last day of the calendar month, established no fiscal year, and, as a consequence, its tax liability must be computed on a calendar year basis. The court, in rendering this decision, relied literally upon the definition of a fiscal year as contained in the current revenue law, which definition is—

an accounting period of 12 months ending on the last day of any month other than December.

As a practical matter, a great number of taxpayers, in the last few years, have adopted the 13 four-weekly accounting periods of closing their books.

We believe that business is entitled to relief from the literal reading of the existing law, and we urge the enactment of legislation in connection with the revenue bill which will cure this situation.

As a matter of fact, Mr. Chairman, the Treasury Department has accepted thousands of tax returns in the case of fiscal year corporations having closed their books on the last Saturday of the calendar month.

Senator MILLIKIN,. Why, Mr. Oliver, did the Treasury Department allow this point to go to court in the *Parke-Chambers* case?

Mr. OILVER. I do not know the merits of the *Parke-Chambers* case, but it is the literal language of the definition of a fiscal year which the court relied upon, of which I am complaining in this instance. I rather suspect that the Bureau paid little attention to the fact that a decision in this case might be embarrassing to a large number of tax payers and that this is simply a parallel to what happened in the Higgins case. In that case, Mr. Senator, you will remember that it was the established practice of the Treasury Department to allow the deduction of non-business expenses, which was the issue in the Higgins case and, in spite of that fact, they permitted this matter to go to court as a test case. No doubt the *Parke-Chambers* case is somowhat similar in that respect.

Thus, unless corrective legislation is enacted, a vast amount of uncertainty will exist, in spite of the fact that most any one with practical experience will admit that accounting reports and tax returns prepared on a basis of Saturday closings when inventories can be correctly computed and all accruals easily determined are, on an average, found to be more accurate than where closings are invariably made on the last day of the calendar month which, in most instances, comes sometime during the week.

We suggest that section 48 (b) of the Internal Revenue Code, entitled "fiscal year," be amended to read as follows:

(b) FISCAL YEAR.—"Fiscal year" means an accounting period of not less than fifty-two or more than fifty-three weeks beginning on the first day of any month other than January or beginning on the nearest Sunday to the last day of any month other than January, and ending on the last day of any month other than December, or ending on the nearest Saturday to the last day of any month other than December. This subsection shall be applicable to taxable years beginning after December 31, 1938, and, in addition, this subsection shall be effective as if it were a part of the Revenue Act of 1938 or any prior Revenue Act.

Amend subsection 47 (g) of the Internal Revenue Code to read as follows:

(g) RETURNS WHERE TAXPAYER NOT IN EXISTENCE FOR TWELVE MONTHS.—In the case of a taxpayer not in existence during the whole of an annual accounting period ending on the last day of a month or on the nearest Saturday to the last day of a month, or, if the taxpayer has no such annual accounting period or does not keep books, during the whole of a calendar year, the return shall be made for the fractional part of the year during which the taxpayer was in existence. This subsection shall be applicable to the taxable years beginning after December 31, 1938, and, in addition, this subsection shall be effective as if it were a part of the Revenue Act of 1938 or any prior Revenue Act.

We are in favor of incorporating in the new tax bill a provision that would fix the rate of tax on capital gains of individuals at not to exceed 15 percent. We do not advocate a change in the present rates at this time, but urge repeal of the existing provisions to become effective upon cessation of hostilities.

We also urge that provision be made in the proposed revenue law for capital losses of individuals, and that such losses should be allowed as an offset against ordinary income.

We are opposed to the imposition of increased pay-roll tax for social-security purposes at this time. We are further opposed to the amplification and extension of the present Social Security System as recommended by the Secretary of the Treasury. The present system should be carefully reviewed in the light of experience before considering any proposal for its extension.

We feel strongly that the automatic increase of 1 percent in the pay-roll tax on employers and workers, effective January 1, 1944, should be further suspended by Congress because the revenues from social-security taxes at the present rate of receipts is far in excess of requirements for the present or near future; also, because discussion of the urgent need of revenue for the winning of the war ought not to be beclouded by combining or confusing revenue proposals with recommendations for social-security legislation.

We believe that if additional revenues must be raised they must be obtained from new sources. Such a source is a general retail sales tax, and we believe that provision should be made for the enactment of such a sales tax with no exceptions, except for sales to the Government itself. Such a tax will aid in the more equitable distribution of the burden of war taxes, since its application would be in direct proportion to spending by individuals with current excess spending power.

Such a tax would be distinctly anti-inflationary.

We believe that provision should now be made in the proposed Revenue Act of 1943 for the removal of governmental barriers to the active resumption of healthy business enterprise, and to the prompt conversion of war business to an efficient peacetime basis with provision for ample production and employment of labor.

Taxes in the post-war period must be such that they will permit, and not obstruct, the flow or availability of venture capital, which is essential to our economic system.

Provision should be made at this time in the revenue laws so that this essential requirement will be recognized.

Provision should also be made at thistime for the expiration of the excess-profits tax at the end of the year in which major hostilities cease.

Provision should also be made at this time for the reduction of other tax burdens so that corporate and individual taxes will not operate to prohibit cautious and prudent risk taking on the part of enterprise.

The present cost of Government and the multitude of corporate and other agencies that have been created, only a few of which are directly concerned with the prosecution of the war, have added a tremendous burden of taxation in order to support the activities of these Government agencies.

Many recommendations have been made by the Byrd committee for economies in Government and the reduction of governmental expenses.

The huge army of civilian employees now in the service of the Government must be drastically reduced if individual and corporation taxes are to be kept within the capacity of the people to provide. This offers a fruitful field for Congress and the officials to survey with a view to compelling economies in the operation of the Government. Such economies would reduce the need for a substantial part of the new tax program suggested by the Treasury.

In addition, the foregoing revenue bill adopted by the House and now pending before the Senate Finance Committee contains some objectionable features to which we are opposed and omits certain amendments to the existing law which we believe should have been made. They are as follows:

1. The pending bill proposes to amend section 710 (a) (1) (A) of the code by increasing the excess-profits-tax rate from the present rate of 90 to 95 percent. We respectfully urge the restoration of the excess-profits-tax rate to 90 percent because we are convinced that the present rate of 90 percent is the limit beyond which we do not believe Congress should levy this tax.

2. The pending bill amends the existing law by providing for a reduction of excess-profits credit based on invested capital. Under existing law the invested capital credit is computed as 8 percent of the first $5,000,000 of invested capital, 7 percent of the next $5,000,000, 6 percent of the next $190,000,000, and 5 percent of the balance over $200,000,000. The amendment contained in the proposed bill provides for a credit determined as 8 percent of the first $5,000,000, 6 percent of the next $5,000,000 instead of 7 percent provided in the existing law, 5 percent of the next $190,000,000 in place of the 6 percent provided in the existing law, and 4 percent of the balance over $200,000,000 in place of the 5 percent provided for in the existing law. The existing credits, especially in the upper brackets, can hardly be said to be too liberal, and we do not believe that they should be further reduced.

In addition, we suggest that section 713 (a) of the code, subsection A, subdivision 1, paragraph a, be amended so that those using average income as a basis of excess-profits tax credit would be allowed the full amount of that income in place of the 95 percent in the present law.

3. No provision has been made for the allowance by corporations for reconversion expenses, for deferred maintenance or accelerated depreciation. We believe that it is imperative that some provision be made in the existing law to cover the expense of reconversion by industry and for accelerated depreciation and deferred maintenance. The tremendous excessive use of equipment by railroads in handling the enormous war traffic has resulted in excessive depreciation. Lack of manpower has compelled a reduction in roadbed maintenance, and this will require abnormal expense in order to restore equipment and roadbed to efficient operating condition in the post-war period or as soon as critical materials may be secured for this purpose. The same condition will be faced by public utilities of all kinds, which render essential service to the public. Many existing manufacturing companies engaged in war work will also be similarly affected, and we believe that the Senate should incorporate a provision that would make allowance for reconversion, for deferred maintenance or accelerated depreciation.

4. No provision was made in the bill as passed by the House, to suspend the operation of the automatic increase in social security rates that would become effective on January 1, next, and for the reasons stated in the main part of our memorandum we believe that this suspension should be incorporated.

5. No provision was made in the House bill to change the unfair discrimination in the existing law, which is contained in the second windfall provision for individual income taxes. We believe that the Senate should amend this provision in the interest of fairness.

6. No provision was made in the bill as passed by the House for the payment of dismissal wages to labor employed in the war industries. We believe that some provision should be made to take care of those who will be thrown out of employment due to the suspension or sudden stoppage in the production of war materials and munitions, so that they may have opportunity to carry on until they may secure employment in some other industry.

7. No change was made in the bill as passed by the House, which would eliminate the tax on inter-corporate dividends. We think that this is an unfair tax and that the present-day methods of conducting corporate business require that this type of tax should be eliminated.

No change was made in the law that would eliminate the penalty tax on consolidated returns, and we believe that this provision of existing law should be repealed.

A major objective of the Commerce and Industry Association of New York is to use its wide influence in advancing, to the utmost, all-out production and successful prosecution of this war of survival.

As the representative of thousands of large, medium-sized, and small concerns that are now engaged wholeheartedly in the war effort this association has reached the conclusion that the present law governing the renegotiation of contracts is proving a serious detriment to the continuation and expansion of war production.

We are quite in accord with the objective of the Government not to permit any company to make excessive profits out of war contracts, but the method of obtaining this objective, through the setting aside of contracts entered into in good faith and carried out with zeal and enthusiasm, is so contrary to American principles and so confusing and unfair in its application that Congress should hasten to correct the mistake which has been made.

In view of the uncertainties that the law creates, manufacturing firms involved in war production cannot fail to regard it as an attack on their very security. Confidence is destroyed, enthusiasm is lessened, and the time of officials that should be given to production problems is taken up with renegotiations. A carefully considered and negotiated contract ceases to be a contract. This law causes uncertainty and confusion among those who are doing their utmost to meet the Government requirements for increased production. Considering all the factors that are involved, it is not too much to say that it strikes at the very heart of war production.

Specifically, some of the objections to the law are—

1. It threatens the security of those concerns called upon to make capital investments to fulfill war contracts. As long as this law is in effect no corporation doing war work can know what its profits are, or what its liabilities are, nor can it safely undertake capital expenditures or pay dividends to stockholders as long as its contracts are not renegotiated.

2. There is no requirement in the law that members of the price-adjustment boards, which have been created to readjust these contracts, shall be familiar with the problems of production of war materials. Not only is this necessary qualification withheld, but to date none of the boards has set down any definite standards that may be used as a guide in administering the law.

3. It has recently been indicated that the boards do not propose to deal with individual contracts, but that the over-all profit of a company as a whole is to be taken as a basis of renegotiation and not the individual contracts for war materials. Such an attitude is unfair.

4. Since taxes must be paid in cash, and taxes are a preferred liability, it is unfair and unjust to ask businessmen to renegotiate contracts being carried out or executed in 1942, while the tax bill, the rates of which will determine what part of the profits of such contracts can be retained, is still the subject of discussion before Congress.

5. The law fails to offer any premium for efficiency. Two companies may be making identical products at the same prices. The less efficient company, because of higher costs, will have a smaller margin of profit. The other company, because of ingenuity and more efficient management, produces at lower costs and the profits realized may, therefore, be larger. But this law would give to the efficient the same reward as to the inefficient.

6. The law leaves the patriotic concern that has gone all-out for war production holding the bag, while his rival, who may be continuing on civilian production, reaps the profits that might otherwise be his. It is extremely probable that, where one firm has been converted to 100 percent military production, another firm, which has continued its civilian business, will absorb in whole or in part the civilian business formerly carried on by the "all-outer". We can think of nothing more unfair than to thus penalize the firm whose facilities have been placed 100 percent on Government work.

7. There will be times when production is proceeding at top rate, when the unit cost of production will be low and the profits high. If renegotiation of contract should be forced during such a period, there would be no compensation for the time when production would be interrupted by lack of materials or interruptions due to other causes. Such delays unquestionably would result in a rapid rise of unit cost that would cause profits to vanish.

8. The law does not set up any standards by which excessive profits are to be measured.

The above, and many other considerations, warrant the conclusion that the whole scheme and basis of this law weakens respect for contracts and is repulsive to decent business principles. To continue it will be to decrease confidence, weaken enthusiasm for Government work and put a damper on patriotic zeal of the thousands who have voluntarily turned over their entire resources to Army and Navy production.

The law is not needed in order to prevent the reaping of excessive profits. The existing tax law under consideration by Congress already insures the limitation and recapture of excess profits, and we are firmly of the opinion that the excess-profits tax, rather than the process of renegotiation, should be used to accomplish the purposes sought in Public Law 528.

We, therefore, urge Congress, and the President of the United States, to repeal this law and restore the sanctity of contracts, particularly at a time when every available facility is, or will soon be, required to bring our war production to the point where it will so far exceed that of our enemies that it will insure a speedy victory.

STATEMENT OF HON. CARL A. HATCH, UNITED STATES SENATOR FROM THE STATE OF NEW MEXICO

Senator HATCH. Mr. Chairman, I wanted the opportunity to appear and make some suggestions because of my interest in renegotiation developed because as a member of the Truman committee I was appointed chairman of a subcommittee to make an investigation and study of the operations under the renegotiation law. We held hearings; we had all the department heads before us, and other people. We employed an attorney, an exceptionally fine young man, Mr. Samuel Stewart is his name. He spent days and weeks down in the departments working with the various boards of renegotiation.

As a result of that study we filed a report from the Truman committee, which appears as Report No. 10, part 5, of the Seventy-eighth Congress, under Resolution 71, authorizing our committee.

We are not a legislative committee, and we did not draft legislation, but in the course of this study, I thought, as chairman of the subcommittee, that certain suggestions ought to be made, so I introduced Senate bill 1366 on the 21st day of September. I will ask that that bill be made a part of the record.

Senator WALSH. It was referred to this committee?

Senator HATCH. Yes.

Senator WALSH. It will go in the record.

(Senate bill 1366 is as follows:)

[S. 1366, 78th Cong., 1st sess.]

A BILL To amend section 403, Public Law 528, Seventy-seventh Congress, as amended by section 801, Public Law 753, Seventy-seventh Congress, by section 1, Public Law 108, Seventy-eighth Congress, first session, and by Public Law 149, Seventy-eighth Congress, first session.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That subdivision 403, of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, is amended as follows:

"For the purpose of coordinating and simplifying the work of price adjustment pursuant to section 403 of title IV of the Sixth Supplemental National Defense Appropriation Act of 1942, as heretofore amended, the Secretaries are hereby authorized and directed within a reasonable time after the approval of this Act to create a single board, to be known as the Price Adjustment Board, and to delegate to such Board power (1) to make, declare, and publish uniform policies of administration and interpretation of the renegotiation of War Contracts Act, 1942, which shall be binding upon all of the departments and all persons subject to the law; (2) to make all assignments of cases to departmental boards for renegotiation; (3) to hear appeals by contractors from determinations of departmental boards in such cases as the Price Adjustment Board, in its absolute discretion, shall find involve questions of basic policy or obvious injustice. Such Price Adjustment Board shall consist of seven members, of whom four, including the Chairman, shall constitute a quorum. Six of the members shall be appointed, one by the Secretary of War, one by the Secretary of the Navy, one by the Secretary of the Treasury, one by the Chairman of the Maritime Commission and Administrator of the War Shipping Administration, one by the Boards of Directors of Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation and Rubber Reserve Company, and one by the Chairman of the War Production Board. The seventh member, who shall be Chairman, shall be elected by the vote of any four of the other six members. The Chairman may be an employee of a department. The Price Adjustment Board shall act by vote of a majority of the members present at any meeting at which a quorum is present."

SEC. 2. The present provisions of subdivision 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, are further amended as follows:

(1) Paragraph (4) of subdivision (a) is amended to read as follows:

"(4) The term 'excessive profits' means any amount of a contract or subcontract price which is found as a result of renegotiation to represent excessive profits.

The term 'profit' as used in this Act means that part of gross income which remains after deduction of the items which the Secretary is required to recognize under paragraph (3) of subdivision (c) hereof. Except as hereinafter provided, the profit of any contractor or subcontractor engaged only pursuant to a fixed-price contract or contracts in manufacturing products purchased by a department during any one calendar or fiscal year shall not be deemed excessive for the purposes of this Act if it amounts before the deduction of Federal income and excess-profits taxes to 8 per centum or less of such contractor's total contract sales price on deliveries made during such calendar or fiscal year and if the total sales of such contractor or subcontractor during such calendar or fiscal year shall not be more than three times the average total sales of such contractor or subcontractor during his 'base period'. The term 'base period' means the calendar years 1936, 1937, 1938, and 1939, inclusive, or the four fiscal years ended in those calendar years, except in the case of contractors or subcontractors who first commenced business after December 31, 1935, and before January 1, 1939, whose base period shall be the period from the commencement of business to December 31, 1939. Contractors or subcontractors who first commenced business after December 31, 1938, shall not be entitled to the benefit of the exemption provided in this subdivision four hereof."

(2) Paragraph (5) of subdivision (c) is amended to read as follows:

"(5) Any contractor or subcontractor who holds contracts or subcontracts, to which the provisions of this section are applicable, shall file with the Price Adjustment Board on or before the date on which it is required to file Federal income and excess profits tax returns, true copies of such returns, together with true copies, certified by a responsible individual, of its balance sheets and profit and loss statements for each expired calendar or fiscal year which ended after January 1, 1936, unless the aggregate sales by such contractor or subcontractor, and by all persons under the control of or controlling or under common control with the contractor or subcontractor under contracts with the Departments and subcontracts thereunder (whether or not the provisions of this section are applicable thereto) do not exceed $100,000 for such fiscal year. The balance sheets and profit and loss statements furnished for the most recent calendar or fiscal year and for the calendar or fiscal year next preceding such most recent year shall be in sufficient detail to show, among other things, the recipients and amounts of all compensation paid to any individual who received in excess of $10,000 per year, the amount of all outstanding V loans, if any, the amount and general nature of all Government furnished facilities, if any, and the amount and purpose of all contingency reserves set up on the contractor's books, including reserves for post-war purposes, inventory shrinkage, and the like. No such contractor or subcontractor, however, shall be required to file copies of any such financial statement which has once been filed with the Price Adjustment Board. Within one year after the filing of such statements, or within such shorter period as may be prescribed by regulation of the Price Adjustment Board, the Price Adjustment Board may give the contractor or subcontractor written notice, in form and manner to be prescribed in such regulation, that the Price Adjustment Board is of the opinion that the profits realized from some or all of such contracts or subcontracts during such fiscal year may be excessive, and fixing a date and place for an initial conference to be held within sixty days thereafter. If such notice is not given and if renegotiation is not commenced by the Price Adjustment Board within such sixty days, the contractor or subcontractor shall not thereafter be required to renegotiate to eliminate excessive profits realized from any such contract or subcontract during such fiscal year and any liabilities of the contractor or subcontractor for excessive profits realized during such fiscal year shall be thereby discharged. Any person who willfully fails or refuses to file any copies of such returns and statements required of him under this subparagraph (5), or who knowingly files any information hereunder which is false or misleading in any material respect, shall upon conviction thereof be punished by a fine of not more than $10,000 or imprisonment for not more than two years, or both."

(3) By adding the following subdivision (l):

"(l) This Act may be cited as the 'Renegotiation of War Contracts Act, 1942'."

SEC. 3. Each of the foregoing amendments shall be effective ten days after their final approval, except that the amendments set forth in subdivision (2) of section 2 hereof shall first become effective with respect to renegotiations relating to the calendar year 1943 or fiscal years ended in the calendar year 1943.

Senator HATCH. At the same time I made a statement on the floor explaining what was said to be accomplished by the amendment which we proposed, and I had planned, if you had the time, to discuss here

with the committee those recommendations. Of course, it is late in the afternoon; I know the members of the committee are tired, and I won't ask your indulgence to go into the details, but I would like, Mr. Chairman, that the statement I made on the floor be incorporated as a part of the hearings at this point.

Senator WALSH. That may be done.

(The statement referred to is as follows:)

STATEMENT BEFORE UNITED STATES SENATE, BY SENATOR CARL A. HATCH, CHAIRMAN OF SUBCOMMITTEE (OF TRUMAN COMMITTEE), ON RENEGOTIATION OF WAR CONTRACTS

Mr. President, some months ago the Truman committee made a study of practices under the Renegotiation Act. Renegotiation procedure is something new. It certainly behooves the Congress to understand as much as possible about the procedure and practices under the existing law and to consider carefully questions of proposed amendments. Under usual, normal, peacetime competitive conditions renegotiation of contracts would not and should not be tolerated. Under wartime conditions, which in many instances practically obliterated all competition, and also under the extraordinary expansion of plants and facilities with production far exceeding any conception of ordinary needs and requirements, it appeared that renegotiation of contract was absolutely necessary.

Experiences of the past 18 months indicate that some renegotiation procedure is still necessary. We continue to purchase many new and unfamiliar articles and continue to deal with rapidly fluctuating production volumes. Free competition which in peacetime provides the usual methods of holding prices in line is not operative in wartimes and some substitute for that free competition continues to be necessary.

While the excess-profits tax is effective in a large way to prevent exceedingly large profits, there are cases of profiteering by a few greedy war contractors, scandalous cases. Such contractors apparently seem to think that the extra dollars they try to obtain for themselves, regardless of the stress and strain under which the whole country labors in our gigantic war enterprise, is of more importance than the splendid reputation which industry on the whole has earned and is daily earning for patriotism, honesty, and fair dealing. To guard against such unpatriotic and selfish practices renegotiation is a powerful weapon. It not only presents the opportunity of controlling scandalous profits but also it is sufficiently flexible to permit additional rewards to the most effective and efficient contractors as incentive for better performance.

The Truman committee made its report to the Senate some months ago on this subject of renegotiation. We have continued our studies, and, as chairman of the subcommittee, I felt that we should not content ourselves with reporting to the Senate but we should make specific recommendations concerning what we believe to be necessary amendments to the existing law.

Since the report was filed, counsel for the subcommittee, Mr. Stewart, of New York City, has been in constant touch with the departments observing the different steps in the renegotiation procedure and the results obtained. As na outgrowth of the investigation and the studies which have been made, amendments to the act have been drawn and I submit them today. I cannot say that these amendments are recommended by the Truman committee, because they have not been submitted to the committee, which is, after all, not a legislative but is an investigating committee. The committee which has responsibility for legislation concerning the Renegotiation Act is the Committee on Finance, of which the able Senator from Georgia, Mr. George, is chairman. The amendments which have been drawn and which I introduce today are suggestive in character and I introduce them for the purpose of sending them to the Committee on Finance, to which committee I have asked that the amendments be reported in the hope that that committee, which will, I am sure, review and study the entire principle of renegotiation, will carefully consider the suggestions made in these amendments.

In order that they might be fully understood, I asked Mr. Stewart, counsel for the committee, to prepare a statement explaining the amendments and their effect on the present law. I want to give that explanation at this time. The general purpose of the proposed amendments is to preserve the admitted advantages of renegotiation and to correct at least in some particulars the principal causes of complaint which have been made against the existing law.

The specific amendments now proposed are intended to accomplish three objectives:

(1) To bring about increased uniformity of policy and procedure, to reduce the chances of conflicting administration among the numerous agencies now charged with the responsibility for administering renegotiation, and to provide a central authority to which contractors dealing with all departments may appeal, by requiring the delegation of power to supervise those functions to a single board composed of representatives of all affected departments;

(2) To establish a workable, minimum test—a floor below which profits shall by law be deemed not excessive; and

(3) To expedite the work of renegotiation both for the Government and for businessmen by a requirement of compulsory filing of such material as will, on the one hand, permit the Government authorities to screen out those contractors who have obviously not earned excessive profits, and, on the other hand, will not impose upon business the burden of additional unnecessary questionnaires.

With these amendments, the law will, in my opinion, be greatly improved, but, as with all laws, its effectiveness will be determined by its administration.

I. THE SINGLE PRICE ADJUSTMENT BOARD

There are now subject to renegotiation six separate departments, each with its independent Price Adjustment Board, the War Department, the Navy Department, the Treasury Department, the Maritime Commission, the War Shipping Administration, and four subsidiaries of the Reconstruction Finance Corporation. The Treasury Department, the War Shipping Administration, and the subsidiaries of the Reconstruction Finance Corporation have been added one at a time at different times over the past year. They are at various stages of organizing their work. At least one, the Reconstruction Finance Corporation, is still at the very threshold. Some of the others are now well along in the job. The three departments which were originally made subject to the law are organized on entirely different bases. The Maritime Commission and Treasury Department have only one board each. The Navy Department has four boards, but their functioning is closely coordinated. The War Department alone, however, has between 40 and 50 subsidiary price-adjustment sections scattered around the country and set up as a part of the Army Service Force. These sections function directly under military command in the various services of supply of the Army. Indeed, the lines of military command are so closely observed in the War Department set-up that the Army maintains five separate boards in the city of Chicago. The price-adjustment sections in the War Department are also subject to the same command as the original procurement.

All departments attempt to handle renegotiations with all types of war contractors. For example, a steel manufacturer or a rubber tire manufacturer may be renegotiated by the Navy Department, while one of his competitors is being renegotiated by one section of the War Department, another competitor by another section of the War Department, a third competitor by the Treasury Department, a fourth competitor by the Reconstruction Finance Corporation, and so forth. The only basis agreed on by the departments for the determination of which department shall renegotiate with which contractor is the dollar amount of contracts outstanding. This method of assignment sometimes results in a contractor being renegotiated by a department which has only 15 or 20 percent of its contracts, while one of its competitors doing exactly similar work but with a somewhat different distribution of contracts will be renegotiated by an entirely different group.

A plan for so-called industry assignments or product assignments would make it possible for substantially all competitors to be renegotiated by the same group. Each group could in that way acquire a good understanding of the problems of a particular business and administer renegotiation with uniformity and fairness. But such a plan can never be worked out practically except under the supervision of a single authority with power to make assignments and supervise administration for all departments.

The Truman committee's report on this subject which I presented last March recommended the creation of such a single board at that time. The advantages of the plan have received general recognition. But the departments have not yet put the plan into effect.

The principal objection which has been raised is that the existing organizations have acquired experience in the handling of renegotiation, and that it would retard the administration of renegotiation to turn over the function to new and inexperienced personnel. The plan which I now offer meets this objection by

utilising existing personnel of the departments and simply requires the creation of this single coordinating board from within the departments and gives it supervisory powers, which should enable the board to administer the entire job of renegotiation much more effectively than has been possible under the highly departmentalized set-up which has existed heretofore.

A second objective which could be achieved through this change is that of publication of price-adjustment policies. The scattered authority which now exists has resulted at times in the determination and application of departmental policies before publication for the information of contractors and before adoption by the other departments. If all policy making for all departments were vested in a single body and that body were required by law to publish its policies and interpretations, there could be no room for misunderstanding.

A third objective of the single board is to provide an impartial appeal in such cases as involve questions of basic policy or obvious injustice. The only appeal now open to contractors is to the secretary of the department whose board is responsible for the original renegotiations. The natural tendency of the secretaries is to back up their boards. The only practical method of bringing about uniform administration of the policies of a single board is to give that board the final voice in controversial cases. The appeal function should not prove unduly burdensome to the board because the bill vests in its discretion to determine which cases it will hear and it is not assumed that a hearing on appeal would be found necessary in very many cases.

I think it is fair to say that I have seen evidence of closer coordination among the departments in recent months than existed at the time of the commencement of the Truman committee's investigation of this subject last January. I believe, however, that the present set-up can still be greatly improved by adoption of this amendment with respect to a single board.

II. THE TEST FOR AUTOMATIC EXEMPTION

I propose and aid to the screening process for the elimination of contractors who obviously have not earned excessive profits. This is not a formula for renegotiation but a method of reducing the number of companies which will have to go through the renegotiation process.

The test selected is applicable to manufacturers doing business on fixed price contracts, and requires such a contractor to meet two conditions to obtain automatic exemption from renegotiation: (1) His profits before the deduction of Federal income and excess-profits taxes must not exceed 8 percent of his total sales. (2) His total sales must not be more than three times his average total sales during the base period years, 1936 to 1939, inclusive.

The desirability of some test which can be applied readily by contractors and renegotiators alike has been evident from the inception of renegotiation. One of the principal complaints of contractors has been a lack of standards. By that term most contractors have meant lack of a mathematical formula by which they could figure out in advance what result would be reached by the renegotiators. Experience has demonstrated that no exact formula for computing the proper amount of refunds due from all war contractors is possible. The same experience, however, has demonstrated that an exemption formula such as that now proposed is practical and should aid the work of renegotiation, as well as be of assistance to businessmen in formulating business policies and plans.

I have had an analysis made of each of the 683 cases cleared without any recapture of excessive profits by the War Department prior to July 24, 1943. That analysis shows that 469 of the 683 cases involved profits on all sales (whether renegotiable or not) of 8 percent or less. I have also had an analysis made of more than 3,000 cases in which recaptures were effected by the War Department Price Adjustment Board prior to September 10, 1943, and that analysis shows that of these more than 3,000 cases the contractors were left after renegotiation with less than 8 percent profit on their total sales in only 163 cases.

A second test therefore was sought which would exempt a worth-while part of the clearance cases under 8 percent and at the same time preserve the right to renegotiate in most of the recapture cases under 8 percent. The test found most practical was that of 3 times the average volume of sales during the 1936-39 base period. Three hundred and thirteen of the clearance cases would have been cleared under this test and only 30 of the more than 3,000 recapture cases would have avoided renegotiation. None of the very large war contractors was included among these 30. The maximum recovery obtained from any one of the 30 was $90,000. The total recovery obtained from all of the 30 was $847,500. It may

be safely assumed that 75 percent of even ... is figure would have been recovered under the excess-profits tax law.

Needed checks to prevent the concealment of excessive profits by padding such cost items as salaries, advertising, and reserves for contingencies may be made by the Price Adjustment Board with the aid of the information received pursuant to the compulsory filing provision in the proposed amendments.

III. COMPULSORY FILING

There is now pending before the Congress a bill sponsored by the War Department and the Navy Department, which, among other things, requires the compulsory filing of information by contractors subject to renegotiation. The departments have doubtless been handicapped during the first 18 months of renegotiation by the lack of some such provision. It has made for a great deal of uncertainty as to the extent of the job to be done and as to the certainty and location of the contractors with whom renegotiation should be instituted. For example, at the time of the hearings on the renegotiation law conducted by the Truman committee last January and February, the representatives of the War Department estimated that 85,000 contractors were subject to renegotiation. Their latest estimate, as a result of their experience of the past 6 months and their searches for contractors subject to the law, has convinced them that the number does not exceed 20,000. There seems no doubt, therefore, that some form of compulsory filing is necessary to make possible proper planning for the job ahead.

In my opinion, however, the bill sponsored by the War Department and the Navy Department is properly subject to criticism as going too far. In substance, it requires contractors to file any information which may be requested by the Departments. That is a reasonable requirement as to contractors whose available figures have been examined and have been found, as a result of preliminary examination, to indicate the probably presence of excessive profits. It does not seem to me to be a reasonable requirement for all contractors regardless of the possible presence of excessive profits.

The amendment now proposed, therefore, is designed to give the renegotiators such information as they need for a preliminary examination, without increasing the burden of questionnaires already imposed upon business to an alarming degree. The information required by my proposed amendment should be readily available in any business organization, and should be adequate to enable the Price Adjustment Board to determine in a preliminary way whether there is any likelihood of excessive profits. If, as a result of the preliminary examination, they should determine that there is likelihood of excessive profits, they have complete authority under the law as it now stands to require the filing of any additional information which they may require.

IV. POST-WAR RESERVES

One of the most frequently heard complaints of contractors respecting renegotiation has been the policy of the renegotiators to disallow reserves for post-war conversion of plant facilities, inventory losses determined on cancelation of war contracts, severance pay for unneeded wartime employees, overhead losses during post-war periods of change-over, and the like. Congress has already made at least three provisions for this purpose: (1) The post-war credit under the excess-profits-tax law, which, in the case of top-bracket corporate excess-profits taxpayers, may amount to as much as 9 percent of the total profit before taxes; (2) the provision for acceleration of amortization of emergency facilities which are worthless at the end of the war, if the war should terminate before the expiration of the 5 years currently allowed for the emergency amortization; (3) provision for a 2-year "carry back," as well as "carry forward" of losses, with the requirement of a cash refund by the Government in the event of application of the "carry back" provision. This last provision could be very important to contractors whose businesses are really hard hit at the termination of the war and could result in losses for a 2-year period at the end of the war being entirely made up by the Government.

Nevertheless, there is undoubtedly real justification for the complaint that some war contractors are so vitally affected by war conditions that these provisions are not enough. The problem is to make additional provision for such contractors which will give them something approaching their needs without providing improper and unwarranted windfalls for other contractors upon whom the impact of war is not so severe. No exact determination of the amounts required can be made at this time. Inquiries which I have had made of the 100 largest

war contractors in the United States during the past 2 months have shown that very few of them are able to estimate their own post-war reserve requirements with any degree of accuracy.

It has been urged by members of the price adjustment boards that post-war reserves do not present a question which can properly be determined in renegotiation and that excessive prices for war matériel are not warranted by the businessman's natural desire to provide a cushion for the shock of possible post-war business reserves.

They urge that the proper place for relief legislation of this character is the tax law, and I agree with that view and have, therefore, refrained from offering any amendment authorizing the allowance of post-war reserves as a cost in renegotiations. Although it is not within the purview of these amendments to set up a scheme for amendment of the tax law, I do urge, as the most practical method of handling this problem, a proposal which has recently been made that the tax law be amended so as to provide—

(1) That reserves claimed by taxpayers in amounts not exceeding 20 percent of their taxable income shall be deductible as an operating expense in computing Federal income and excess profits taxes, subject to the following conditions;

(2) That the amount set aside in such reserves be invested in a special issue of nonnegotiable, noninterest bearing Government bonds, redeemable at any time prior to a date 18 months after the cessation of all hostilities;

(3) That simultaneously with the liquidation of such securities, the taxpayer must return the amount derived from such liquidation to his taxable income for the year of liquidation.

This plan has several notable advantages over every other plan I have heard for the handling of the post-war reserve problem. In the first place, it is simple to administer and does not require the exercise of discretion by any Government bureau. In the second place, it automatically differentiates between those contractors who have a serious post-war expense and declining income problem and those who have not. The former would get the maximum benefit of this provision, while the latter would get little or no benefit from it. In the third place, this plan would keep all moneys required for these intangible post-war items now in the form of Government securities, making such funds completely available for war purposes until they are actually needed for post-war purposes.

Such a plan is in my judgment infinitely superior to any proposal which can be made for the handling of post-war problems through the renegotiation process. I commend the plan to the consideration of those committees of the Congress now about to undertake a revision of the tax law.

Senator WALSH. It would be helpful to the committee, I think in view of the amendments made by the House committee since the time you laid your bill, Senator, if you would let us have your comments on those.

Senator HATCH. Frankly, I haven't had an opportunity to study it.

Senator TAFT. It is a question of allowing post-war reserves, isn't it?

Senator HATCH. That was one of the suggestions I made. I did not offer that as an amendment. Does the House bill cover that?

Senator TAFT. No; I think it does not.

Senator HATCH. I would like an opportunity to discuss that.

Senator TAFT. What was your suggestion? Can you summarize it in a moment or two?

Senator HATCH. One of them dealt with a single board. We thought that was very necessary. We found, as a result of our investigation, that the Navy would be negotiating a contractor and the Army would also be negotiating the same contractor, or renegotiating him, under perhaps different standards, different rules.

Senator WALSH. I thought the department which had the major amount of money involved would be the one to renegotiate.

Senator HATCH. That was not true when we made our investigation. As the result, I think, of our report also the bill that we

introduced, they made some changes. No changes were made until the actual legislation was introduced.

We made our report in March with certain specific recommendations. Nothing was done about it whatever until I actually introduced a bill, and then within a few days this consolidated or joint board was set up. I make no criticism of that; I am just telling you the facts. But that is one of the things we recommended, that there be one single board.

That is in the House bill now.

There were questions asked this morning as to whether or not we could set up standards. That is a thing that all industries, all contractors want. They want some standard by which they can be guided. We found it practically impossible to set up just ordinary standards to guide them in every instance. What we did work out was a rule which we believe would be satisfactory, judged by the cases that had actually been before these various boards, to provide an automatic exemption for certain companies who would not come under renegotiation, and we provide that rule in the bill I offered. I explain it in this statement of mine.

As to post-war reserves, Senator Taft, as I said, I am not familiar with the House provision.

Senator TAFT. There isn't any.

Senator HATCH. Oh, I thought you said there was. We make a recommendation on that in this bill which I have introduced. This recommendation is not original with me, and I said so on the floor; it is not original with the attorney for the committee, but it struck us, both the attorney and me, and the other members of the subcommittee, as providing perhaps a pretty safe plan for setting up war reserves. That is set forth in this statement. I really think it is a reasonable provision and one that would work out.

Senator WALSH. The committee may, in executive session, see fit to call upon you.

Senator HATCH. I will be very glad to come. I was thinking this: This man that the committee employed, Mr. Stewart, spent weeks and weeks down there with the departments. He is very able, a very conscientious young man, and if the committee would like to have him, I would be glad to have him come before it.

Senator WALSH. We will first try to find out what is beneficial in the House language relating to renegotiations. What further amendments or changes were made?

Senator HATCH. The reason I said I would call Mr. Stewart—this question of raising the limitation to $500,000 instead of $100,000, I was impressed when we had our hearing that that was very necessary, it ought to be done, but we made further studies and we found out that this great mass of cases which we thought were going to be renegotiated along early last year are dwindling. There are not nearly as many cases as appeared at that time, so I began to think perhaps we ought not make that change, perhaps we should leave it at $100,000 where it is now.

You can take a man who is making a $100,000 contract, out in New Mexico, he can make a terribly excessive profit on a $100,000 contract. Perhaps that ought not be removed, and I think a study of the actual cases before the board might suggest that that change

ought not now be made, although last spring I thought it should be made.

Senator MILLIKIN. Senator, did you reach any conclusion as to when we ought to bring this to an end?

Senator HATCH. Yes; I think it ought to be brought to an end with the duration. There is no justification for the renegotiation except for the emergency.

Senator MILLIKIN. I mean short of the duration. Did you study that?

Senator HATCH. Yes; we studied that very carefully.

Senator CLARK. As a matter of fact, the whole renegotiation business is necessary because of the apparent reduction of the predilection on the part of both the War and Navy Departments to deal with a few big contractors rather with the small contractors. They just wallowed around and did not care what it cost; they made contracts right and left with a few big contractors who went out and subcontracted for what they pleased, and that is a situation where renegotiation is about the only remedy the Government has.

Senator HATCH. Senator Clark, I think you stated the case quite clearly, and I am not too critical about it. These men did get the jobs—these men had to go out and get the work done, and they could more easily get the big contractor.

Senator CLARK. Yes; it was easier to get them.

Senator WALSH. I think the reason for the remark made by Senator Clark was to show the necessity for the renegotiation law.

Senator CLARK. Yes; I say that is the situation that made renegotiation necessary.

Senator HATCH. Let me add this: Judge Patterson quoted here this morning a statement made in our report, that they had brought here to Washington on these various boards the very best men in America from a business standpoint. I would like to be convinced of that. I think they have got some of the finest men in this country from business at the head of these renegotiations, and I think on the whole they have tried to do a pretty good job. That doesn't mean that I approve everything that has been done.

Senator RADCLIFFE. I think we ought to consider the attitude of mind we had a year or 2 ago when the pressure for production was so terrific, and now it isn't and we can be a little more philosophic. We ought to take that into account—the need to get production as best we could.

Senator HATCH. I tried to bear that in mind in the conduct of this investigation.

I may say this: I was out in Illinois a few weeks ago, and I met one of the largest manufacturers in this country. He told me he had been discussing the renegotiation law in a public meeting, and he said he was advocating that it be continued because he believed the excess profits do not relieve the situation, just as Secretary Patterson said this morning. I think myself it tends to increase cost and all that.

This man told me after the meeting was over—he said: "Senator, we have a lot of contracts with the Government; we were one of the first companies renegotiated." He said, "They took a lot of money away from us—just a lot of money, but," he said, "Senator, they left us all we were entitled to receive."

I thought that was a very fine statement from an industrial leader, a man who had his money taken away from him on the recommendation of the Board of Renegotiations.

If I may have this statement printed, and if you like, I will have Mr. Stewart come down and be subject to call by the committee at any time.

Senator CLARK. Senator, in connection with the subject of renegotiation and also post-war reserves, won't we have to give a lot of consideration to the thing that was barely touched on this morning by Judge Patterson? That is, we have to consider the nature of the work the company has done, whether it required conversion from its ordinary business, and whether it requires reconversion at the end of the war to get back——

Senator HATCH. Certainly, we do.

Senator CLARK. In other words, take this company we were talking about this morning, that did not have to convert and does not have to reconvert. That is not entitled to as much consideration as the company that gave up its ordinary business, had to convert over for an entirely different business, and now will have to reconvert in order to do any business at all.

Senator HATCH. I agree with that.

Senator WALSH. If there is nothing to come before the committee, then the committee will conclude until tomorrow morning at 10 o'clock, when it will meet in executive session.

(Whereupon, at 4:50 p. m., the hearings were closed.)

REVENUE ACT OF 1943

WEDNESDAY, DECEMBER 15, 1943

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

The committee met, pursuant to notice, at 4 o'clock p. m., in room 312 Senate Office Building, Senator Walter F. George (chairman) presiding.

Present: Senators George (chairman), Walsh, Barkley, Connally, Bailey, Clark, Byrd, Gerry, Guffey, Johnson, Radcliffe, Lucas, La Follette, Vandenberg, Lodge, Danaher, Taft, Thomas, Butler, and Millikin.

The CHAIRMAN. The committee will come to order, please.

Senator BARKLEY. There are four or five witnesses here representing different phases of this problem, the first is Mr. Cox, who is from Louisville, Ky., and he represents the Kentucky Distillers' Association. He will be the first witness, I understand and Mr. Cox understands there is nothing in this bill about this problem they are here to discuss. There is an amendment offered by Senator Overton, undertaking to lift the tax as between 4 and 8 years up to as high as $16 a gallon. There has been a suggestion that the distillers be required to tax-pay whisky at the end of 4 years or a somewhat shorter period than the law now allows. I presume you understand that you are to discuss those problems.

The CHAIRMAN. I don't think there is any misunderstanding, Senator Barkley. I have had briefs filed with me for 2 or 3 weeks, even before we ever attended the hearings, by distillers. The matter which we have before us is the question of the shortening of the withholding period in bond. Now you have a good many witnesses. How long do you think it is going to take us?

Senator BARKLEY. Well, there are six witnesses here. Mr. Cox, representing the Kentucky Distillers' Association, Mr. Englehard from the Glenmore Distillery, which is at Owensboro, then there is one witness here from Seagram, one from Schenley, one representing the insurance phase of the matter, and one representing the Stietzel-Weller Distillery, Mr. Van Winkle, who testified the other day. We will shorten it as much as we can.

The CHAIRMAN. I have got briefs filed by different gentlemen here. We will have to complete this afternoon so I hope that you can consolidate it as much as possible without repetition, going over the same point.

STATEMENT OF MILLARD COX, REPRESENTING THE KENTUCKY DISTILLERS' ASSOCIATION

Senator BARKLEY. You might give your name for the record.

Mr. COX. My name is Millard Cox, and I am counsel for the Kentucky Distillers' Association. I will endeavor to be brief, Senator. I feel perhaps that I ought to make a general statement here which

may be helpful to the members of the committee because the subject covers so many ramifications and has so many consequences, so I have prepared a statement which will not take me very long, and I think it will cover some phases of this question that perhaps are in the minds of you gentlemen.

Under the existing law distilled spirits, when barreled at the distillery, are deposited in so-called internal revenue bonded warehouses for ageing. The tax is paid as the distilled spirits are withdrawn from the bonded warehouses, such spirits to be withdrawn at any time within 8 years.

The 8-year bonded period was first enacted in 1894, and has been the law of this country ever since that time, excepting during the prohibition period when distilled spirits could remain in bond for an indefinite period. I may say, of course, that in Kentucky the entire industry has been built around this Government act.

Whisky is a distillate from grain and consists of alcohol, water and so-called grain congenerics. These congenerics are grain extracts which ultimately give the whisky its flavor and bouquet. These congenerics in raw whisky make the product impotable and noxious. By storage in charred oak barrels these congenerics are converted to other flavors, ethers, and esters. The charred barrel acts as a catalyst, it is porous and therefore permits air to enter the barrel. This oxidation process in the presence of the catalysts, combined with the extractives from the barrel, results in a chemical reaction which ultimately converts these congenerics to those flavors and aroma or bouquet ingredients which give mature whisky its proper taste and aroma.

That action is, in fact, a chemical action.

The congenerics requiring conversion are different in different types of whisky. It all depends on the grain bill and the method of distillation.

For instance, whisky run on a column still may be so fractionated as to reduce the congenerics, depending on how the still is operated. This so-called light-bodied whisky matures more rapidly than whisky so distilled as to leave more body and flavor. In this country there has been produced everything from a very light-bodied whisky to a very heavy-bodied whisky. The heavier the body the longer the ageing necessary to properly mature the whisky. Many of the whiskies in this country are still unpalatable when 4 years old.

The CHAIRMAN. Right on that point, the Government officials tell me that 70 percent of the bonded whisky in this country sold heretofore through the years has been 4 years old or less.

Mr. COX. Since repeal?

The CHAIRMAN. Yes, sir.

Mr. COX. That is undoubtedly so.

The CHAIRMAN. All right, go ahead.

Mr. COX. But I would like to explain why that is so.

The CHAIRMAN. All right, you may explain it. I just wanted to know if that is a fact.

Mr. COX. Repeal caught this country with about 20,000,000 gallons of aged liquors on hand. The industry knew that it would be up against the competition in the whiskies, where the bonded period in some instances is unlimited. Scotch whiskies, for example, are matured from 4 to 12 years and sold in this market. Canadian whiskies are matured in 6 or 7 years. Really, it has got to the point

that one, or we were to the point when whisky production stopped in this country, where distillers were just beginning to have 6-, 7-, and 8-year-old whisky—that is, the thing at which they were aiming.

The CHAIRMAN. That is all right. I just wanted to know what the percentage was.

Mr. Cox (continuing). This type of whisky was produced in reliance upon the 8-year bonded period which has been the law for 50 years. To force it out of bond now, before it has matured, is to force immature American whisky on the American people.

Throughout the world the necessity for properly aged distilled spirits has been recognized for many years. This is the first time so far as I know that any legislative body has given any consideration to requiring that distilled spirits be sold when young. On the contrary, legislative and governmental administrative bodies in other countries have heretofore always attempted to prohibit the sale of immature distilled spirits. In Ireland whisky cannot be sold at all until it is 4 years old; Scotch whisky cannot be sold until it is 3 years of age; and Canadian whisky cannot be sold until it is 2 years old. In this country the bonded period has been extended from time to time, the period being 1 year under the act of 1864, extended to 3 years by the act of 1868 and extended to 8 years by the act of 1894.

Several of the States have attempted to prevent the sale of immature spirits. Under the law of Kentucky, no whisky can be labeled as Kentucky whisky until it is 2 years of age and under the law of California whisky must be 4 years old to be labeled "whisky."

By Federal regulation, attempt has been made to so label the younger whisky as to make it unattractive to the public. The labeling regulations promulgated under the Federal Alcohol Administration Act prohibited the labeling of whisky as straight whisky until it is at least 2 years of age.

The proposal before the committee fixes a maximum age of 4 years for whisky, despite the fact that many types of whisky heretofore made will not, and were not intended to, mature in 4 years. The result will be that in October 1946 the consumers of this country will have no domestic whisky as old as 4 years. On October 8, 1942, all distillation of beverage spirits in this country was stopped. Since that date all beverage distilled spirits plants have been converted 100 percent into the production of war alcohol. Just when beverage distillation will again be permitted is not known. If beverage distillation were permitted January 1, 1944, the oldest American whisky in the United States on October 8, 1946, if the proposal becomes law, would be 2 years and 10 months old and there would be no 4-year-old American whisky until January 1, 1948, at the earliest. If, because, of the grain requirement of the alcohol requirements of the country, or for any other reason no whisky is produced until January 1, 1945, it is obvious that by 1946 only 1-year-old American whisky would be available to the consumers of this country if the proposal were adopted.

In this connection we call attention to the fact that in Ireland, Scotland, and Canada there is no limitation on the bonded period. Whiskies are still ageing and maturing in those countries. As a matter of fact, the Scotch whiskies are normally sold at 8 to 12 years of age, Canadian whiskies are normally sold at approximately 6 and 7 years of age, and Irish whiskies at much above 4 years of age. If the

present proposal were adopted the only mature whiskies available to American consumer beginning October 8, 1946, and for an indefinite period thereafter, would be the imported whiskies.

It is not fair to the American consumer to require him to rely solely upon foreign production for his matured whiskies.

The proposal can be of no advantage to the Government. Every gallon of whisky produced in this country will eventually be tax-paid. To require the tax to be paid when the whisky is 4 years old rather than when it is fully matured, is merely to require tax anticipation. There have been all kinds of estimates in the newspapers as to the amount of tax the proposal would bring in immediately. We point out that the total amount of the tax brought in by this proposal in 1944 would not be altogether anticipated tax payment. A substantial portion of the tax will be paid anyhow during 1944.

The tax anticipation this year will result in tax collection decrease next year and can be of no real advantage to the Government. Assuming, which may not be the fact, that every distiller could secure enough money to pay the tax as his spirits reach their fourth birthday. It is perfectly obvious that the money would have to be borrowed. The distillers would have to pay interest on the borrowed money and the interest would be deductible for income-tax purposes. To the extent that income taxes are thus reduced, the Government would be paying interest on the anticipated tax collection and we submit that the rate thus paid by the Government would be higher than they now have to pay for short-time money. There is therefore, no justification for high rate short-time borrowing by the Government from the distillers to the disadvantage of the American consumer and the American industry.

Inasmuch as there has been no beverage distillation in the United States since October 8, 1942, and inasmuch as the purchasing power of the country is now stated to be somewhere between forty-five and fifty million dollars in excess of civilian supplies——

The CHAIRMAN. Billion you mean, not million.

Mr. COX. Billion, excuse me—the demand for distilled spirits is obviously in excess of the supply. It may be that the proposal is being given some consideration on the theory that it will increase the supply to meet the extraordinary demand that now exists.

While we have no exact figures as to the quantity of distilled spirits which the proposal would require to be tax-paid in 1944, it is estimated there would be forced out of bond a quantity much in excess of any previous annual tax payment. The effect would be merely to flood the country for a time and thereafter, possibly when the war is over and moonshiners have more facilities, to materially shorten the available stocks. We submit that the Congress should give serious consideration to the danger of flooding the country in wartime and thereby creating a post-war shortage.

The proposal creates further problems for the Government. In order to collect the tax the Government must gage; that is, measure the whisky. This would require a very substantial increase in the staff of storekeeper gagers employed by the Government. With all the distillers in the country running 24 hours a day on war alcohol, the Government gaging staff today is hardly adequate to handle the present beverage tax payment. We understand that the Treasury is now unable to supplement its gaging manpower so as to adequately take

care of present distillery operations. If the tax payments are substantially increased the Government will have great difficulty in securing sufficient manpower to handle the gaging and tax payment collections.

There is still another problem. As the whisky is tax-paid it obviously must get on the market. The war requirements for glass, paper, and wood are such that the distillers are today limited in the number of bottles and the number of cartons they can get. At the present time the bottlers can procure only 65 percent of the number of bottles they received in 1942. They can get fiber cartons only in an amount of 80 percent of those they used in 1942, and wood boxes cannot be used at all for beverages unless they are what is known as multiple-trip returnable containers. If the tax anticipation is to be required and above normal quantities of spirits are to be forced on the market, then obviously more glass and more cartons must be made available to the distillers. This might very possibly be so great as to hamper the war effort.

Even assuming that the glass and cartons are made available, there are still other problems. Under present O. D. T. regulations wholesalers, for instance, may make deliveries only once a week to retailers. If the quantity to be delivered is materially increased, more trucks, more tires, and more gasoline will be required. Unless the Government is in a position to make more automobiles, more tires, and more gasoline available to the liquor industry the proposal cannot result in materially increasing the amount of liquor available to the consumer. We submit that increasing the delivery facilities of the liquor industry at this time is neither practical nor to be expected.

From the above it is obvious that the proposal is of no advantage to the Government revenue and that it might develop problems which would place a burden on the war effort. The proposal would not satisfy the demand which the excessive purchasing power of the country has created for liquor and we submit that there is serious question as to whether attempt should be made to satisfy such demand.

The proposal is unfair to the industry and is highly disruptive thereof. For over 50 years the industry, under the aegis of Government regulation and law, has developed American whiskies which require aging to mature to potability. As stated, there are made in this country both light-bodied and heavy-bodied whiskies for consumption straight and whiskies to be used as a base for blends. The heavy-bodied whiskies and the whiskies made as the base for blends require more than 4 years to properly mature. Thousands, if not millions of dollars have been spent in developing brands which meet the taste of the American consumer. If the whiskies already produced are to be forced on the market at 4 years of age, many of them will not be palatable, will not meet the consumer's requirements, and the brands under which those whiskies have been bottled at 5, 6, 7, and 8 years of age will be virtually destroyed. Even those whiskies which have been bottled at 4 years of age will be entirely off the market from October 8, 1946, for some indefinite period. That period cannot be shorter than 13 months. Age is not only a factor of quality in the minds of the American consumer, but is a factor of quality in fact.

To take the older American whiskies off the market while the Scotch, Irish, and Canadian whiskies are still aging is to turn American industry over to the foreign producer.

Immediately following repeal the customs duty on imported whisky was by Presidential proclamation reduced by 50 percent. This reduction is still in effect and it is particularly significant that the reduced rates apply only to whiskies 4 years or more of age. This action was obviously taken to supply aged imported whiskies to the American consumer.

The American distiller, due to 14 years of prohibition, has virtually lost the international markets. To now reduce the normal ages of American whisky and to leave only very young whisky on the market 2 years hence is to make it impossible for the American distiller to recapture those markets in spite of the fact that large sums of money have been spent in an attempt to develop them.

To finance the above normal tax payments which the proposal would require would be a great hardship, particularly on the smaller distilleries. Many of them might not be able to raise the funds with which to pay the tax as proposed, and to that extent, at least, many of the smaller distilleries might be forced out of business.

If the distillers are compelled to pay the tax and do not have the bottles, containers, and shipping facilities available, and such facilities would not be available under present governmental restrictions, many of them would be obviously forced into bankruptcy. Certainly a large number of the distillers of the country could not finance the tax unless they would immediately dispose of their whisky.

Even if the bottles, cartons, transportation, and all other supplies were available, the manpower situation is such that the distilleries could not handle the physical work of moving the barrels and bottling the spirits in the quantities that would be forced out of bond.

In the main the above applies to rum and brandy as well as whisky.

To sum up, we submit:

1. The proposal forces on the market much whisky heretofore produced before it reaches maturity.

2. It leaves only very young American whisky for sale 2 years hence.

3. It produces no new revenue and merely anticipates tax payments at probably high rates to the Government.

4. It disrupts and disorganizes and in many instances may destroy an industry which has wholeheartedly turned over their producing facilities to the war effort. That is hardly equitable or fair treatment, we submit.

The CHAIRMAN. I am told by the authorities, by the Federal officials, I am not going outside of that, that there are now 117,000,000 gallons of whisky 4 years old in bond, is that correct?

Mr. COX. Four years and more.

The CHAIRMAN. Four years or more.

Mr. COX. I accept that.

The CHAIRMAN. One hundred and seventeen million. You have already answered the question that my other statement was correct, that throughout the year 70 percent of the bonded liquor has been 4 years or under when put on the market—a little better than 70, I am told, but say 70.

Senator DANAHER. Since prohibition?

Mr. COX. Since repeal.

The CHAIRMAN. Before repeal, also. Now what shrink are you getting on your whisky after 4 years of age?

Mr. Cox. I hate to say it, Senator, but it runs up to 18 gallons at 8 years.

The CHAIRMAN. Eighteen gallons at 8 years. Now you put a barrel of whisky in and take it out at 4 years, what is the shrinkage?

Mr. Cox. I think that is about 11 and a half.

The CHAIRMAN. Is it that high?

Mr. Cox. I think so.

The CHAIRMAN. Eleven and a half shrinkage at 4 years, and if you had 8 years the percentage will then be about 18 gallons.

Mr. Cox. I think it is all of that.

The CHAIRMAN. That is allowing for evaporation. Of course you do not pay any tax on that.

Mr. Cox. No, sir.

The CHAIRMAN. So the longer it stays there the more it evaporates and the Government loses the tax, loses out against the tax paid at 4 years.

Mr. Cox. Well, Senator, I think you will find a difference in the types, because the excise taxes have been levied on this, but really the Government has withheld the tax until it actually went into consumption.

The CHAIRMAN. Yes, I understand that. I am just saying that at 8 years of age 16 gallons out of the barrel is gone and therefore not subject to tax.

Senator LUCAS. He loses the whisky at the same time.

The CHAIRMAN. Yes.

Senator BARKLEY. Mr. Chairman, I might call your attention to a table put in the other day by Mr. Van Winkle, showing that liquor 4 years old has lost 11 gallons out of the barrel—that is a 40 or 45 gallon——

Mr. Cox. Ordinarily it is a 50-gallon barrel, but it is not filled to the top, about 47½.

Senator BARKLEY. Eleven gallons at 4 years, and 84 months, which is 7 years, 17 gallons, and of course 12 months more would be around 18 gallons.

The CHAIRMAN. Yes. I just wanted to get those facts before the committee.

Now you have not been permitted or have not made beverage liquors since October 8, 1942; is that correct?

Mr. Cox. That is when the final shut-down came, but the distillers have not made any for a year prior to that.

The CHAIRMAN. And are not making any now?

Mr. Cox. No, sir.

The CHAIRMAN. So that if they continue that restriction you will eventually arrive at a time finally when you won't have any aged whiskies.

Mr. Cox. That is inevitable.

The CHAIRMAN. Undoubtedly so. Well, now, on the question of finance, of course, the consumer pays this tax, doesn't he?

Mr. Cox. Correct.

The CHAIRMAN. Undoubtedly.

Mr. Cox. There is no question about that; we are merely a tax collector.

The CHAIRMAN. Yes; just merely a collector. He pays the tax. A lot of complaints have come to the committee about very, very

little whisky being sold and very bad whisky being sold all over the country. Now, have you any information on that that you can give the committee?

Mr. Cox. No; but I assume that there is some very bad whisky and a lot of very good whisky sold—always has been and always will be.

The CHAIRMAN. Well, the State authorities in my State—they have a number of counties that legalize the sale of whisky, and the State authorities have complained to me personally that all of the whisky coming into the State for the last month or 2 months or 3 months has been decidedly offgrade and inferior green liquor, almost to the point where they are about to exclude it from the State, and probably would if they did not feel that they might encourage illicit distilling, so that you got bad stuff anyhow.

Mr. Cox. Yes, sir. Well, tastes in liquor, Senator, as you very well know, sir, vary a great deal. What would be considered good whisky by one man would not be considered good by another. From Kentucky we ship a certain whisky, known as green whisky, into some of the Southern States. So far as I am concerned, it is wholly unpalatable whisky. It has not matured at all, it is put in a barrel and it is labeled under the Federal regulations as green whisky, and there is quite a market for it.

The CHAIRMAN. Yes, so far as the question of containers—of course, this committee would not think of shortening the period required for the payment of the tax unless we also provided for priorities to get the necessary containers to take care of your whisky. We would not think of that, and even if you were required to pay the taxes at 4 years, you would not necessarily have to sell your whisky. Now, as a practical proposition, we concede you would have to sell and let the consumer pay the tax, or you would have to borrow the money. I mean, the law would not require the sale.

Mr. Cox. No, but after the whisky is tax-paid, Senator, we get no further outage allowance.

The CHAIRMAN. That is right; no further shrinkage.

Mr. Cox. So, if the whisky were not bonded, it would stay in what we call a tax-paid-free warehouse.

The CHAIRMAN. That is very true.

Mr. Cox. And shrinkage would go on, and we would pay on the basis of so many gallons when the whisky is withdrawn from bond, we pay you a tax on every gallon of the whisky and the whisky continues to shrink, we pay our tax on whisky that is not there when we bottle it.

The CHAIRMAN. That is right, and the Government has lost the tax on the whisky that was there, in order to carry that.

Mr. Cox. And the distiller lost the whisky, too.

The CHAIRMAN. The distiller has lost the whisky and the Government has lost its tax.

Mr. Cox. We are talking about a product, Senator, in the course of manufacture.

The CHAIRMAN. Now, coming to that, I know the chemists all practically say that whisky in barrels becomes pure, so far as purity is concerned, between 3 and 4 years, does it not?

Mr. Cox. Well, you may get that information from some chemists. I don't know. I know in Kentucky we do not regard whisky so much a matter of chemistry as we regard it a matter of cooking. It is a

culinary art. That is, you may like your steak rare, I might like mine medium, and Senator La Follette might like his well done. As I say, it is a question of taste. There is no question about it, some whiskies mature very well at 4 years of age.

The CHAIRMAN. That is the point I wanted to bring out. As a matter of fact it does mature somewhere between 3 and 4 years of age, does it not?

Mr. Cox. No, sir; it may mature very well at 4 years, some whiskies are made to mature in that time, as I have stated in my statement, in order to get what we call light-bodied whiskies. You can do it in two ways, your mash bill has something to do with it, the content of small grain. In other words, the smaller the proportion of small grain the nearer we get to what we call light-bodied whisky. That is one way to start it. Now you can also get a light-bodied whisky by carrying your fractionation in your distillation processes higher. In other words, distillation at a higher proof so as to give you a lighter-bodied whisky, so that when you get to the absolute proof, which is 200 proof, you have got a spirit that has no odor, flavor, or taste——

The CHAIRMAN. Well, there was a hearing at which a noted chemist in this country appeared, conducted by the House, which I will present to the committee, in which the most eminent chemist of the country stated that whisky was pure after somewhere in between the period of 3 or 4 years. Of course, that is a general statement.

Mr. Cox. That is an expression of opinion. My friend, Mr. Van Winkle, who is here, president of the Stitzel-Weller Co., and who has been in the whisky business 40 years, and has made a very high-class product, was conducting a group of friends through his distillery, and they wanted to know where his chemical laboratory was, so he turned to a little room and said, "There it is," and there was a little sink, a couple of test tubes and a hydrometer, and nobody can say that the Stitzel-Weller does not make a superior whisky. They age it for 7 years.

The CHAIRMAN. Yes. I understand it is the aging which makes it better.

Mr. Cox. Not all whiskies. I have been informed that there are some that do not improve much after 4 years, and there are some that will mature at 6. That is particularly true of the Maryland ryes. The rye is a heavy-bodied whisky, and I think you will find—I don't like to testify for the people from Maryland—I think you will find they will tell you that rye whisky reaches probably its best maturity around 7 or 8 years.

The CHAIRMAN. Well, anything further?

Senator BARKLEY. You say, of course, as we all know, the consumer pays the tax.

Mr. Cox. Yes, sir.

Senator BARKLEY. But the distiller has to pay it first to the Government?

Mr. Cox. The distiller advances the tax.

Senator BARKLEY. The distiller advances the tax, and that means you have got to finance it until he has put it on the market and recovered the tax after it is sold to the public.

Mr. Cox. That is right. The dealer has to finance the tax and it depends on how rapidly the credits are turned over.

The CHAIRMAN. Let me ask you one question, Mr. Stam. In reference to this increase in whisky tax, Does it automatically go off within 6 months after the war ends; is it included in the increased excise taxes that go back after 6 months?

Mr. STAM. I didn't quite get that.

The CHAIRMAN. The last increase of——

Mr. STAM. Nine dollars.

The CHAIRMAN. Does that remain on beyond 6 months after the war?

Mr. STAM. That goes off; that is a temporary increase.

The CHAIRMAN. So that 6 months after the war the old tax——

Mr. STAM. Is then restored.

Senator BARKLEY. I would like to ask Mr. Cox this question also: There is every inducement for the distiller to sell his matured whisky when it is matured, if it happens to mature in 4 years; the longer he keeps it after that the more whisky he has lost, and of course the Government loses its proportion of the tax also, but if the whisky is matured and has been made to mature at a certain time, the sooner thereafter he pays the tax and puts it on the market the more whisky he will sell.

Mr. COX. Absolutely.

Senator BARKLEY. Therefore, there is no inducement for a distiller deliberately to hold his whisky off the market if there is a market for it, the market will absorb it, just for the purpose of keeping it, is there?

Mr. COX. That is right, Senator. I do not know of any distiller in the country that would not be very pleased to sell all of his whisky just as it comes off the still from day to day were it possible to do so, but it is simply an impotable product at that age, but in order to compete with foreign whiskies, fully matured, the distiller has had to build his business accordingly, and they have been operating under the rules made by the Government in 1894 and the business has been entirely built around those rules.

Senator BARKLEY. I am informed that ordinarily, in normal times, the distillers keep in storage about 500,000,000 gallons of whisky in the United States. Do you know whether or not that is correct?

Mr. COX. That would be about right. The Alcohol Tax Unit——

Senator BARKLEY. The Treasury Department, on the 31st of October, through its Alcohol Unit, reported that there was 399,000,000 gallons of liquor in storage at that time; that is, that that much was in storage or had been originally put in storage in the barrels. If you deduct the soakage, outage, or leakage, whichever you call it, of about 96,000,000 gallons, it would mean that you would get about 303,000,000 gallons now in storage in bonded warehouses. Have you any opinion, if we force that liquor on the market, how long it would last the present demand and purchasing capacity?

Mr. COX. Well, Senator George said there was probably 117,000,000 gallons which would be forced out, but I think it would all be disposed of just as rapidly as the consumer could grab himself a case here and there. That is one of the things that has caused this tremendous shortage, this terrific consumer demand. The person who used to buy a pint or a quart and felt perfectly satisfied is now looking for a case of liquor. I think that is common knowledge among the members

of this committee. That is true, and in ordinary times, any whisky—in 4 or 5 months the consumer demand would drop off, and a person would only use what he would normally consume in a day or a week.

In that connection, I have a very interesting letter, a V-mail letter, received by the Stitzel-Weller Distillery, which I would like to read. It comes from a first-class private who is serving over in Italy, and it is dated November 30.

DEAR SIRS: I am writing this letter to you from somewhere in Italy while standing in a foxhole which is half full of mud and water, and was just thinking how wonderful it would be if I had a quart of Old Fitzgerald to sort of take the chill out of my bones. I know it is impossible for you to send me a quart so I thought of a better idea. My home town is Kansas City, Mo., and from letters I receive from my friends I have found out that you just cannot buy any Old Fitzgerald at any price, so now I have a proposition to make to you people. I know there is a terriffic shortage of good whisky, but there is still some to be had to the right people. Now, I am at a disadvantage, being overseas, and have not the opportunity to buy but little Old Fitzgerald there should happen to be on the market, but I am prepared to send you my money order each month for the current Office of Price Administration price on 2 quarts of Old Fitzgerald which you may keep for me until I return home or the supply runs out.

[Laughter.]

Senator BARKLEY. Let me ask you this question—Had you finished reading the letter?

Mr. COX (continuing):

I am appealing to your sense of fair play, as I cannot understand why the 4F's back home should have the opportunity to buy good liquor while I get thirsty over here. I will be pleased if you will give this your immediate consideration. Please answer via V-mail at once.

Yours very truly,

———— ————, *Private First Class.*

Senator DANAHER. What was your answer?

Mr. COX. I am not connected with this distillery, but Mr. Van Winkle is here, the president, Senators, and I will be glad to have him tell you what he has answered or will answer.

Senator BARKLEY. Has there been any substantial increase in the price of liquor by distillers, except to take care of the tax, of the additional tax that has been put on them by Congress and certain adjustments that the O. P. A. has made in the price ceiling?

Mr. COX. Senator, I would like to think that there has not been any violation whatsoever among distillers. Now, there may have been, I am certain the violations, if there have been any, have been very, very few indeed.

Senator BARKLEY. Yes; I have understood the distillers, of course, are attempting to cooperate fully in carrying out the O. P. A. ceilings.

Mr. COX. They certainly are.

Senator BARKLEY. The liquor which they distill, of course, the distillery cannot control what happens to it after it leaves the warehouse and gets into the hands of the dealer.

The CHAIRMAN. What percentage is the tax at $9 per gallon of the whisky, as against the cost?

Mr. COX. Against the cost?

The CHAIRMAN. In other words, what does it cost to get it there.

Mr. COX. Well, O. P. A. ceiling price, I think—Senator, if you mean—I do not understand your question exactly. The relation between tax and actual cost?

The CHAIRMAN. Yes, sir; if you want to put it that way.

Mr. Cox. Well, the O. P. A. ceiling price on 8-year-old whisky is $2.50 a gallon, and the tax is $9.

The CHAIRMAN. The tax is $9, so that the Government really is paying most of the tax loss on your whisky, isn't it, when it cost $2 to put it in the warehouse and you have to pay $9 to get it out; so that if it evaporates, all that evaporates——

Mr. Cox. I think you can look at it this way, that if it evaporates, the distiller is losing his whisky. Your idea is he has not had as much because the Government tax is so much more.

The CHAIRMAN. Yes, I want to know, the percentage, tax is to the cost of the whisky.

Mr. Cox. Nine dollars as against two dollars.

The CHAIRMAN. Nine dollars as against two dollars. All right. How much of the 117,000,000 gallons that is now said to be 4 years old in Government bonded warehouses would normally be withdrawn in 1944, say, or next year?

Mr. Cox. I have some accurate figures on that, but I would guess normally half of it—no, more than half, probably two-thirds.

The CHAIRMAN. Normally, two-thirds, so that there is another one-third of it there that would be involved if you had to bring it out.

Senator BARKLEY. The figures show that for last year the withdrawals were about 100,000,000 gallons.

Mr. Cox. I have some accurate figures here. May I give them?

Senator BARKLEY. And the year previous to that it was 153,000,000.

Mr. Cox. Now, these, Senator, are the figures taken from the Treasury Department on the comparative basis of the first 10 months of 1942 and the first 10 months of 1943. In the 10 months of 1942, 117,874,166 gallons were withdrawn.

The CHAIRMAN. That is in 1942?

Mr. Cox. In 1942. In 1943, for the first 10 months, through October—the first 10 months of 1943, there were 81,733,291 gallons withdrawn, or a decrease of about 30 percent.

Senator BARKLEY. Is it true that the distillers have put into effect a sort of self-rationing in order to try to make the distilled liquor spread over the period which may be covered by the possible period of no manufacture at all, on the theory that in the interest of the public, to have that spread over the period, so the time will not come when there will be nothing but new raw whisky?

Mr. Cox. That is absolutely true, Senator; it is not only good business, in my opinion, it is good sense.

Senator BARKLEY. Then you estimate that you would withdraw about 100,000,000 in 1944, altogether?

Mr. Cox. I doubt it; it might run that high but it would be purely a guess.

Senator BARKLEY. Your estimate is around 80.

Mr. Cox. For the first 10 months.

Senator BARKLEY. Of the 4-year old whisky, you said two-thirds, which would be 48,000,000 gallons of 4-year-old whisky alone, then there are some withdrawals from younger——

Mr. Cox. I think it would be somewhere around that figure, probably 80,000,000 gallons.

Senator BARKLEY. Eighty million of the 4-year-old whisky.

Mr. Cox. Of all whisky.

The CHAIRMAN. All bonded whisky.

Senator BARKLEY. I thought you said of the 117,000,000 4-year-old whisky, two-thirds would be withdrawn in all probability in 1944.

Mr. COX. Well, I said that before I had gotten these figures there. I read an estimate of comparison between 1942, which was the year in which the withdrawals were very heavy, Senator, there were very heavy withdrawals in 1942, and now in 1943 for the first 10 months I think it shows 80,000,000 gallons.

Senator BARKLEY. About 100,000,000 for the year. Would '44 probably be as much as that, or do you think it would be less?

Mr. COX. I would not like to hazard a guess, but I would say it would be less unless there is some possible resumption.

Senator TAFT. May I ask what the Treasury figures are based on, for withdrawals?

Mr. COX. I will have to look them up.

Senator LUCAS. While he is getting those figures, may I ask this question: You estimate somewhere between 80,000,000 and 100,000,000 withdrawal under the present law?

Mr. COX. Yes, sir.

Senator LUCAS. Now, if this graduated tax should become part of the legislation, would it be the inclination of the distillers to get as much alcohol, as much liquor on the market as they possibly could in the coming year because of the increased taxes the following year after this year? In other words, you get, as I understand it, a $2 increase in taxes next year. Am I correct about that?

Mr. COX. No.

Senator LUCAS. What is the increase?

Mr. COX. No; there is only a flat increase——

Senator TAFT. He means the Overton amendment.

Mr. STAM. Under the bill that is a flat $2.

Senator BARKLEY. Under the Overton amendment the tax is jumped up from $9 to $16 over a period of 4 years—1948.

Now, what would that do to American liquors 6, 7, and 8 years old with the increased tax, as compared to foreign liquors, Canadian, Irish, and others that come in based on the $9 tax and import at $2, I believe that is correct.

Mr. COX. Import $2.50, Senator, on whisky over 4 years old.

Senator BARKLEY. $2.50 and also a $9 tax.

Mr. COX. Yes, sir.

Senator BARKLEY. So that it would have an advantage over American liquor of the same age, as a matter of fact.

Mr. COX. You would have Scotch whisky at 8 and 12 years of age coming in here for $2.50 duty plus $9 internal revenue tax, that is $11.50, against American whisky of the same age paying a $16 tax.

The CHAIRMAN. Yes; that is the point.

Senator LUCAS. Would not the Overton amendment force the whisky off of the market in the event of that tax?

Mr. COX. Not only do that but force the distillers out of business all at one time.

Senator LUCAS. I am serious about my question. In other words, as I look at the Overton amendment, the graduated tax, it would be to the advantage of the distillers to get rid of the whisky as quick as they could in view of the tax, and thereby clean the market completely, and in the course of a couple of years at the latest, we will find ourselves in the post-war period with no whisky whatsoever——

Mr. Cox. Competition with Scotch and Canadian whiskies.

Senator LUCAS. And Irish as distinguished from American.

Mr. Cox. That is absolutely correct.

Senator RADCLIFFE. According to the figures that have been presented here there has been a decrease of forty or fifty million gallons in the amount of whisky there has been withdrawn. How do you account for that?

Mr. Cox. Well, Senator, the decrease has been brought about by the self-rationing program which the distilling industry has put into effect. It has really undergone anywhere from 50 to 75 percent of the comparable period of the year before. Now, under normal times I don't think you would experience much shortage. Now, 1942 was a very heavy withdrawal year. What has happened now, the consumer has had wide notice, it has been advertised in the press, and discussed in Congress, that the liquor supply is dwindling and is going to disappear, so every man who used to buy a half a pint now wants at least 2 quarts, and the man who used to buy a pint thinks he is being cheated unless he can get a case.

Senator RADCLIFFE. Wouldn't that result in an increase rather than a decrease of this stock.

Mr. Cox. In consumption.

Senator RADCLIFFE. Well, in purchases.

Mr. Cox. There is no question about the fact that all the whisky is being withdrawn from bond and being sold, Senator.

The CHAIRMAN. Is that all from this witness; Senator Barkley?

Senator BARKLEY. That is all, I think, from Mr. Cox.

Senator DANAHER. Mr. Cox, do your figures include importations of whisky over the same 10-month periods?

Mr. Cox. No, Senator, they do not.

(A tabulation, submitted by Mr. Stam, at the conclusion of Mr. Cox's statement, is as follows:)

Distilled spirits statistics by month—From reports of the Alcohol Tax Unit of the Treasury Department

[Tax gallons]

	Whisky production		Tax-paid withdrawals of beverage spirits					
			Whisky			Total spirits [1]		
	1942	1943	1942	1943	Percent change	1942	1943	Percent change
January	13,068,553	0	6,513,936	7,113,846	+9.2	9,284,138	10,272,896	+10.6
February	11,455,814	0	6,412,312	6,137,625	−4.3	9,423,047	9,053,982	−3.9
March	10,515,406	0	7,492,745	6,648,924	−11.3	11,803,733	10,056,291	−11.0
April	8,444,933	0	6,631,041	5,773,971	−12.9	9,626,030	8,669,105	−10.0
May	6,909,518	0	5,848,447	4,725,304	−19.2	9,163,699	7,361,268	−19.7
June	6,336,482	0	5,323,905	4,778,586	−24.4	9,212,405	7,180,950	−22.1
July	7,041,896	0	8,574,963	4,638,725	−45.9	12,778,287	7,092,311	−44.5
August	6,743,775	0	10,140,281	4,755,733	−53.1	15,365,558	7,234,815	−52.9
September	6,944,703	0	10,070,208	4,879,296	−51.6	15,143,056	7,357,508	−52.1
October	1,796,928	0	11,425,433	5,338,224	−53.1	16,575,203	7,554,145	−54.4
10-month total	76,568,010	0	79,433,272	54,810,236	−31.0	117,874,166	81,733,291	−30.7

[1] Includes high-proof spirits produced at registered distilleries. Such spirits are not included in stocks. Does not include commercial alcohol.

Stock on hand

	Sept. 30, 1942	Sept. 30, 1943	Percent change	Oct. 31, 1942	Oct. 31, 1943	Percent change
Whisky	500,144,220	405,893,744	−18.8	487,550,265	399,023,881	−18.2
Rum	3,050,500	1,500,221	−50.8	2,959,127	1,505,683	−49.1
Gin	409,961	184,850	−54.9	416,807	180,851	−56.6
Brandy	17,544,375	11,451,646	−34.7	16,303,926	11,909,769	−27.0
Total	521,149,146	419,040,461	−19.6	507,230,125	412,620,184	−18.7

STATEMENT OF JOSEPH A. ENGLEHARD, REPRESENTING THE GLENMORE DISTILLING COMPANY, LOUISVILLE, KY.

Senator BARKLEY. I suggest, Mr. Englehard, you do not cover, if you can avoid it, any points covered by Mr. Cox.

Mr. ENGLEHARD. My statement will be very brief. I would like to correct one thing that came up just a minute ago in Mr. Cox's figure concerning the million-gallon figure that was being discussed. That figure, as I understand it, covers the tax statements on gin, rum and neutral spirits, and whisky and other products, and it is not a fair comparison to take that as compared with 117,000,000 gallons of whisky only remaining in bond. I believe the highest tax payment on whisky in any year was about 87,000,000 gallons. I believe that 117,000,000 includes gin, neutral spirits, and other products—I think that is correct.

The CHAIRMAN. How much whisky is there in the Scotch whisky sold here?

Mr. ENGLEHARD. The Treasury does not release import figures since the war started.

The CHAIRMAN. No; I mean the Scotch whisky that goes on the market here, how much of that is liquor and how much neutral spirits or something else?

Mr. ENGLEHARD. I don't feel qualified to answer anything on Scotch.

The CHAIRMAN. All right.

Mr. ENGLEHARD. On October 1, 1942, the distillation of beverage spirits was converted into the production of war alcohol. My own company voluntarily started production of war alcohol in February 1942, and thus we have made practically no whisky for almost 2 years.

From present indications it will be 1945 before beverage distillation is resumed. Whisky distilled in 1945 will not be 4 years old and marketable in 1949, thus present stocks will not last throughout the year 1948. We have allocated our bottling on this basis. This bottling quantity can be revised up or down at any time as it becomes apparent that the war is going to be of longer or shorter duration than we had figured on. If the distillation of beverage spirits is advanced or delayed past 1945 neither program would seriously be effected.

I may say there that the distilled-spirits industry has at no time ever requested any vacation to make whisky. We have placed our plants at the disposal of the Government voluntarily before they were taken over. We have never asked for a vacation and we do not propose to now. If the time comes that they do not need the alcohol we will be glad to make whisky, of course.

The flavor and boquet which are characteristic of American bourbon and rye whiskies is the result of slow chemical reaction which takes place in the barrel, although the time required is not the same to mature all whiskies. There are heavier bodied productions which is a characteristic of the whisky at the time it is distilled and the distiller knows the amount of time that is required for maturing it. The light-bodied whisky is normally distilled at a higher proof in a continuous still while the heavy bodied whisky is usually made in a still in a continuous column still which is operated in such a manner as to make a product of relatively low proof. The temperatures used throughout the process have a great effect on the character of the product. The various components which make up the grain bill have an effect on the character of the body of the whisky, and as a general rule the more small grain, rye, barley, malts, and so forth, in the mash, the heavier the body of the whisky.

From the above it can be seen that the distiller can control the character of the whisky that he is producing and can use a product which he knows in advance will require a definite time to mature. When the whisky comes off the still it contains various impurities which are known as congenerics. The amount and character of these congenerics which can be and are controlled in the process of distillation determine the time required to mature the whisky.

After distillation the whisky is put into charred oak barrels, and those barrels act as catalysts in the chemical reaction which slowly takes place and which changes the congeneric into esters and ethers which has formed and given the American type of whisky its characteristic taste and boquet. In the new whisky the congenerics impart to the product a raw unpalatable taste and unpleasant odor. As the congenerics gradually change into the esters the characteristics of mature taste and full boquet of whisky are brought about.

It would obviously be very unfair to require a distiller who has already made a whisky to mature in 6 to 8 years to market this whisky at 4 years before it was ready. As I recall only a few years ago one very large distiller put on the market a heavy-bodied whisky that was 4 years old, bottled in bond under a label that was well known and backed up by thousands of dollars in advertising. The whisky in question was too heavy to mature in 4 years, and after much of it had been returned to the distiller by dissatisfied customers the brand was withdrawn from the market and a famous old brand name was completely destroyed. The same whisky which was marketed as 4 years old is now being bottled as 7 years old under another label and has now reached a maturity that has resulted in a readily acceptable whisky that is being widely sold and well received. It would obviously have been unfair to the distiller and to the public to have forced this whisky bottled at 4 years on the public, or that the public should be allowed or required to purchase that quality of whisky.

Senator CONNALLY. Are you making the point now that from the distiller's standpoint he has built up his trade on these good whiskies properly aged, and that to force a sale now would react upon his record?

Mr. ENGLEHARD. To force him to sell a whisky which was made with a body that required over 4 years to properly mature would certainly be great discrimination against him.

Senator CONNALLY. And against the business he has built up?

Mr. ENGLEHARD. Certainly.

The CHAIRMAN. I take it then you think distillers have a vested interest in withholding his trade until 8 years have passed, war or no war, or what not?

Mr. ENGLEHARD. I don't see what is gained by flooding the market. Now, the result will in a few years be that we will be completely out of whisky, brand names that we have spent large amounts building up.

The CHAIRMAN. How do you know you are not going to be allowed to make some more whisky?

Mr. ENGLEHARD. I don't.

The CHAIRMAN. You are just assuming that you are not.

Mr. ENGLEHARD. My opening statement was, Senator, if we were permitted——

The CHAIRMAN. Yes; I understand that, you are still not talking about the 4-year-old period. Now, as I understand the whole point is as I get it, I suppose you have sold yourself to the 8-year period and you seem to think you have a sort of a vested interest in it, not withstanding the war and everybody being obliged to pay taxes——

Mr. ENGLEHARD. Senator, we don't want to be legislated out of business.

The CHAIRMAN. We don't want to legislate you out of business, we just looking for a little revenue.

Mr. ENGLEHARD. If we are to be competitive after the war with imported whiskies coming into our market at 8 and 12 years old, it is going to be necessary for the domestic distiller to have some matured whisky on hand. The effects of this proposed legislation are so great and will have such a revoluntionary effect on our industry, glass, cases, labels, are not available, and to finance the insurnace presents a tremendous problem, I may say, in a firm of our size, we had to borrow about $3,500,000, a little over that, to finance our accounts receivable and tax pay whisky in advance of the time we collect from our customers. Under the proposed new tax, if we carry out our scheduled bottling at the rate we are set up to do, we would have to borrow so much money there would be no alternative left but for us to sell out, we could not raise it any way in the world.

The CHAIRMAN. You would still have very good collateral; whisky is still good.

Mr. ENGLEHARD. It is hard to borrow $16 on $2 collateral, Senator. In fact, I found it was hard to borrow $3,500,000 that we needed before.

The CHAIRMAN. I grant you that.

Mr. ENGLEHARD. The price structure will be unbalanced and there will be a tremendous tax charge, on about 30 percent of the blended or aged whisky which takes a higher tax rate, and the floor-stock tax collection will be impossibly difficult. Imported liquors will not be taxed on the same basis as domestic.

The CHAIRMAN. You keep talking about these importations. How much are the English paying now on liquor?

Mr. ENGLEHARD. I understand in England there is a punitive tax on liquor. I don't know what it is, sir, I know it is very high.

The CHAIRMAN. I understand $16 to $18 a gallon.

Mr. ENGLEHARD. I don't know. I am not familiar with the English tax, but I think the English tax is probably punitive rather than a revenue tax.

The CHAIRMAN. It may be, but they still have got some whisky over there I hear. I have not been over.

Mr. ENGLEHARD. For the purpose of this bill, in order to get more revenue from whisky it is certainly an unfair tax differential between competitors. That is not the way to raise it. Now I had handed to me as I started up here today some figures which are based on the new O. P. A. distillers, processors, price regulation, which is a comparison of 73 months old bottled in bond prices, as established by the O. P. A. processors and distillers regulation, on an arbitrary price set up for 100-proof spirit blend containing 30 percent of whisky of the same 73 months' age and 70 percent neutral spirits and the present tax and proposed O. P. A. price schedule of 100-proof bottled in bond to the retailer at $4.91 a quart and the blended containing 30 percent of 73 months' old whisky estimated roughly at $3.58, or a difference of 73 cents, which is 20 percent differential. The straight whisky cost 20 percent more than spirit blend.

Now under the proposed Overton bill the net gain on the same price schedule of taxing the 100-proof bottled-in-bond 73-month-old whisky would be $7.57 a quart, and blend, containing 30 percent or more of whisky and the balance neutral spirits, would only make $5.36 or a difference of $2.21 in favor of the spirit blend, or a difference of 41 percent differential favoring blends as against 20 percent under the present tax structure. That would completely disrupt the industry.

Senator DANAHER. As it stands now the tax adheres only to the whisky withdrawn from bond and is bottled.

Mr. ENGLEHARD. Yes, sir. Not necessarily bottled but withdrawn from bond.

Senator DANAHER. Have you gentlemen given any thought to the question how we get the power to tax inventories of any commodity within a State? In other words, if we can tax whiskies in inventory why can't we tax stock of any goods within the State?

Mr. ENGLEHARD. I am not qualified to answer that.

Senator BARKLEY. There is a heavy State tax.

Mr. ENGLEHARD. There is a heavy State tax.

Senator DANAHER. That is all right, the State has the power to tax directly any commodity, any article of value in it, whether standing timber or any other thing. I am wondering how we get the power to reach into States and tax inventories.

The CHAIRMAN. We have had that for a long time, Senator.

Senator DANAHER. We do certainly on any commodity upon which an excise is levied that is withdrawn from bond.

The CHAIRMAN. They don't have to withdraw it, they can pay the tax and let it stay there for 8 years.

Mr. STAM. We are taxing the privilege of manufacturing the whisky, that is a matter of privilege, they don't have to pay the tax until it is withdrawn from bond. The theory is, I think, that we get the tax when it is withdrawn from bond. The tax we are determining is a gross one when the liquor came into existence. As a matter of privilege, the payment is deferred until it is withdrawn from bond.

Senator TAFT. May I ask whether the O. P. A. price ceiling has in effect any theory of withdrawing from bond.

Mr. ENGLEHARD. I don't think so; no, sir; our prices are exactly what they were in March of 1942.

Senator TAFT. I understand that is not the question. The question is whether the fact that those prices are held has led distillers to hold their whisky longer thinking in time those price ceilings will be off.

Mr. ENGLEHARD. I don't think so; no, sir. I think the whole idea of that—I think most distillers have a bottling program very similar to our own, until such time as the whisky may, after the war, become——

Senator LUCAS. You want to continue in business?

Mr. ENGLEHARD. That is right.

Senator TAFT. Have you any estimate as to how much the withdrawal will be in 1944?

Mr. ENGLEHARD. I think it will be substantially the same as it was in 1943, possibly up to 10 percent less would be my guess.

Senator TAFT. The estimate we are basing our tax on here seems to be 93,000,000 gallons without counting rum or brandy and imports.

Mr. ENGLEHARD. My guess would be that is a little bit on the high side.

Senator RADCLIFFE. Mr. Englehard, the Glenmore Distilleries have spent a large sum of money in advertising its products.

Mr. ENGLEHARD. Right; over many years.

Senator RADCLIFFE. Over many years, and you have always carried out the effect on the whisky you advertised.

Mr. ENGLEHARD. Yes, sir.

Senator RADCLIFFE. Yes. If you took out 4-year-old whisky in the same bond you would lose the effect of that trade-mark and the good will and the name of your brand, is that right?

Mr. ENGLEHARD. Yes, sir.

The CHAIRMAN. That is true of a good many products that have been made heretofore for the civilian trade and are not being made now. They are losing their trade-mark and brand.

Mr. ENGLEHARD. I believe there is a distinct difference between whisky and many other products.

The CHAIRMAN. I know that, I just want to point out——

Mr. ENGLEHARD. A company making washing machines may lose its trade-mark, but the very next day when the war is over, they are back making washing machines.

Senator BARKLEY. They have not made these things under Government regulations.

The CHAIRMAN. All right.

The British tax is 7 pounds 17 shilling 6 cents or in dollars, $39.32 a gallon. That is proof spirits, 51 percent Fahrenheit weight 12–13 qual volume of distilled water, containing 49.28 percent alcohol by weight, 57.1 by volume, and 60 percent Fahrenheit. I thought it was $16, it is different.

Mr. STAM. It is about $24, I think, on a comparable basis. The Imperial gallon is a little more.

The CHAIRMAN. That is, they are 5 full quarts.

Mr. ENGLEHARD. They have no State tax on top of that, and no production tax before it is made.

Senator BARKLEY. I understood you to say in this amendment, the Overton amendment, or the other suggestion which has not been reduced to the form of an amendment, requiring tax payment at the end of 4 years or any shorter period than you now have under the law, your company could not finance the payment of the tax.

Mr. ENGLEHARD. I don't think we possibly could.

Senator BARKLEY. Would not that contribute to the possibility of a few large companies buying up—these men have been able to buy now because a lot of others have been compelled to sell out, go out of business.

Mr. ENGLEHARD. It would not contribute to the possibility, Senator, it would force them out.

Senator BARKLEY. Yes.

The CHAIRMAN. Well, you got a pretty good concentration of the distilling business in the country, haven't you?

Mr. ENGLEHARD. Yes; but a few American independents we want to try to keep on.

The CHAIRMAN. I understand, but you have got that situation.

Mr. ENGLEHARD. But under the proposed tax they would be forced to sell.

The CHAIRMAN. Why would you be forced to sell?

Mr. ENGLEHARD. We could not raise the money to taxpay; take our business, we could not raise fifteen or twenty million dollars to taxpay the whisky to save our lives, and we are not a big company, we have no public financing, no bond issues, or anything of that kind, but we could not possibly undertake to finance a tax-payment program.

The CHAIRMAN. If this rate stays at $9, 6 months after the war is over, what is going to be your condition then?

Mr. ENGLEHARD. We will be out of business.

The CHAIRMAN. Out of business——

Mr. ENGLEHARD. Yes, sir.

The CHAIRMAN. If the rate stays at $9?

Mr. ENGLEHARD. And the whisky is not forced out.

The CHAIRMAN. Well, it will come out at 8 years anyhow.

Mr. ENGLEHARD. Our whisky schedule, over the time it is now scheduled, we can finance at $6 and—but if it has got to be taxpaid in the next 2 years, we could not finance it.

The CHAIRMAN. You only have to pay the tax when the whisky gets 4 years old.

Mr. ENGLEHARD. Our youngest whisky is almost 2 years old now.

The CHAIRMAN. You still have 2 years before you have to pay that, then it will be only 2 or 3 years old, after all, it cannot all be forced out at one time—I have no further questions.

STATEMENT OF FRANK SCHWENGEL, PRESIDENT, JOSEPH E. SEAGRAM & SONS, INC.

Mr. SCHWENGEL. I shall be very brief, Mr. Chairman. I have no written presentation, but I have made some notes back in the "amen corner" and I would like to emphasize certain points.

Senator BARKLEY. Will you state your name and connection for the record.

Mr. SCHWENGEL. Frank R. Schwengel, president of Joseph E. Seagram & Sons, Inc., the American company.

In the desire to raise income and get more whisky, I am afraid the author of the bill failed to consider its effect on quality and really, the essential survival of the industry.

After 10 years the American whiskies have about reached the zenith of quality. As a matter of fact we were just about to begin to establish the distilling industry as a producer of a quality item.

Now, at the very time when the liquor was coming along that established the American whiskies as a premier product to the world, we face a situation, merely for the purpose of squeezing out a little more whisky, we now face the situation whereby this bill would establish the 4-year aging period as the maximum. To us it has always been regarded as the minimum. That means that the American distillers would be placed at a tremendous disadvantage against the distiller of imported whisky who can run circles around us competitively with 8-, 10-, 12-, 13-, and 15-year-old whiskies.

Now, we are not ageing whiskies merely to sit on them. To us it represents a great loss. As a matter of fact, the cost of the whisky is not essential, it is the relation, the length, the evaporation that really places the value on whisky. Now, if it is the intention to squeeze out the only thing we have got in the business at this time, I mean the furnishing of these fine stocks, I fail to see when the American distilling industry is going to get back on its feet.

Now, it certainly has contributed notably in the war effort. It is asking for no relief and has been so contributing since October 1941 and totally so since 1942. Now the only thing we have got left after 10 years is a lot of 117,000,000 gallons of whisky.

Now, let us see what will happen. You are not going to get another bottle of it, neither am I, because the moment that whisky is made available, even at $16 per proof gallon, you are not going to get it, because of the opportunists. This situation always brings about new people, believe me. A question was asked today how long is that going to last. Let's see how long that lasts. That 117,000,000 gallons will last, except for the restraint under which we are put in our bottling operations by reason of the 65 percent allowance of bottles——

Senator LUCAS. Will the hijackers get any of it?

Mr. SCHWENGEL: Senator, I only need point to you a newspaper account which appeared in the papers less than 2 weeks ago, an account of $100,000 robbery of liquor from a truck in New York City, and that recently there was a report of the seizure of some 134 clandestine stills.

In other words, they can make out a good bottle of 8-year-old whisky, they can thin it down and make a case.

I wonder whether these gentlemen are not like the others, they can take $16 a gallon whisky and cut the essence out of it that we have laid aside for years, they will be better merchants than we are, by reason of the fact that they will stretch that whisky out to no end.

Senator BARKLEY. Generally, would those—the Overton bill I am speaking of primarily, would that be an advantage to the Seagram crowd that you represent in Canada?

Mr. SCHWENGEL. Frankly, yes. We are importers.

Senator BARKLEY. That is right, notwithstanding that, as I understand it, you are unalterably opposed——

Mr. SCHWENGEL. I am very definitely, because it is uneconomic. Further than that, it is confusing. You will never know, Senator, what you want to pay for the same line. Let us take that Old Fitzgerald mentioned here. They have 5-, 6-, and 7-year-old whisky, and the labels look the same. You have got to have a microscope to distinguish which is which. If you went into a store and bought a bottle of Old Fitzgerald, you would have—maybe it might be 5 years

old, it might be 6 years old, and again it might be 7 years old, and it would lead to such confusion that it would be impossible to keep their merchandise standard.

Senator BARKLEY. If the Overton bill is adopted, what will the Seagram Co. have to do, will it go out and borrow for the payment of its tax, or what will the Seagram have to do?

Mr. SCHWENGEL. I imagine—we are large operators, and I cannot just estimate the amount, but it would be terrific, but my guess is that we would not have the trouble, being a large company, and having borrowing facilities, we probably would not have trouble in borrowing the money, but the medium-sized distillers throughout the country, the question of insurance—we are fortunately able to build fireproof warehouses where the rate is very low. Others have not those facilities—now again I am trying to speak here in behalf of the industry, I am speaking of the industry, what would happen to the industry.

Senator BARKLEY. The point I was making is this: In other words, your concern is financially able to go out and borrow a sufficient amount of money to pay the taxes, and perhaps that is not true of the smaller industries.

Mr. SCHWENGEL. That is correct.

Senator BARKLEY. What would happen with the smaller industry if he could not borrow to pay the taxes? He will come to you people to sell——

Mr. SCHWENGEL. That is correct.

Senator BARKLEY. In other words, the big monopoly, as I see it, the whisky business will fall into the hands of a few big fellows, a thing that I hope will never happen in this country.

Mr. SCHWENGEL. That might very well be so. Certainly, this situation will augment that.

The CHAIRMAN. How many distilleries are there in the country now? Do you have any figures?

Mr. SCHWENGEL. I imagine there are about 120 registered distilleries.

Senator BARKLEY. Approximately 134, 88 of which are independents. That is my information. I got those figures from the Treasury.

The CHAIRMAN. Eighty-eight independents now.

Senator LUCAS. Let me ask you one question: Have you had any opportunity during the last 6 months or year to purchase any of these smaller industries in the country?

Mr. SCHWENGEL. Have I—has our company bought any smaller industries?

Senator LUCAS. Has your company bought any of the smaller industries.

Mr. SCHWENGEL. Yes, sir.

Senator LUCAS. How did it happen?

Mr. SCHWENGEL. They were offered to us. We didn't seek the purchase. In other words, they were offered to us apparently for reasons of their own.

Senator LUCAS. You think if the Overton amendment were passed that the sale of these smaller industries would increase?

Mr. SCHWENGEL. It might very easily, but beyond that, the whiskeys, when they are put out, I am afraid, would reach the hands of the opportunists, not the retailer, not the operator, so that in the

end, Senator, you would not get an extra bottle, neither would I, they would probably use it to send it out for a large number of bottles, that is one thing I fear.

Senator BARKLEY. Within your company, Seagram, you have an American company and a Canadian company.

Mr. SCHWENGEL. Yes, sir.

Senator BARKLEY. Now, this proposal, as I understand you, in reply to Senator Lucas, would be an advantage to the Canadian company and a great disadvantage to the American company?

Mr. SCHWENGEL. Correct, and we are competitive against our Canadian branch. There is no question but what it is discrimination.

Now, with respect to the British tax, I should like to tell you for your consideration that the British taxes are well known as punitive taxes, that 50 percent of the Scotch tax is not paid by the British, it is paid here, because the British are satisfied to drink ale and strong beers. That is a punitive tax, I do not think we have gotten to the point where we have got to punish a man who desires to buy a bottle of good whisky. That is the purpose of the tax and is very much higher than the present Canadian tax.

The CHAIRMAN. What is that in Canada?

Mr. SCHWENGEL. Well, I imagine it runs around $11 the imperial gallon, that is my recollection.

The CHAIRMAN. We have it here.

Mr. STAM. About $11.

The CHAIRMAN. About $11.

Mr. SCHWENGEL. Yes, sir.

Senator BARKLEY. What is the difference between an imperial gallon and an ordinary gallon?

Mr. SCHWENGEL. Thirty-three ounces, an imperial gallon. Now, there is one thing I would like to say and that is that most of us are now, we want to maintain the quality and standard, and our investment in brands for 6- and 7-year old whiskys. In other words, in the blending process, those of us in the blending business, it might still become an art of blending, because we believe blending starts where whisky-making ends, and under this condition we will have none of the finer whiskys with which to finish up the products with the uniformity and with the taste which we have made, and which we can expect of American whiskys.

The CHAIRMAN. All right. And who will you call next?

Senator BARKLEY. Mr. Benenman.

STATEMENT OF GEORGE BENENMAN, ATTORNEY, SCHENLEY DISTILLING CO., WASHINGTON, D. C.

Senator BARKLEY. Mr. Benenman, will you give your name to the reporter for the record?

Mr. BENENMAN. My name is George Benenman.

Senator BARKELY. I understand you represent Schenley.

Mr. BENENMAN. Yes.

Senator BARKLEY. What position do you hold?

Mr. BENENMAN. I am attorney for Schenley here in Washington. I am pinchhitting for the chairman of the board who is at the bedside of a critically ill wife in California, and for the president who is burying his mother in Alabama today. I will try not to cover the field that has been covered.

I have been connected with this industry for a long time, some thirty-odd years. If you gentlemen have any questions about the field that has been covered, I may be able to answer, I will be glad to do it, but unless you have, I will confine my discussion to this proposed graduated tax rate in the Overton amendment. As Mr. Stam pointed out, the tax is an excise tax on the privilege of production, a tax that attaches to the spirits as they come into existence. By putting up a bond to guarantee the payment of the tax and depositing the spirits in a warehouse to which the Government official carries the key, you can defer payment until you withdraw the spirits for sale. Otherwise, for the first time on that kind of a tax the whisky that is lost by evaporation during the period of storage is abated down to the normal evaporation in the evaporation figure that Congress has fixed by statute as the normal evaporation. You pay the tax, whether the whisky is there or not, and there are very frequently cases where the whisky is paid on more than there is whisky in the barrel, and there are debates in Congress and the reports of the committees are full of discussion as to whether it is sound or unsound tax to be levied in the barrel from normal evaporation, and Congress many years ago decided that was not the proper thing to tax.

Now, this proposal that Senator Overton has introduced which will graduate the tax based on age seems to me not only to be entirely unfair and of questionable legality. I think it is probably true, but frankly I have not had a chance to run down the cases or make a study of the legal question, but I think it is true that Congress can impose a retroactive excise tax on the privilege of producing whisky though I doubt very much if Congress can set a new rule for the classification of the taxable operation retroactively after the product has been produced.

Here is a group of men that went into business to make whisky knowing that they had to pay a tax for that based on the number of gallons that they ultimately produced, but yet with the statutory provision that all of them competing would pay the same tax on each gallon that they sold. They made whisky of different types requiring different age periods, and incidentally, whisky does not always sell at a price proportionate to the age. There are many 6- and 7- and 8-year-old whiskies on the market that sell for lower prices than some 4-year-old whiskies on the market. Now, to say to these men retroactively your excise tax on production has been reclassified, instead of being two types but because you produce a quantity or type of whisky that takes you longer to mature, your excise tax on production is going to be increased, your competitive position is going to be changed entirely, seems to me to be not only unfair but I think of very doubtful constitutionality.

I think it would be interesting for you gentlemen to know this, it is physically impossible to bottle whisky on its birthday, that is, due to the manpower situation, and it is due to the way stocks are made. After all, a man makes a whisky to sell 4 years hence or 5 years hence or 6 years hence and he knows as to what his volume is going to be at that time, and he may make 3-year-old whisky the same way and in fact, 4½ or 5 years old. Under the law you can insist that he shall not sell it for older whisky that it is, but you can sell the older whisky at the younger age. I doubt if very much of the bottled-in-bond whisky, which has to be bottled the same day

it is tax paid, is sold as 4-year-old whisky that is in fact only 4 years old, it is at least a few days over 4 years old, and in many instances will be 4½ or 5 years old, so that if this graduated tax were to be passed, the same brand of whisky sold under exactly the same age, some of it would be one age and some of it would be another age, and you can well see what they would do to the industry, so all I have got to say is that this graduated tax is in my opinion of very doubtful constitutionality and certainly is unfair as any I have seen submitted to Congress in many a year.

The CHAIRMAN. You do not think there is any constitutional difficulty in a tax on production?

Mr. BENENMAN. No, sir; I think there is a great deal—a grave constitutional question in this proposed new graduation.

The CHAIRMAN. That seems to be based on the period it is kept. We are fixing to base it on how long it has been made.

Mr. BENENMAN. And is a complete reversion of the theory——

The CHAIRMAN. Yes; I understand that.

STATEMENT OF A. REUTHINGER, REPRESENTING CERTAIN INSURANCE INTERESTS

Senator BARKLEY. I understand that you are here to speak for the insurance interests?

Mr. REUTHINGER. We insure, either directly or through brokerage accounts, approximately 80 percent of the whisky stored in the State of Kentucky, which is about half of the whisky in America. I have been in this business for a period of 32 years, and I only came here to speak on one question, and that is the availability of insurance in case this tax is imposed or has to be paid prior to the withdrawal of the whisky.

The whisky will have to be put in free warehouses, and we will have to pick up on each barrel of whisky $360 of value, that is at $9 a gallon or, on a 40-gallon average, it would mean that on the average of 30,000 barrels—we are having difficulty now in getting as much as $3,000,000 of insurance, and that used to be on the old-time market—we would have to pick up and furnish as collateral to the bankers to use for a loan of that money to the distillers.

Senator George said whisky was good collateral. Whisky is only good collateral because it is highly inflammable material when accompanied by a fire-insurance policy.

Now, in the normal warehouse, 30,000 barrels, we would have to insure that whisky for $11,000,000, and there is not that insurance obtainable in the world market. The insurance companies that we have, less than 400 available that are operating now, they grade their commitments from $2,500 up on the exposed warehouses, which are close to other warehouses, or the unprotected warehouses, such as country distillers, their lines are very moderate. The average that we can get at the present moment is about $3,000,000 worth of insurance. There was a representative here from Seagram. Taking in Kentucky, the Seagram houses have 58,000 barrels. Even in the fireproof houses that they have we would have to provide $26,000,000 of coverage per house and it absolutely is not available at any price, so that that would force—the result of this tax would be to force every distiller out of business for the reason that he could not raise the money, due to insufficient collateral.

The CHAIRMAN. How do you mean, I do not understand what you mean, they say there is about 300,000,000 gallons in storage.

Mr. REUTHINGER. That is right, sir.

The CHAIRMAN. That is all insured.

Mr. REUTHINGER. Yes, sir; for $100 per barrel on the average.

The CHAIRMAN. That insurance when the $9 tax goes on——

Mr. REUTHINGER. When this tax goes on, they will have to add $360 a barrel of insurance, and that is absolutely——

The CHAIRMAN. You mean that has to take it out.

Mr. REUTHINGER. No, sir; the minute the tax is paid because that whisky will enhance immediately by the amount of the tax.

The CHAIRMAN. That tax is being paid—I have no doubt who is going to pay the tax, the consumer is going to pay the tax.

Mr. REUTHINGER. Eventually.

The CHAIRMAN. It won't be there eventually, it will be paid with this proposal——

Mr. REUTHINGER. In the meantime the tax has been paid by the distiller, and if the distiller has to carry the insurance he must borrow the money.

The CHAIRMAN. That is not going to take you very long, to sell this whisky, if you haven't got very much.

Senator BARKLEY. The more insurance placed upon the value of the whisky in bond before the tax is paid——

Mr. REUTHINGER. Yes, sir.

Senator BARKLEY. So that when the tax is paid the marketable value of the whisky insurance has to go up accordingly.

Mr. REUTHINGER. That is correct. Right now the Federal tax unpaid is not insured. Now, the minute the whisky tax is paid—of course, we do insure some tax-paid whisky because there is always some whisky in the free house ready for sale, we have to pick up the additional value created by the tax which has been paid.

The CHAIRMAN. Well, I think that is an assumption. If, for instance, we require the payment of tax for distilled whisky after it has been in bond 4 years, you just assume that the whisky on which you paid the tax would still have to be insured by the distiller.

Mr. REUTHINGER. Well, the distiller is your tax collector.

The CHAIRMAN. Well——

Mr. REUTHINGER. He has to carry that whisky until he can dispose of it, he has a highly inflammable liquid, it is a fuel, and without insurance, even if it would be one night, he would face ruination unless covered by insurance.

The CHAIRMAN. He would not take it all out in 1 day, he would take several days to take it out.

Mr. REUTHINGER. Well, in the meantime he would have to insure it.

The CHAIRMAN. It is just like cotton, everybody whoever bought any cotton takes out insurance on it, and one bale is sold and the insurance is canceled and another bale comes in and they cover that, there is nothing like the volume of insurance you are speaking of.

Mr. REUTHINGER. Well, Senator, it is not like the insurance of cotton. Cotton is slow burning, like tobacco.

The CHAIRMAN. I know, but it is still true.

Senator BARKLEY. Cotton does not go up overnight because the Government collects a tax on it, because there is no such tax.

Mr. REUTHINGER. A moderate rate of tax is paid.

The CHAIRMAN. You mean the Government would carry this whisky after paying the tax——

Mr. REUTHINGER. They have to insure it.

The CHAIRMAN. How long?

Mr. REUTHINGER. They have to borrow the money to pay the taxes.

The CHAIRMAN. Yes.

Mr. REUTHINGER. All right, in presenting collateral to the bank they have to present warehouse receipts which call for the whisky and these warehouse receipts with an insurance policy is good collateral. I mean, it would be impossible to sell the warehouse receipt unprotected by insurance.

The CHAIRMAN. How long are you going to carry that insurance?

Mr. REUTHINGER. I don't know.

The CHAIRMAN. It would not take any time to get rid of the whisky.

Senator BARKLEY. That would depend upon whether you can get the bottles and cartons. In a normal market you certainly would have to carry the whisky at the increased rate of value and insurance until it was bottled and put on the market.

Mr. REUTHINGER. Senator, the point I am bringing out is this, that before the distiller can get his hands on this money to pay that tax he has got to furnish the banker with a warehouse receipt and insurance policy and that insurance policy at these values will not be available to us because the market does not exist in the world today.

Senator BARKLEY. To sell, he must pay the tax.

Mr. REUTHINGER. Yes, sir.

Senator BARKLEY. The whole tax, and in order to get the insurance for the value of the liquor which includes the tax after the tax is paid——

Mr. REUTHINGER. That is entirely correct.

The CHAIRMAN. And you are liable for that tax unless you contemplate this tax is going down.

Mr. REUTHINGER. Taxes are not insured under our policy, but the minute you pay it, it has to be insured.

The CHAIRMAN. The consumer pays the tax.

Mr. REUTHINGER. Eventually, yes, sir; in the meantime the distiller has to present collateral.

The CHAIRMAN. You are speaking on the theory that continuous insurance would have to be maintained on this immense volume.

Mr. REUTHINGER. No, sir; I am speaking on the theory that before he can get the money to pay this tax he has to present to his banking connection two things, a warehouse receipt and an insurance policy.

The CHAIRMAN. I understand that, but he would not have to do it all in 1 day.

Mr. REUTHINGER. Beg your pardon?

The CHAIRMAN. He would not have to do it in 1 day and not in 1 month.

Mr. REUTHINGER. If the tax is ordered to be paid when the whisky attains the age of 4 years it has to be insured on the same day.

The CHAIRMAN. It has all got to be 4 years old in the first place.

Mr. REUTHINGER. No.

The CHAIRMAN. Certainly not.

Mr. REUTHINGER. But you cannot have intermingled whisky. Senator, everyone knows that. You cannot take whisky in bond and whisky free and keep them in the same house, you have to have a bonded house and a free house, so when you move it into your free house, doing that is tax-paid whisky.

The CHAIRMAN. You mean when the tax is due, and now under the present law it is due at 8 years, you can move it into your free house and carry insurance?

Mr. REUTHINGER. Yes, sir.

The CHAIRMAN. But you would not move it all in there at one time.

Mr. REUTHINGER. You would have to—you would move all the 4-year-old whisky in at one time.

The CHAIRMAN. You would move the 8-year-old whisky, if you kept it 8 years, you would move it there.

Mr. REUTHINGER. That is right.

Senator BARKLEY. If you are required to pay this tax at 4 years and they do not have the facilities to bottle it and market it, through which the distiller has got to get his tax back from the public, then he is bound to carry insurance policy on the increased value.

Mr. REUTHINGER. Yes; and he cannot buy it, we do not have any available insurance market today.

The CHAIRMAN. No insurance can be procured.

Mr. REUTHINGER. The insurance companies operating in the world today could not take care of that. I say that advisedly, after 30 years' experience.

Senator BARKLEY. That is due primarily because the liquor is extra hazardous.

Mr. REUTHINGER. Because, even though it is enclosed in fireproof warehouses, the fireproof warehouse only excludes loss coming from the outside, and the contents of the house is where the hazard is.

The CHAIRMAN. But you assume it is going to be kept right along, that when the tax is paid the consumer is going to start paying you right back, and that will reduce the tax and your insurance by the same process.

Mr. REUTHINGER. Senator, how are they going to pay the tax unless they can get the money?

The CHAIRMAN. They have got to get the money to pay the tax.

Mr. REUTHINGER. And to get the money they have to present collateral to get it.

The CHAIRMAN. I understand that, they have to get the money. However, it is just a continuous process from selling the liquor he reduces the insurance on the liquor and puts the money in his pocket to pay the tax.

Mr. REUTHINGER. Yes; but he has to get the money from the bank in the first place; unless he presents proper collateral no banker would loan him the money. You would not if you were in the banking business, you would not loan the man the money on whisky warehouse receipts without a fire-insurance policy with it.

The CHAIRMAN. You would have the same problem if you kept it there 8 years, and I assume you have some whisky that soon will be 8 years old, and you have to pay the tax.

Mr. REUTHINGER. There are a few barrels of whisky 8 years old.

The CHAIRMAN. You got identically the same problem, varying only in degree. The minute you pay the tax you can sell that liquor.

Mr. REUTHINGER. The variation in degree is not the whole story.

If we could keep our values down to $100 a barrel we would have no trouble insuring it, if we could gradually withdraw the whisky we would have no trouble to take care of it by insurance, and the proposition of degree would solve itself.

The CHAIRMAN. They don't need to get the insurance 1 day or 1 minute——

Mr. REUTHINGER. So as to be moved from the house.

The CHAIRMAN. At 4 years old?

Mr. REUTHINGER. Yes, sir.

The CHAIRMAN. But they don't all go there exactly the same day or the same month, even the 4-year-old whisky, it does not all become 4 years old on the 10th of March, it will become 4 years old over a given time throughout the period.

Mr. REUTHINGER. All right, sir, if a distillery has 40,000 barrels of whisky——

The CHAIRMAN. And before getting any insurance on that you would have sold that as you took it out.

Mr. REUTHINGER. No; if he has 40,000 barrels of whisky that matures today, say, or 10,000 barrels of whisky that matures——

The CHAIRMAN. He could not get insurance on that amount?

Mr. REUTHINGER. No, sir.

The CHAIRMAN. He could not get insurance?

Mr. REUTHINGER. No, sir; because we immediately would have to provide for 10,000 barrels at $360 a barrel, $3,600,000 in one house based on the value of the whisky itself, which is a million dollars, $4,600,000 and the ordinary house that would hold only 10,000, of ordinary construction, nobody would take it.

Senator RADCLIFFE. That maximum amount of insurance which you think was possible, I am assuming that is not any surmise on your part, but represents the well-considered opinion of people in the insurance business.

Mr. REUTHINGER. It is not only the well-considered opinion, it is actual experience over 30 years. For instance, on that illustration which I gave in my statement when I said the average warehouse of 30,000 barrels, the Schenley people in Louisville, in the Bernheim Distillery, they have a house that holds 80,000 barrels. Now, in that house that holds 80,000 barrels, if that whisky is taxed we would have to provide $40,000,000 of insurance on that house. It is not available. There is not an insurance company in the market to take care of it.

The CHAIRMAN. You are assuming the total volume of insurance is going to go on the minute you start paying the tax——

Mr. REUTHINGER. No, sir.

The CHAIRMAN. And when anything else is sold, by the time you take out the remaining quantity——

Mr. REUTHINGER. If you will pardon me, sir, I am not assuming that, I am assuming this, that there is a pick-up that has to be taken care of.

The CHAIRMAN. Yes, I know. You are talking about the pick-up.

Mr. REUTHINGER. Yes, sir.

The CHAIRMAN. I am thinking your consumers will be reducing your liability just about as fast as you incur it.

Mr. REUTHINGER. Well, we have to reduce our liability down to the capacity we can carry it, and we cannot provide for picking this merchandise that will protect it. The market is not there.

The CHAIRMAN. The market is not there?

Mr. REUTHINGER. No, sir.

Senator RADCLIFFE. When you speak of maximum insurance, you are speaking of that as strictly a preferred business.

Mr. REUTHINGER. There is nothing in the moral hazard.

Senator RADCLIFFE. I assume if because of physical conditions which probably cannot be changed, some of these warehouses are not very desirable from the standpoint of insurance and you would want to make sure about that.

Mr. REUTHINGER. That is true.

Senator RADCLIFFE. In other words, you are assuming 4½ million would be the maximum for a strictly first-class business.

Mr. REUTHINGER. Some houses you could not write half a million.

Senator RADCLIFFE. You could not write any considerable amount at all.

Mr. REUTHINGER. That is right, if you got a house that was out of true, where the bricks are cracked, or anything like that, we could not insure the whisky at any price.

Senator RADCLIFFE. That would reduce very materially your maximum you can sell for 4½ million.

Mr. REUTHINGER. That is correct.

The CHAIRMAN. I have no further questions.

Senator BARKLEY. I have no further questions.

STATEMENT OF ARTHUR W. WILLIAMS, SECRETARY-TREASURER, THE WHISKY BROKERS OF AMERICA, LOWELL, KY.

Senator BARKLEY. Will you state your name for the record?

Mr. WILLIAMS. Arthur W. Williams, Lowell, Ky., secretary-treasurer of the Whisky Brokers of America. I am president of the Kentucky Distillers Exchange, a whisky brokerage office that has been 33 years in the whisky business. Most of my business has been with the smaller or independent distillers. The independent distillers, as you gentlemen know, all the distillers have to put up all their property in bonded Government warehouses and the Government has a first lien on that property. In addition to that, they must carry a surety bond. The independent distillers have always been under financed, and a great many of them have had to sell out in the last few years; they didn't make enough money to continue operations, and if this new bill becomes effective, I don't believe there will be any more than a half a dozen independents or a dozen at the most in existence within the period of 1 year.

The brokers naturally depend on the smaller distillers. Our business is almost entirely with the smaller distillery because the larger distillers do not need sales outlets that we brokers afford. In the event that this new tax becomes operative that would force the whisky out of bond and at the end of 4 years the independent distiller who has got his credit stretched would probably have his bank loans called, and there have already been threats that the bank loans would be called, in view of the insurance problem which we could not meet.

Senator MILLIKIN. Would the threat to call the loans force the stuff out prior to the time it would be 4 years old?

Mr. WILLIAMS. The independent distiller is not only responsible for the whisky he owns himself and the whisky he sold or which he has stored but the Government really looks to the distillery warehouseman for that tax money.

Senator MILLIKIN. The bank would not.

Mr. WILLIAMS. They might not feel----

Senator MILLIKIN. Give an additional grant, I know that, perhaps the existing loan that they had there is not as desirable as a bank might wish, does that not exert pressure to push the stuff out even before it is 4 years old?

Mr. WILLIAMS. It would except for the fact that they cannot get the glass and containers to bottle it.

Senator MILLIKIN. What has he got now?

Mr. WILLIAMS. He has probably got about 65 percent of his normal supply. What is he going to do with the other 35 percent? He is going to be forced to carry it, he is going to be forced to pay the tax, he cannot borrow against the distillery plant because the Government has got first lien on it and his bank credit is stretched, there has been quite a number of distilleries sold out in the last 2 or 3 years, small distilleries, which could not make the money, and their storage account has gone down decidedly because they are not making any more whisky, from the bottler's operation it has dropped about 35 percent, so their income is shattered.

Senator MILLIKIN. I am afraid I diverted you.

Mr. WILLIAMS. I remember back a good many years ago, old Billy Patterson of Lowell, he was pressed for ready cash, he could not raise the money to pay the tax, and at the end of 8 years he was forced to ship a considerable quantity of 8-year old whisky for export to Hamburg, Germany. That whisky remained there 4 years in the hopes that the market would improve.

Senator MILLIKIN. When was that?

Mr. WILLIAMS. Back before the World War, Billy Patterson was a small distiller, and he was always hard-up for cash.

Senator MILLIKIN. Do you mean this present World War?

Mr. WILLIAMS. No, the last; but those things do happen. There have been a number of cases where distilleries have been forced to ship whisky for export so as to escape the payment of taxes at the moment.

Another problem would be this increase in taxes—we know the bootleggers thrive, even on the $4 tax and the old war tax of $6.40. Today, they are having difficulty in getting sugar, which prevents the bootleggers from being very active, but there has been a very marked increase in sugar thefts from wholesale houses, that is about the only place a bootlegger can get sugar today; he has to go to the penitentiary if he is caught distilling liquor, so he says, "What is the difference, I might as well get me a little sugar."

There has been one theft lately of 1,500 pounds and another theft of 2,000 pounds of sugar. We have our increased cost. The taxes are getting so high that the bootlegger is in heaven and the illicit distiller.

There is one distiller in Kentucky which I sold, and when they first made whisky they made a very heavy-bodied type whisky on what was known as a small-type sugar-mash process. The whisky owner

could not carry it 6 or 7 years. They realized it would not become mature before that time, and before that time had arrived they were all burned out, and in fact, before 4 years he could not sell his whisky.

Senator MILLIKIN. Are there many of these what you might call small distilleries that still carry any 7-, 8-, or 10-year-old whisky?

Mr. WILLIAMS. There is quite a number of them. They have been interested in selling nothing but bonds and premier whisky, 5 or 6 years old and over. There is one concern in Chicago, I understand, put out no whisky under 6 years old. On some of these heavy-bodied whiskies the small distiller, not having the volume, he must depend on knowledge and making a better product. The big distiller producing 100 barrels of whisky a day, he has got the volume that would justify advertising, sales promotion, but the small distillers making 20 barrels a day, his return does not justify any large outlay of advertising and sales promotion, he cannot do it. The only thing he can hope to accomplish is a quality product. That is the man that is going to be put out of business.

Senator RADCLIFFE. You heard the arguments on this proposal which have been presented by the preceding witnesses.

Mr. WILLIAMS. Yes, sir.

Senator RADCLIFFE. Do you endorse fully everything they said, or would you modify in any particular what has been offered or the suggestions made?

Mr. WILLIAMS. There are some points that have been made, I am not familiar with. Anyway, I am not familiar with the operations of the larger distillery companies, their financial arrangements. I do realize that the insurance problem is one that there is no way in the world that they can be coped with.

Senator RADCLIFFE. I have had some wide contact with the insurance business and I realize that it is inclined to offer the maximum amount of insurance possible in an industry.

Mr. WILLIAMS. I can state one case of a large warehouse building in Lowell back before the World War, with a capacity of either 150,000 or 160,000 barrels. After they got the warehouse built they discovered that they could not fill that warehouse and insure the contents because they overrun the insurance in the world. All of them in the world could not take that much insurance in one location under one roof.

The CHAIRMAN. That is very true in the case of a great many valuable products that are produced in the United States. There are not enough insurance companies to cope with that proposition and carry it continuously, but it is not a continuous proposition, the liability of the insurance begins to go out as fast as it is sold. Now, if you do not have an abnormal situation in the United States, and abnormal from the standpoint of the money that is flowing freely and the demand that exists for whisky, you would have a different proposition.

Mr. WILLIAMS. Senator, taking a blend house, for instance, making a good blend, you need whisky. You have got to have a base of 7- or 8-year-old whisky, and you have got to have some 5 or 6.

The CHAIRMAN. Yes; I grant you that.

Mr. WILLIAMS. Before you—before that whisky has passed the 4-year maturity it is not good for blending purposes. Before you

can blend straight whisky you have to have an older whisky that you have to give body to your product.

The CHAIRMAN. I grant you that. Yet the Bureau of Official Statistics shows that more than 70 percent of your whisky now goes out at 4 years old. That is bottled in bond. Only 30 percent of it goes beyond the 4-year period. I grant you, however, that you are handicapped somewhat in maintaining certain brands and making certain blends, because you have got to have certain aged liquor.

Mr. WILLIAMS. There is a little distillery down in Bardstown. It has one brand that has been continuously undersold since they started business.

The CHAIRMAN. I don't question that at all, but I don't see how anybody ever gets a vested interest in the date to which the tax on liquor is diverted. The tax is really due when you make it, but that has always been the theory upon which it is imposed, in order to help the industry and in order to make it possible for the industry to develop, why, the tax is diverted until the various periods starting off with 1 and going up to 8.

Mr. WILLIAMS. Under these proposed bills I don't think the independent distillers, a good many of the small ones, will make a barrel of whisky.

Senator BARKLEY. As a matter of fact the Government has not diverted the payment of the tax as a charitable proposition. To accommodate the distiller, the Government has always recognized the distiller could not pay the tax without selling the goods, and in order to get the tax, the law provided for it to be diverted until the commodity could be moved to the market, because the Government has recognized that the distiller cannot pay large taxes to the Government until he is ready to put it on the market, even though he has to carry what he has paid in the tax for months and maybe sometimes for years before he gets it back.

The CHAIRMAN. That is true under normal conditions where it takes several years to get your crop of stock moved on the way out. I can see very well how maybe a 4-year period is possibly too short. I don't see how it would, except it will interfere with certain types of business. I know very few civilian enterprises that have not been affected by war conditions, and sometimes put out of business.

Mr. WILLIAMS. Senator, what other industries does a man have to figure his crops and make it just like you grow a crop and a man figures 4 years in advance when he is going to use it? No other industry that I know of.

The CHAIRMAN. If you will have a period of 4 years in which you will have low stock and terrific demand, I don't see that there is any tremendous problem. Of course, I know the distillers are assuming, but I don't assume it at all, that you are not going to be permitted to make any more whisky. I know you are.

Mr. WILLIAMS. Well, the W. P. B. rather seriously indicates that you are not.

The CHAIRMAN. Yes, but you will.

Mr. WILLIAMS. Thank you.

STATEMENT OF JULIAN VAN WINKLE, PRESIDENT OF STITZEL-WELLER DISTILLERY OF SHIVELY, KY.

Mr. VAN WINKLE. I put a brief in here last week that I suppose you have all read.

Senator BARKLEY. Mr. Van Winkle, will you give your name to the reporter?

Mr. VAN WINKLE. President of Stitzel-Weller Distillery of Shively, Ky.

Senator BARKLEY. You make that Old Fitzgerald?

Mr. VAN WINKLE. Yes, sir; I wish to say to begin with I think I heard you speak of no vested rights. Senator, I was under the impression, when I built that distillery 8 years ago, and our second distillery, we sold one and bought another, that we did have a vested right to keep that whisky in bond for 8 years, else I would never have built the distillery.

The CHAIRMAN. You might not have built that distillery, but you could not consider you had a vested right.

Mr. VAN WINKLE. I don't know what kind of a vested right that means; we had that experience with 8 years in bond.

The CHAIRMAN. Yes, I know that.

Mr. VAN WINKLE. I thought we had the right to expect that in the whisky we made, and we would have the right to keep it there for 8 years, and therefore, we built a distillery to mash a large number of barrels of grain, 1,500 barrels of grain a day and a warehouse to take care of 1,500 barrels a day, and bottlers and bottle men and an organization when and as it matured, 4, 5, 6, and 7 years.

Now, if I had thought that we would have had to take up that whisky at the end of 4 years we would not have built that distillery, or we certainly would not have built one as large as we did or as large a warehouse. Why, because we knew we could not force that much whisky out of bond in 4 years.

Now, we sell our whisky when and as made. We are independent distillers, without any public financing, we sell this whisky in bond and in bulk, represented by warehouse receipts to wholesale liquor dealers, and rectifiers, and we explained to them that they must keep this whisky 4 years. It does not mature until it is 4 years old. Therefore, you have got to have 4 years' whisky. If you buy 100 barrels a month, you will have 4,800 barrels of whisky at the end of 4 years before you can start selling it off. Now they have got it.

The CHAIRMAN. That is your trade arrangement?

Mr. VAN WINKLE. That is our trade arrangement, that is something we have told them to do, that is something that they have to do in order to have matured whisky.

The CHAIRMAN. Well——

Mr. VAN WINKLE. Now, if these people, had to go on the assumption that they had to tax pay that whisky when it is 4 years old from day to day, why, their program is not complete, and some of those people have got whisky in there 6 and 7 and approaching 8 years old right now. Now to force that whisky over 4 years old out of bond overnight, they could not pay those taxes, neither could we. We could not pay those taxes, we could not raise that money, we could not borrow the money, we could not even think of borrowing it, and even if the whisky was forced out of bond, some say it would only last a few days. Even if we had all the bottles in the world we could

not bottle it as fast as it came out of there. We would have to keep that whisky in the warehouse until the time came when we could bottle it, physically bottle it.

Now, there seems to be some misunderstanding here that you could keep whisky in a warehouse. You could not keep tax-paid whisky in a free warehouse, it has got to be moved out of there. Where are you going to move it? We have got to take care of it, and if it was only to be left out there 1 month, that whisky has got to be covered with insurance. We could not sleep at night if we did not have insurance on it.

Four thousand barrels of whisky—5,000 barrels of whisky would be enough to wreck anybody of the character of firms we represent.

Now, again, if we are going to have a 4-year-bond period I would not have nerve enough for myself or for my customers to go out and say, "Now you buy 4-year whisky, buy whisky today that you cannot use for 4 years, to begin with, and if it is bottled it has got to come out of there at the end of 4 years."

Now, maybe that man has not got the money at the end of 4 years. That would make a free warehouse distillery of this bonded warehouse the day we started to make whisky, the Government owns the distillery and owns the bonded warehouse, and we have given a surety bond to pay the tax.

Senator BARKLEY. You say the Government owns it. You don't mean the Government owns——

Mr. VAN WINKLE. The Government has got a deed to it.

Senator BARKLEY. You built it.

Mr. VAN WINKLE. Absolutely, but you give the Government a deed, Senator, before you start that distillery they get the deed and in addition to that you have got to furnish them with a surety bond that you are going to pay these taxes. Now, let us say the man who owns this whisky cannot furnish the taxes. I have given a surety for it as a distiller. Suppose I cannot furnish that, then the insurance company has got to furnish it. Suppose this insurance company cannot furnish it, and suppose you cannot get a surety bond, then the Government is in the whisky business. They own it. They will have to take it and we are broke.

Now, we have talked here about allowance for taxes. That is merely something that has been in effect for over half a century. It is true we pay the tax on what is left in the barrel. You are allowed a certain outage, but suppose it exceeds this outage, Senator, suppose that barrel is empty, you pay the tax on every gallon that you are supposed to have in it. If you are supposed to lose 11 gallons of whisky and you lose the whole barrel of whisky, you got to pay a tax on that barrel with the exception of 11 gallons, regardless.

The CHAIRMAN. Of course, you have to take that risk when you renew the tax on it the day it went in there.

Mr. VAN WINKLE. Oh, yes, Senator.

The CHAIRMAN. The sliding scale before evaporation.

Mr. VAN WINKLE. Look at the burden you put on that. Let us take over the other amendment, you are going to run this tax up from $9 normal tax up to $16 and you pay a tax on a barrel of whisky that is not there at $16 a gallon, at the present tax, of $9 a gallon we might stand it, but when you get $16 now in there behind it you have to gage the tax-paid whisky before you tax-pay 1 barrel or 80 barrels. The gager will tax-pay that barrel. Then suppose, on the old allow-

ance, we will say of 39 gallons; now the gager gages that barrel at 39 gallons. We expect to get 13 cases out of every barrel and when you gage it out, when you bottle it, you may not get over 12½. That frequently happens.

The CHAIRMAN. Sometimes you get more out.

Mr. VAN WINKLE. And you pay a tax on the additional.

The CHAIRMAN. Yes.

Mr. VAN WINKLE. Absolutely, but if you don't get it you lose it.

The CHAIRMAN. You mean you pay the tax and you are allowed 11 gallons at 4 years old.

Mr. VAN WINKLE. Let us say a barrel is based on an outage allowance of—39 gallons.

Senator BARKLEY. In other words, it held that when you put it in?

Mr. VAN WINKLE. It held 48 gallons, now down to 39.

The CHAIRMAN. When have you paid on that barrel, when you took it out?

Mr. VAN WINKLE. No, sir; that barrel is supposed to produce 13 cases, 39 gallons, 13 cases of quarts. If it does not produce but 12 cases at the end of the bottling line you are just out 3 gallons of whisky.

The CHAIRMAN. Yes.

Mr. VAN WINKLE. That is $16 a gallon. Now, if you got 14 cases instead of 13, the gager is right there, and you pay for that extra case of whisky at $16, or $6 or $12, absolutely.

Senator BARKLEY. In other words, if you have a lesser amount you pay the tax on what you have lost and if you have more, you do not—you get the whisky if you have more but the Government gets the $16 or whatever it is?

Mr. VAN WINKLE. It has happened. That is a concrete example.

Senator BARKLEY. And the Government gets the shrinkage.

Mr. VAN WINKLE. Heads I win, tails you lose, Senator.

About a month ago or so we gaged 50 barrels for a house in New Orleans. They owned the whisky in bond, they sent us a warehouse receipt and told us to tax pay the whisky and ship it to them. We tax-paid the whisky. At the end of bottling we were 45 gallons short and had paid the tax on 45 gallons of whisky.

The CHAIRMAN. Yes. That is right. I can understand that.

Mr. VAN WINKLE. How had that happened? I said to the Government officers, how had this happened, could he have read our stem wrong, could he have read our thermometer wrong? That is all the whisky you are going to get. I didn't have the nerve to tell the customer in New Orleans we had lost 45 gallons of whisky so I went over to the warehouse and got a barrel out and tax paid it, had it bottled up, put it in his lot and sent it to him and never said a word about it. Now, 45 gallons of whisky, if we had had that $16 a gallon—it cost $6, which at 45 gallons is $270, but had it been $16 it would have cost $450 more. Now, those are the hazards of the business.

Now, speaking of the Overton amendment, talking about bottling whisky 4 years old, you people know that it has to be 4 years old, and it has got to be that, so you cannot change that, maybe the gager could not take it out for you when it would go through and tomorrow your tax goes up $2 overnight. It is impossible, totally impossible for anybody to bottle whisky today that is 4 years old today, it cannot be done, therefore, instead of paying $9 and the $2—$11—now as the gentleman said here a while ago, after this hearing the other day we

went down to the hotel, we just happened to have three bottles of whisky setting there all labeled "Fitzgerald," all bottled in bond. We looked at the stamp, one was 6 years old, one 5 years old and one 4 years old. It has all been sold at the same price. You can imagine what confusion would exist if you had three bottles of Fitzgerald whisky selling for something like $7.50 and setting alongisde of it one selling for $6.50 and setting alongside of that was one selling for $5.50. Under the O. P. A. laws you know what kind of confusion that would be. The public could not understand it and nobody could understand it. And of course what happens, the retailer, he didn't know any different and it is all $7.50 so far as I am concerned and they were sold for $7.50.

The CHAIRMAN. Well, they were, and it was the consumer who paid the tax.

Mr. VAN WINKLE. Talking about 4-year old, as I say, I would be afraid tomorrow to sell a crop of whisky if I knew this tax was going to be put on it, if I knew the whisky was going to be forced out, why I would be afraid that if the wholesaler could not take the whisky and pay the tax I could not take it out at the proper time, and it would fall back on me and we could not finance it. Therefore, we would be afraid to make a crop of whisky in the orderly way that we have heretofore done for a period of 8 years without any increase of tax, without any question, and we would not make it.

I don't see how we can stay in business, now. Mr. Schwengel said here awhile ago he bought several distilleries. I know every one he has bought, Senator, and he bought them because they were broke. That is the reason he bought them. They could not maintain themselves, and representing the small distillers in Kentucky, I believe, Senator Barkley, that if you want a guarantee, I think I can guarantee you there won't be 10 of them left in a year if either one of these bills are adopted.

The CHAIRMAN. Let me make this suggestion. Now I am not convinced by anything that has been said—I regard all of you gentlemen as gentlemen of character, honor, and integrity—now, if you please, if we shorten the period to 4 years and require you to pay the tax, we certainly would make provision for containers, we certainly would do that.

Mr. VAN WINKLE. Senator, if you gave us the containers we could not bottle the whisky we have, our bottlers are not prepared for it.

The CHAIRMAN. Yes; but suppose we said you have a 6-month period in which you could take out and pay us the tax on the 4-year-old whisky.

Mr. VAN WINKLE. What is that?

The CHAIRMAN. Give you 6 months in which to do that.

Mr. VAN WINKLE. Give us 6 months in which to pay the tax?

The CHAIRMAN. Yes, sir; to take it out.

Mr. VAN WINKLE. Well, you still got the whisky coming in behind you all the time.

The CHAIRMAN. No; didn't you fellows tell us you haven't got any coming in behind, you would not—you are not going to be allowed to make any more.

Mr. VAN WINKLE. I don't think you got the right idea about it.

The CHAIRMAN. I haven't got the right idea?

Mr. VAN WINKLE. We have got continuity.

Senator BARKLEY. New whisky put up in——

Mr. VAN WINKLE. No; we got continuity of whisky, we got '38, or '39, '40, '41, and '42.

The CHAIRMAN. Oh, yes; only about 300,000,000 gallons altogether.

Mr. VAN WINKLE. Every distiller has got continuity whisky, except that he has not got any in the last 14 months.

The CHAIRMAN. That is as I understand it, you got a limited stock now.

Mr. VAN WINKLE. Exactly.

The CHAIRMAN. Well, suppose we said from now on that you are going to be given up to 4 years to take your whisky out, either you got to do that or pay the tax 4 years, and there will be a period of 6 months after the whisky reaches 4 years old in which you can take out this whisky and put it on the market and sell it.

Mr. VAN WINKLE. Well, there is going to be a period of 6 months all right, there is going to be a period of 6 months, you then have to take the whisky from 4 years and 6 months.

The CHAIRMAN. No, no.

Mr. VAN WINKLE. All over 6 months.

The CHAIRMAN. No, at 4 years, but then you may not take it out and therefore pay the tax, and you may have the period of 6 months after it becomes 4 years old.

Mr. VAN WINKLE. Senator, that being the case, your bonded period would be 4½ years.

The CHAIRMAN. Not necessarily, they might want to take it out at 4 years, and they would have that length of time in which to do it.

Mr. VAN WINKLE. When are we to take out the whisky that is presently 6 years old?

The CHAIRMAN. Well, you take that out within the 6-month period if you sell that. You see now the whisky is taxable after it is 4 years in bond, but in view of the change we are going to permit this period of tolerance in which you can make your readjustments.

Mr. VAN WINKLE. Well——

The CHAIRMAN. That would be where——

Senator BARKLEY. You would still have the whisky.

Mr. VAN WINKLE. You say that you would give this 6-month tolerance. All right, but all of our whisky presently 4 years old would have to be tax-paid in a year and 6 months from now.

The CHAIRMAN. That would still be better than having to take it out and pay it exactly on the day it is 4 years old.

Senator BARKLEY. Wouldn't you still have the whisky in the bonded warehouses?

Mr. VAN WINKLE. Our secretary, Mr. McLure, just made a figure here for us that it would take us 447 days to do what we are talking about, running at the capacity, with all the glass we got, 447 days.

The CHAIRMAN. Then you must have figured since then, I suppose.

Mr. VAN WINKLE. Not any to speak of.

The CHAIRMAN. You are just talking theoretically?

Mr. VAN WINKLE. Oh, no; we got 95,000 barrels of whisky in our warehouse, but it belongs to Smith, Jones, and Brown, all over the United States who bought that whisky, and we have built up continuity whisky to take care of their business in an orderly way. They are taxpaying that whisky, Senator, in a very orderly way.

The CHAIRMAN. Yes, I understand.

Mr. VAN WINKLE. I—a year ago we had 125,000 barrels, today we have in these warehouses 95,000 barrels. Now, they have tax-paid about 30,000 barrels in 1 year and if that rate keeps up for the next 3 years there will be no whisky in the warehouses. That is fair, that is the regular arrangement. That is fair. That is what they rely on, that is fair enough because some of them are going to be out of whisky necessarily before they can get some more. It is just like any other business. Suppose a man is in the publishing business and he heard that he was not going to get any more paper. He had been using paper at the rate of 100 tons and he was not going to get any more for another year. He would not use up all that paper would he, in 1 year as he would normally do in his business, no; he would make that paper last, he would cut it in half and make it run 2 years, which is what they are doing today.

The CHAIRMAN. Yes; I understand.

Senator BARKLEY. Then even if you had 6 months' tolerance, would there be many distilleries that have whisky in bonded warehouses to mature in 5, 6, or 7 or 8 years that would have to convert it in 4½ years instead of carrying it under the original plan until they marketed it?

Mr. VAN WINKLE. Certainly. This gentleman told you that he could not write that insurance. He is having trouble writing it today and no matter—he also told you that in order to get that whisky tax-paid he would have to borrow that money from the bank.

Now, the bank is not going to loan you the money unless you can furnish them collateral warehouse receipts covering the whisky, either tax-paid, or in bond, plus insurance.

The CHAIRMAN. That is the reason I said you take it out within the calendar year if the whisky had been there 4 years, provided we say at least 6 months until you had to take it out. Wouldn't that be better than to take it all out at the end of 4 years?

Mr. VAN WINKLE. That would just prolong the agony.

Senator BARKLEY. Mr. Chairman, I would like to put in the record a table——

The CHAIRMAN. I would like to gamble with you that there will be plenty of distillers coming and telling me it will help them to give them that period.

Mr. VAN WINKLE. It will help a lot.

The CHAIRMAN. It will help you to get your stuff out on the market and sell it to pay the tax.

Mr. VAN WINKLE. You cannot get it on the market. Mr. McLure just told us, and he is our secretary and runs our bottlers and he knows the figures, that it would take us 447 days to bottle that whisky.

The CHAIRMAN. All of it?

Mr. VAN WINKLE. All of it that would mature in that period.

The CHAIRMAN. At 4 years you got that much to sell.

Mr. VAN WINKLE. I have not got it. It is in our warehouse. We are speaking of bottling it.

Senator BARKLEY. You have, in addition to a distillery, you have a warehouse and a bottling house, is that true?

Mr. VAN WINKLE. Government bonded warehouse and bottling house.

Senator BARKLEY. You built it with your own money, that is, and you gave the Government a deed to it.

Mr. VAN WINKLE. That is right.

Senator BARKLEY. You have a bottling house there which you put your money in and you would have to bottle this if you sold off every barrel that you are under obligation and contract for.

Mr. VAN WINKLE. Yes, sir.

Senator BARKLEY. So it happens that you have a bottling facility according to the plans you have outlined, in advance for manufacture of your whisky.

Mr. VAN WINKLE. The bottle house will not provide for more than a certain amount, and we cannot build another bottling house, we cannot but the equipment for a bottling house.

Senator BARKLEY. And you cannot build any more warehouses.

Mr. VAN WINKLE. Cannot do anything.

Senator BARKLEY. But you have to have a free warehouse after you take it out of the Government house upon payment of tax.

Mr. VAN WINKLE. You pay the tax and if you lose a gallon of whisky in addition to the evaporation, you have not only lost your whisky that is worth $2 a gallon, but you have lost the Government tax you put in the whisky. The whisky lays in a bonded warehouse and you do not pay the tax on that. Further, bear in mind that these imports come under the—come into this country, they do not pay any tax in England. They are shipped to this country tax-free from England, Scotland, Ireland, or Canada, and pay no tax.

Senator BARKLEY. Yes.

Mr. VAN WINKLE. There were thousands of barrels of whisky moved out of this country in the olden days because the distiller could not raise the money to pay the taxes—that might happen again.

The CHAIRMAN. They do pay the tariff.

Mr. VAN WINKLE. They pay nothing when they ship it out.

The CHAIRMAN. If it is shipped in here they have to pay the tariff.

Mr. VAN WINKLE. When it comes in they have to pay the actual regaging plus the import duty, when we ship it out we pay $16.

The CHAIRMAN. You mean what you here ship out.

Mr. VAN WINKLE. Yes, sir.

The CHAIRMAN. But from the outside——

Mr. VAN WINKLE. Yes, sir; everything that they bring in you only pay $2 and $9 tax, and not $16.

The CHAIRMAN. And don't they pay any import duty?

Mr. VAN WINKLE. You pay $2 and $9, that is $11, against our $16.

The CHAIRMAN. Where do you get $16?

Mr. VAN WINKLE. I believe you got $16 on the 8-year bonded.

The CHAIRMAN. That is Senator Overton's amendment?

Mr. VAN WINKLE. Yes, sir.

I don't know. I hope you are not going to pass either.

Senator BARKLEY. I would like to put in the record a telegram from Mr. J. T. McGinnis, vice president of the Farmers Bank & Trust Co., Bardstown, Ky., with respect to this proposed amendment; also letter from Wilson & Muir, bankers, of Bardstown, Ky. I am not going to take the time to read them. I will put them in the record.

Also a lengthy telegram from Mr. Oscar F. Meredith, vice president of the First National Bank of Chicago with respect to the effect of this amendment upon the financing of liquor and the present situation with respect to financing liquor. I ask that they be printed in the record.

(The above-mentioned telegrams are as follows:)

BARDSTOWN, KY., *December 14, 1943.*

Hon. ALBEN W. BARKLEY,
United States Senate, Washington, D. C.:

The 4-year limitation of the bonded period detrimentally affect bankers and insurers of whisky. We are opposed to this limitation and trust that you will do all you can to retain the 8-year period which is in the interest of the Government, distillers, bankers, and insurance.

FARMERS BANK & TRUST CO.,
J. T. MCGINNIS, *Vice President.*

BARDSTOWN, KY., *December 14, 1943.*

Hon. ALBEN W. BARKLEY,
United States Senator, Washington, D. C.:

Bill proposed by Senator George on 4-year limit on whisky will work a great hardship to Kentucky distillers. Would appreciate your opposition.

WILSON & MUIR, *Bankers.*

CHICAGO, ILL., *December 15, 1943.*

Hon. ALBEN W. BARKLEY,
Senate Office Building,
Washington, D. C.:

Regarding amendments involving liquor taxes our bank is a leading lender to the industry. Outage allowances are a prime factor. Carlisle allowance proved inadequate resulting in the acceptable O'Neil schedule April 1942. Any reduction from present allowance irrespective of age would impair borrowing ability by an industry which has had to depend heavily on banks. Additional margins of collateral at rate of prevailing tax would have to be provided to cover rate of tax on proven outage records. Understand consideration being given to forcing whisky out of bond at 4 years to get it to consumers. A careful checking reveals labor and restrictions on bottles, cases, etc., would prevent this being done but would result in difficult and in many cases impossible money requirements. As an example a customer with a dollar volume of $7,000,000 would need immediately for taxes $2,400,000 and in the next 12 months $4,000,000. Borrower presently owes to bank, trade, and for income taxes $1,750,000. Working capital about $700,000. Example: No. 2 distillery did a volume slightly under $20,000,000. Would require approximately $19,000,000 at $9 for whisky presently 4 years of age or over and an additional $8,000,000 during the next 12 months. Company's present liabilities approximately $5,500,000 with working capital about $4,000,000. There have been cases where insurance protection was not immediately available. I do not attempt to speak for insurance companies but they, like the banks, probably would not provide the protection for tax-paid merchandise in bulk subject to subsequent tax-paid evaporation. Think advertisement by Distilled Spirits Institute eminently fair and truthful. If older whisky is forced on to the market won't it largely disappear with the knowledge that subsequently older whiskies may not be available rather promptly producing an equally or greater deficiency than now exists under industry voluntary allocations?

Respectfully submitted.

OSCAR F. MEREDITH,
Vice President, The First National Bank of Chicago.

The CHAIRMAN. I want noted in the record, I don't want it copied, section 2901 of the Internal Revenue Act with reference to loss allowances and especially subsection B (3).

(Whereupon, at 6:30 p. m., the committee recessed to 10 o'clock, Thursday, December 16, 1943.)

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